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ADDRESSING MARKET FRAGMENTATION:

THE NEED FOR ENHANCED GLOBAL REGULATORY COOPERATION

Financial markets are experiencing increasing levels of fragmentation, which undermine the progress that has been made in re-building resilience of the global financial system since the financial crisis and result in negative consequences for economic growth and job creation. Fragmentation resulting from excessive regulatory and supervisory divergence can trap capital, liquidity, and risk in local markets, create significant financial and operational inefficiencies resulting in additional unnecessary costs to end-users, and reduce the capacity of financial firms to serve both domestic and international customers. It is critical that market fragmentation be addressed to avoid these consequences and the correlated impact on the global financial system and the world economy.

As jurisdictions act unilaterally without proper coordination, it also can create level playing field problems, affect comparability across jurisdictions and even risk sensitivity in regulatory frameworks. It is, therefore, very welcome that the Financial Stability Board (FSB) has launched a new initiative to explore ways to address the risk of market fragmentation. This paper seeks to define the problem of market fragmentation and identify four specific categories of market fragmentation – Local Supervisory Measures and Ring-Fencing; Diverging Standards; Extraterritoriality; and, Obstacles to Cross-Border Cooperation and Information Sharing – with 12 specific current examples. It then concludes with a number of recommendations for the regulatory and supervisory community to consider that can help prevent market fragmentation and address and mitigate its negative impacts when it occurs.

1. INTRODUCTION

The Institute of International Finance (IIF) strongly supports the Financial Stability Board's (FSB) increasing focus on dynamic implementation and rigorous evaluation of the effects of the agreed G20 reforms.[1] Global standards underpin cross-border investment and economic activity by enabling financial institutions and markets to optimize allocation of the international finance flows that support a growing global economy and expanding workforce. Given the importance of these reforms, it is critical that there is a clearer understanding of how the final rules are being implemented, if there are adverse unintended consequences and, if so, what remedies can be introduced to minimize the unnecessary impact on economic growth and job creation.

Defining Market Fragmentation: The Financial Stability Board has identified the risk of market fragmentation as "*a divergence in regulatory frameworks, which could impede the development and diffusion of beneficial innovations in financial services, and limit the effectiveness of efforts to promote financial stability.*"

Global coordination and consistent implementation have been long-standing G20 goals as evidenced in the G20 Leaders Statement at the 2009 Pittsburgh Summit, to a joint commitment to "take action at the national

[1] FSB 2018. "FSB Chair's Letter to G20 Ministers and Governors March 2018" March 2018 and "FSB assesses financial vulnerabilities and takes stock of actions under its 2018 workplan" June 2018

and international level to raise standards together so that our national authorities implement global standards consistently in a way that ensures a level playing field and avoids fragmentation of markets, protectionism, and regulatory arbitrage."[2]

The G20 post-crisis reforms since Pittsburgh have made the global financial system significantly more resilient. Unfortunately, despite considerable progress in areas such as capital, liquidity, recovery and resolution and governance, the IIF and its members observe that such progress has not translated in restoring trust among the regulatory and supervisory community, and on the contrary, we are seeing increasing cases where local authorities introduce obstacles to cross-border banking, through local rules or local supervisory powers without proper coordination with foreign jurisdictions, with the view of maintaining control of financial activities performed in their jurisdiction and to preserve local stability of markets.

These national and uncoordinated approaches can create fragmentation that reduces cross-border funding flows through financial institutions. Consequently, fragmentation can undermine broader common policy goals and objectives, such as economic growth, job creation, and financial stability.

BOX: IIF Recommendations to G20, the FSB and global standard setters

A. Specific Recommendations to Address Market Fragmentation

- Refine monitoring of implementation of internationally agreed standards.
- Encourage greater comparability of regulatory regimes through mutual recognition and equivalence rather than line-by-line comparability.
- Anticipate the extent and impact of national discretions.
- Promote impact assessments and include stakeholder involvement.
- Ensure consistency of regulatory and supervisory frameworks across the new competitive environment.

B. Specific Recommendations to Enhance International Cooperation Among Authorities

- Formulate specific objectives towards greater cooperation among regulators and policy makers.
- Facilitate increased trust among supervisors, especially around resolution.
- Promote information and data sharing among regulators.
- Enhance transparency and accountability of international bodies developing rules and regulations.
- Enhance accountability in adoption of previously agreed global standards.
- Place additional emphasis on supervision and promote supervisory coordination among home and host.

Please see Section 4 on pages 14-18 for additional details.

It is encouraging, therefore, that the FSB work program for 2019 includes a new initiative to explore ways to address the risk of market fragmentation, to be undertaken by the FSB Standing Committee on Supervisory and Regulation Cooperation (SRC), exploring what market fragmentation is, under what conditions it can emerge and what its potential impacts are.[3] It is also welcomed that this work emphasizes the importance of

[2] G20 2009. "G20 Leaders Statement" Pittsburgh Summit, September 2009

[3] FSB 2018. "FSB reviews financial vulnerabilities and deliverables for G20 Summit" October 2018

enhancing global regulatory cooperation, which can help reduce fragmentation and regulatory arbitrage, and also help ensure the effective functioning of regulatory policies in a crisis.

Typically, the concept of "market fragmentation" is defined as "a decrease in cross-border holdings of a wide range of asset classes, resulting in a divergence of related asset prices".[4] The FSB has previously described the risk of market fragmentation more specifically as "a divergence in regulatory frameworks, which could impede the development and diffusion of beneficial innovations in financial services, and limit the effectiveness of efforts to promote financial stability."[5] This specific link between uncoordinated regulatory approaches and market fragmentation is key to understand why this is an issue that merits urgent attention by global standard setters and why efforts to promote greater coordination and collaboration can yield clear positive results in both preventing and alleviating the negative effects of fragmentation.

The IIF and its members are committed to work closely with the G20, FSB, and other global standard setters on issues around consistent implementation of global standards and regulatory and supervisory cooperation to ensure a stronger growing economy and expanding workforce.

In this document, the IIF: (i) analyzes the risks and negative consequences of regulatory fragmentation; (ii) describes four specific categories of regulatory fragmentation with current examples of where this problem is more acute; and (iii) outlines potential recommendations for the regulatory community to consider to address negative policy implications of fragmentation on markets and the economy.

2. THE RISKS AND NEGATIVE CONSEQUENCES OF MARKET FRAGMENTATION

The globalization of finance is a necessary corollary of global trade and open economies and must be preserved to ensure efficient access to finance by end-users across continents. The international monetary system relies on a network of mostly freely convertible currencies, where central banks define monetary policies and ensure the proper functioning of their local financial systems, with coordination by the International Monetary Fund (IMF) and the G20.

Within this monetary policy framework, financial institutions develop a variety of business models (from domestic to internationally active) and play an essential role in the transmission of monetary policies to the economy. International capital flows allow excess savings to find investment opportunities in countries where investment needs exceed local financial capacity. The "additionality" of international finance creates growth opportunities and jobs that otherwise would not be served by local finance.

However, the financial crisis has shown that globalization of finance can also be a source of contagion of crisis and of systemic risk. While the response to the global crisis was a multilateral effort leading to the creation of the G20, FSB and the design of an unprecedented range of financial reforms, most of them specifically targeting international financial activities.

Unfortunately, the regulatory response was often accompanied by a supervisory response that was more focused on ensuring that national interests would be preserved in case of a future crisis. Although the shift from bail-out to bail-in was designed to avoid the recourse of taxpayer money being used to save failing banks, a sense of "financial sovereignty" has developed, leading supervisors to establish regulatory and supervisory barriers to cross border finance, so called "ring-fencing".

[4] Roman Horvath 2017. "Financial market fragmentation and monetary transmission in the euro area: what do we know?" Journal of Economic Policy Reform, June 2017

[5] FSB 2018. "Implementation and Effects of the G20 Financial Regulatory Reforms" November 2018

The IIF has consistently recognized the important role of global standard setters – including the FSB, the Basel Committee, the IAIS and IOSCO – in driving international regulatory convergence across all economies, from large developed markets to smaller emerging market economies.[6] These international standards deliver major benefits in four key areas:

- Supporting financial stability;
- Supporting the flow of capital to investment opportunities;
- Promoting greater and fairer competition, and better pricing and services for borrowers and end-users; and,
- Reducing compliance costs and increasing efficiencies.

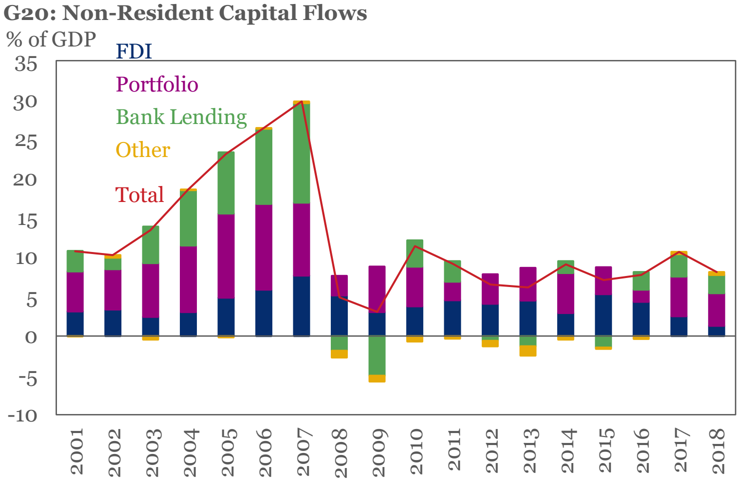
As noted earlier, the FSB has identified the risk of market fragmentation as "a divergence in regulatory frameworks, which could impede the development and diffusion of beneficial innovations in financial services, and limit the effectiveness of efforts to promote financial stability."[7] Increasingly, there have been cases of divergences from global standards – or, even entirely new rules that national authorities introduce that are intended to further support domestic economies and financial stability.

Some divergence is inevitable, and arguably necessary, where there are specific local circumstances which need to be considered (for example, where a jurisdiction does not allow the use of credit ratings), but consistency of global standards is crucial in other areas where there are true global markets and a cross-border level playing field is essential.

The negative consequences of market fragmentation

It is difficult to measure the exact costs of market fragmentation due to the diverse impact over the financial system and given the varying stages of implementation and finalization of rules. A study by the International Federation of Accountants (IFAC) found that regulatory divergence in the financial sector is causing material and increasing costs to the global economy, exacerbating risks in the financial system, and impacting economic growth negatively[8].

G20: Non-Resident Capital Flows



Source: IMF, national sources and IIF staff

The global financial crisis led to a sharp decline in cross-border banking activity. One symptom of financial market fragmentation is that the decline in cross-border flows has not recovered since the 2007-2009 financial crisis. It is noteworthy that cross-border flows among G20 members – which account for more than 90% of global capital flows - have declined sharply from pre-crisis levels (see chart) due to lackluster and volatile cross-border bank credit creation. While it is difficult to disentangle the contribution of the reversal of the credit boom and the structural shift of the regulatory environment, it is nevertheless symbolic that cross-border flows have not fully recovered from their pre-crisis levels.

[6] IIF 2017. "International Regulatory Standards: Vital for Economic Growth" March 2017

[7] FSB 2018. "Implementation and Effects of the G20 Financial Regulatory Reforms" November 2018

[8] IFAC 2018. "Regulatory divergence: costs, risks, impacts" In a survey of more than 250 global compliance regulatory leaders, IFAC concluded that fragmentation is costing financial institutions between 5%-10% of their annual revenue, which IFAC conservatively estimates to cost the global economy more than $780 billion a year.

Another example is the size of the largest foreign banks operating in the U.S. Because of the intermediate holding company (IHC) requirement, foreign banks changed their operational and legal structures. Although the change in balance sheets of foreign banking organization (FBOs) is varied along with their business strategy, some FBOs have drastically reduced the size of their U.S. assets. Indeed, over the last 10-year period, the four non-U.S. LISCC banks saw their combined U.S. total assets decline by 42% to $907 billion from $1,575 billion (over Dec. 31, 2008 – June 30, 2018), and the amount of their combined broker-dealer assets decrease by 64% to $380 billion from $1,063 billion (over Dec. 31, 2008 – Dec. 31, 2017).[9]

Mario Draghi, European Central Bank President, has also stressed that ring-fencing has impaired monetary transmission across the E.U. and reduced the ability of E.U. banks to cushion economic shocks, especially when the financial crisis hit the euro area. "Financial markets then began to fragment along national lines and cross-border funding dried up, exacerbated by defensive risk management by banks and ring-fencing of liquidity by supervisors in the core countries."[10] This resulted in a malfunctioning of the monetary policy transmission mechanism, pressure on the currency union, distortions in competition in the single market, lack of liquidity, capital depletion from domestic losses and a renewed credit crunch.

Against this background, it is important to identify categories of market fragmentation and methods to address and help mitigate the impact of fragmentation. Examples can be found across the spectrum of financial regulation, including prudential regulation, such as capital, liquidity and resolution, markets regulations, such as the G20 derivatives reforms, and in emerging regulatory areas, such as CCP governance, cyber-security and data management and handling. Fragmentation can trap capital, liquidity, and risk in local markets, making these resources unavailable where potentially most needed; create significant financial and operational inefficiencies, resulting in additional unnecessary costs to end-users; and reduce the capacity of banks to serve both domestic and international customers.

In a recent speech, Ryozo Himino, Vice Commissioner for International Affairs at Japan's Financial Services Agency (JFSA), identified similar examples around four sources of "harmful regulatory fragmentation" which he said unduly increase the risk of market fragmentation: (i) discrepancies, (ii) overlaps, (iii) desynchronization, and (iv) competition. He stressed the urgency to address fragmentation as it can "impair financial stability by reducing market liquidity and trapping scarce resources. It can drag efficiency and economic growth. Combatting market fragmentation should be our common goal."[11]

Below are examples of categories of market fragmentation and specific examples of where it already exists, or where it may occur going forward.

3. FOUR CATEGORIES OF MARKET FRAGMENTATION AND SPECIFIC EXAMPLES

As noted above, the IIF has identified four specific categories of fragmentation that deserve further attention. Each category has its own source of fragmentation:

- Local Supervisory Measures and Ring-Fencing is when host authorities take regulatory and supervisory action in order to secure resources within their own jurisdictions. The source of fragmentation is derived from lack of trust among regulators and supervisors.
- Diverging Standards is the implementation of international standards by jurisdictions that differ in substance or timing. The source of fragmentation can also come from uneven implementation of global standards.

[9] Davis Polk 2018. "Feedback on Foreign Banks' July 2018 Resolution Plan Submissions – Key Takeaways" December 2018
[10] ECB 2018. "Risk-reducing and risk-sharing in our Monetary Union" May 2018
[11] Japanese FSA 2018. "Market fragmentation" October 2018

- **Extraterritoriality** concerns the application of one jurisdiction's regulations on the activities and/or persons subject to the regulations of another jurisdiction.
- **Obstacles to Cross-Border Cooperation and Information Sharing** is when national authorities develop localization approaches, in particular regarding data. The fragmentation arises from different regulatory frameworks, or different regulatory or data approaches.

These categories and relevant examples are discussed next.

A. Local Supervisory Measures and Ring-Fencing

The first category of fragmentation is local supervisory measures including ring-fencing. In response to the financial crisis, many jurisdictions moved to protect national interests and adopt stringent controls around local subsidiaries, including restrictions on capital, liquidity and operational support.[12] The new recovery and resolution regimes introduced in various jurisdictions aim to contain contagion, as home and host jurisdictions seek to protect and control their domestic markets. The requirements around these regimes, however, are forcing significant and increased fragmentation within financial groups.

1. *Ring-fencing initiatives:* Several jurisdictions have introduced additional measures aimed at improving the resolvability of banks and banking groups. For example, the U.K. has ring-fenced the retail deposit-taking operations of the largest U.K.-headquartered banks from their broader operations. Some other countries, like France also have implemented a banking separation law to isolate trading activities from banking business and protect depositors. To the extent these rules apply to particular internationally active banks, it would be difficult and costly for such banks to comply with the regulations in each jurisdiction, while continuing to operate in a seamless way from a franchise and risk management perspective.

   As banks enter foreign markets, there are different strategic and operational considerations for why they would choose a branch or subsidiary approach. In the U.S., certain Foreign Bank Organizations (FBOs) are required to create an Intermediate Holding Company (IHC) intended to enhance the supervision of foreign subsidiaries and new requirements have been imposed on branches. Banks have argued that they should be supervised similar to U.S. bank holding companies, based on their U.S. footprint.

   The European Union has followed suit with its own draft rules, which should become final in 2019, to require major foreign banks to create an Intermediate Parent Undertaking (IPU) for the large (> US$ 40 billion) subsidiaries in the E.U. The ECB has further indicated during the development of the IPU rule its discomfort with activity currently undertaken through branches. This trend is magnified by the effects of the U.K.'s withdrawal from the E.U. as London-based branches and subsidiaries will lose their passporting rights to operate in the E.U., which has increased the E.U.'s demands for operations and risk management to be located in the E.U., rather than servicing E.U. clients through branches or utilizing services provided by other group entities (e.g., centralizing risk management in locations with more liquid markets.)

   Both the U.S. and E.U. approaches are not reflective of what is required by the internationally agreed Key Attributes of Effective Resolution Regimes for Financial Institutions, as developed by the FSB, and demonstrate an unwillingness to implement local requirements that recognize consolidated supervision and top-down resolution frameworks from home country authorities.

   It has been argued that ring-fencing might be a rational decision for an individual jurisdiction, but it actually increases the risk in the overall system because there is less flexibility within a firm to address

[12] Banking Perspectives 2018. "Ring-fencing: Escape from the prisoner's dilemma" Q3 2018

issues using cross-border resources.[13] Ring-fencing also has negative consequences for the wider, globally interconnected financial system and economy:

- In particular, it can amplify business cycles as trapped capital chases returns, and less capital is available to those jurisdictions which need injections of resources. It has been estimated that if ring-fencing becomes widespread, that the likelihood of failure can increase by 5x or even 15x compared to an Integrated Bank structure where internal capital is fully mobile;[14]
- Locally funded lending can make it much harder to move liquidity around the world for many international banks; and,
- Ring-fencing is unsuited to wholesale finance, which by its nature tends to rely upon global booking models and the capital efficiencies associated with such models. Global booking models and a global pool of liquidity and capital lead to cheaper costs of financing for businesses and governments.

The Japanese FSA recently said that because the U.S. and E.U. ring-fencing initiatives "may lead to trapped pools of resources and could make problems worse during a systemic event, given the prisoner's dilemma element, Japan and other jurisdictions might be compelled to do the same in the end. The walls will proliferate and become higher. Such an outcome would be in no one's interest."[15]

Randal Quarles, Vice Chairman for Supervision at the U.S. Federal Reserve, said last year that there was willingness to consider a more appropriate balance of flexibility and certainty within the IHC regime, where for example internal TLAC calibration (see the next item below) could be adjusted, to reflect the practice of other regulators without adversely affecting resolvability and U.S. financial stability, and thereby helping further develop the cross-border resolution framework.[16]

2. ***Resolution – Total Loss Absorbing Capacity (TLAC):*** As each relevant home and host jurisdiction translates the provisions of the TLAC Term Sheet into local regulation, certain trends in implementation that could have significant consequences have become apparent. In particular, with respect to the calibration of internal TLAC for a material sub-group in a host jurisdiction, the TLAC Term Sheet specifies a bounded range of 75% to 90% of the hypothetical external TLAC requirement that would apply if the material sub-group were a resolution group. However, while regulators in certain jurisdictions have calibrated or proposed calibrating internal TLAC presumptively at the low end of the range—i.e., 75%, at least one jurisdiction has issued a final rule uniformly calibrating internal TLAC fixed at the high end of the range—i.e., 90%.[17] Such a high level of Internal TLAC adds to the cost of running cross-border business, which is compounded with the fact that in the U.S., interests paid back by the sub to the parent are currently captured under the BEAT tax. Moreover, because a default to the most stringent calibration increases the risk that, in an actual financial distress scenario, there will be insufficient resources left to the parent to allocate where needed ("misallocation risk"). Excessive pre-positioning requirements also means that financial institutions lose the ability for capital to flow freely where it can be most productive. A high and rigid internal TLAC requirement also removes useful incentives for the resolution authority or supervisor to deploy to engender increased resolvability.

   As highlighted above, it is welcome that the U.S. Board of Governors of the Federal Reserve System has expressed an openness to calibration of internal TLAC for the U.S. IHCs of non-U.S. G-SIBs at a starting point of 75%, down from the current U.S. calibration. However, it is expected that the E.U. rules currently

[13] Brookings 2018. "Understanding 'ring-fencing' and how it could make banking riskier" February 2018
[14] Brookings 2018. "Understanding 'ring-fencing' and how it could make banking riskier" February 2018
[15] Japanese FSA 2018. "Market fragmentation" October 2018
[16] U.S. Federal Reserve 2018. "Trust Everyone--But Brand Your Cattle: Finding the Right Balance in Cross-Border Resolution" May 2018
[17] IIF/BPI/GFMA 2018. "Joint Associations Comment Letter on FSB Technical Implementation of TLAC" August 2018

being finalized will still implement a hard 90% calibration. The diverging directions of travel indicates a need for a new global consensus between regulators on internal TLAC and re-emphasize the need for more work around how regulators interact across borders on supervision and resolution.

B. Diverging Standards

The second category of fragmentation is diverging standards. Diverging standards arise when the consensus which has been globally agreed is implemented subsequently in different forms and/or timeframes across jurisdictions. Not all differences are harmful and, as discussed above, some are necessary given the structure and practice in different economies as indeed the same rule can have different impacts depending on the context in which the rule is applied.

While promoting consistent implementation of international standards is an essential goal, consistency does not necessarily mean one-size fits all approaches to regulation. Implementing Basel standards in banking regulation in specific (national or regional) contexts calls for some flexibility, in order to take into account different risk characteristics. So far, such flexibility was given by internal models, which consist in a global framework, populated by risk parameters that reflect local specificities, under the strict validation by supervisory authorities. Another important solution is the use of national discretions, which can be applied under some standards depending on national circumstance.

Internal models and national discretions are appropriate responses to achieve a balance between global consistency and local relevance, in order to ensure that regulation achieves risk sensitivity. Unfortunately, this balance has been broken down by the recent shift toward Standardized approaches in credit, market and operational risks. The more international rules require Standardized approaches, the less they are suited to jurisdictional specificities, and therefore, the more local jurisdictions may seek to diverge from international parameters if they want to maintain risk sensitivity.

Standards, including the Basel capital framework, sometimes contain national discretions to allow the standards to be implemented differently by authorities in different jurisdictions. The Basel Committee said national discretions can be useful when differences in the structure and development of financial systems warrant different approaches.[18] In practice, however, the Committee recognizes that the use of national discretions can also impair the comparability of implementation across jurisdictions, particularly if supervisors do not implement them with the same conservatism. National discretions can also create issues when there are either (i) firm-wide implications for banks operating on a cross-border basis, for example as a result of overall capital or liquidity requirements, and/or (ii) specific implications at a product-level.

It should be noted that such national discretions are sometimes included in the international rule itself. Again, such discretions are understandable when they correspond to legal requirements that translate into differences in risk and therefore capital requirements. However, although the Basel Committee deferring to national discretion for the treatment of derivatives liabilities in the Net Stable Funding Ratio (NSFR) was an improvement over the original Basel standard, the range of 5% to 20% appears to have been driven by an inability to reach consensus rather than true local divergences. Depending on how various jurisdictions implement this range, this may create significant competitive distortions.

As noted earlier, consistency of global standards is crucial in areas where there are true global markets and a cross-border level playing field is essential. There is a natural continuum from the most local activities (such as mortgages, commercial real estate and retail banking) to truly global ones (such as trade finance, derivatives and wholesale banking.)

Diverging standards can lead to adverse consequences. They can disrupt the level global playing field, for example, when higher capital or liquidity standards make banks less competitive, or where local treatments of

[18] Basel Committee 2014. "Basel capital framework national discretions" November 2014

particular products are not recognized by the consolidating supervisor. These situations can discourage cross-border flows and competition in particular markets. Relevant examples, include:

3. *Derivatives Trade Reporting:* In 2009, the G20 agreed a comprehensive reform agenda for over-the-counter (OTC) derivatives markets, including trade reporting. While progress is being made, the pace of the reforms has been uneven across jurisdictions. For trade reporting, as of November 2018, 21 out of 24 member FSB jurisdictions have comprehensive trade reporting requirements in force.[19] The exceptions are Argentina, South Africa and Turkey.

   While implementation has progressed, the FSB has recognized that challenges to the effectiveness of trade reporting remain, including a lack of harmonization of data formats and other data quality issues, and the impact of various legal barriers to reporting and to authorities' access to data.

4. *Differences in Timing:* While pertinent reviews and delays are often appropriate, they can exacerbate discrepancies and unlevel playing fields between jurisdictions. Regulators in certain Asia-Pacific jurisdictions, for example, have in some circumstances implemented Basel standards ahead of their counterparts in the U.S. and Europe.[20] Current examples include the Fundamental Review of the Trading Book (FRTB), and the Net Stable Funding Ratio (NSFR). In both cases there are potential divergences regarding adoption and timing of planned implementation.

   With regard to FRTB, Europe has near final rules pending further legislative proposals due in 2020, and proposed rules in the U.S. are expected in 2019. Differences in implementation timeframes would result in a number of significant trading banks operating under different rules and capital requirements, resulting in financial market fragmentation during this time, with some banks incented to increase exposures to risks for which they have relatively lighter requirements. For NSFR, Hong Kong has final rules in place, the E.U. has draft rules that should become final in 2019 and either a re-proposed or final standard is expected in the U.S. in 2019.

   Complications due to divergences on agreed implementation timelines have also appeared in global derivatives markets reforms. A global framework for the local implementations of uncleared margin requirements (UMR) was developed through the BCBS-IOSCO Working Group on Margining Requirements (WGMR) in what might be viewed as a best-in-class example of global cooperation and coordination. However, while a globally synchronized compliance timetable was agreed with generally consistent underlying standards, ultimately the compliance dates for the first phase of initial margin requirements impacting the world's largest dealers diverged across major jurisdictions, with the E.U. delaying months relative to the U.S. This sparked a global conflict with major jurisdictions aligning with either the E.U. or U.S.'s respective timeline. This, in turn, threatened to fragment liquidity geographically, resulted in concerns that other margin standards and timelines might diverge from the agreed framework, and exacerbated already complex systems and legal implementations.

5. *Divergences in scope:* Divergences in the scope and applicability of regulations between jurisdictions that apply to activity in global markets can also lead to fragmentation and market localization. For instance, individual jurisdictions have made different determinations regarding what constitutes an OTC derivative that should be subject to the enhanced regulation agreed by the G20 as well as which counterparties trading in the market should be held to those requirements. As a result, those regulations are being applied across a partially but not completely overlapping set of instruments and counterparties.

[19] FSB 2018. "OTC Derivatives Market Reforms" November 2018

[20] Global Risk Regulator 2018. "Basel III: Far East regulators strive to maintain good reputation on implementation" February 2018

The U.S. regime, for example, applies to "swaps" and "security-based swaps" (SBS) however, physically settled FX swaps and forwards are not considered to be SBSs and are exempt from the definition of "swaps" resulting in substantive rules, such as uncleared margin, not applying to transactions in those products in the U.S. However, in other major jurisdictions, such as Europe, those products are covered by their OTC derivatives rules. Additionally, as it relates to the counterparties subject to transaction-based requirements, in the U.S., securitization vehicles are considered 'Financial End Users' and therefore scoped into these requirements, which is inconsistent with most other major jurisdictions.

6. ***Benchmarks:*** In 2014, the FSB publicly recognized that the secular decline in wholesale unsecured term money funding by banks poses serious structural risks for unsecured benchmarks, such as LIBOR. Central banks have since been preparing alternative benchmarks and indeed much progress has already been made. Across a number of key markets, working groups convened or sanctioned by the authorities—with industry leadership and participation—have in most cases settled on alternative reference rates, including the BoE's Sterling Overnight Index Average rate (SONIA), the U.S.-developed Secured Overnight Funding Rate (SOFR), Ester (Euro short-term rate), under consultation as alternative rate for both EONIA and Euribor, TONAR (Tokyo Overnight Average Rate) in Japan, and SARON (Swiss Average Rate Overnight) in Switzerland. These have been complied and published, mainly by the central banks in question.[21]

   In 2017, the U.K. FCA, the regulator for the LIBOR administrator, announced that it would stop compelling banks to submit to LIBOR, bringing the future of LIBOR beyond 2021 into question. More recently, the FCA advised that LIBOR may not be deemed representative and firms should treat LIBOR's end as something that will occur and not as a remote "black swan" event. Given the uncertainty around the sustainability of LIBOR past 2021, regulators should provide clarity under what conditions LIBOR will no longer be representative and is no longer fit for market use. This will ensure a coordinated transition across markets globally and minimize financial stability risks.

   The E.U. Benchmark Regulation will, from 2020, restrict the ability of E.U. regulated entities to use third country benchmarks unless such benchmarks obtain the appropriate regulatory status in the E.U. Such an approach goes beyond internationally agreed standards such as those set by IOSCO on benchmarks. Without additional cooperation between regulators and without cost effective measures to facilitate third country administrators in setting up an E.U. legal representative, the withdrawal of E.U. banks and asset managers from such benchmarks will cause significant fragmentation and will severely limit the options that European pension funds and other investors may have to achieve their mandates.

C. Extraterritoriality

The third category of fragmentation identified by the IIF is the impact of extraterritoriality. This concerns the application of one jurisdiction's regulations on the activities and/or persons subject to the regulations of another jurisdiction.

7. **OTC Derivatives:** Post-crisis the G20 agreed to a comprehensive reform agenda for OTC derivatives markets, including the following core elements: trade reporting; central clearing; trading on exchanges or electronic trading platforms; and margining of non-centrally cleared derivatives. Implementation of these reforms is largely complete across the largest global derivatives markets including the U.S., E.U.,

[21] IIF 2018. "Libor Transition: Progress, but Challenges Remain" September 2018

and Japan. However, in some cases the extraterritorial application of rules, and insufficient deference between home-country and third-country regimes, has resulted in a system which is operationally complex, costly, and has caused certain markets to fragment along geographical lines.

U.S. Commodity Futures Trading Commission (CFTC) Chairman Christopher Giancarlo notes that the CFTC's current approach to cross-border derivatives rulemaking has "fragmented what were once global markets into a series of separate liquidity pools" which are "shallow, more brittle, and less resilient to market shocks."[22] The International Swaps and Derivatives Association (ISDA) has identified instances where the extraterritorial application of the CFTC's 2013 trade execution rules has led to a tangible and significant reduction in cross-border trading activity.[23] Similar concerns have been expressed about aspects of the E.U.'s proposed revisions to the European Market Infrastructure Regulation (EMIR), in particular those relating to the oversight of systemically important financial market infrastructure.[24]

Recognizing the global nature of derivatives market, in 2013 the G20 leaders agreed 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."[25] CFTC Chairman Giancarlo outlines a similar approach in his suggested revisions to the CFTC cross-border rules, which would show deference to non-U.S. regulatory regimes that have adopted comparable requirements in order to reduce fragmentary effects.

Greater use of deference, supported by cooperative supervision of global systemically important market infrastructure, would ensure that derivatives markets remain global, supporting effective risk management, greater competition, more efficient pricing, and ultimately enhancing financial stability.

8. *The U.S. Volcker Rule:* As it is well known, this rule prohibits banks from engaging in proprietary trading and limits their dealings with "covered funds", which includes hedge funds and private equity funds. It applies to U.S. banks and any non-U.S. bank that has a U.S. branch, agency or bank subsidiary, along with all of its affiliates around the world. As a result, the Volcker Rule has had a vast extraterritorial impact on non-U.S. banks, and has required most internationally active banks to adopt complicated compliance programs that have negatively impacted their trading, asset management and structured finance operations around the globe. Certain proposed amendments in June 2018 by five U.S. financial regulators could pose some relief, particularly with respect to trading operations of non-U.S. banks outside of the United States thereby reducing extraterritorial impact.[26]

9. *MIFID II:* Another example is the E.U.'s Markets in Financial Instruments Directive II (MiFID II), that provides for harmonized regulation for investment services in the E.U. The regulation provides for generated significant changes in business and operating models, systems, data, people, and processes; and will impact those engaged in the dealing and processing of financial instruments. This can lead to MiFID II generating a number of material extraterritorial impacts, including in relation to E.U. counterparty compliance processes, the need to charge fees for research entering the E.U., and making non-E.U.

[22] CFTC 2018. "Cross-Border Swaps Regulation Version 2.0" October 2018
[23] ISDA 2015. "Cross-Border Fragmentation of Global Derivatives: End-Year 2014 Update" April 2015
[24] ISDA 2018. "The Case for CCP Supervisory Cooperation." April 2018
[25] FSB 2014. "Jurisdictions' ability to defer to each other's OTC derivatives market regulatory regimes" September 2014
[26] Linklaters 2018. "Volcker 2.0: The Promise and Pitfalls for Non U.S. Banks of Proposed Amendments to the Volcker Rule" June 2018

counterparties subject to E.U. requirements when trading with at trading venues in the E.U. that are themselves entities subject to MiFID II compliance requirements.[27]

D. Obstacles to Cross-Border Cooperation and Information-Sharing

The fourth and final category of fragmentation is the presence of continuing obstacles to cross-border cooperation and information sharing. Policies that foster forced localization are often designed to compel companies to relocate all or part of their data, information or operations within a country's borders. These laws can prevent the usage of data across jurisdictions and can impact the ability to share information critical to Cyber Security or AML/CFT efforts.

10. *Data localization:* On the grounds of data protection, supervisory access, law enforcement, national security or protection of local industries, a growing number of countries have introduced or are considering introducing restrictions to the movement of data outside of their national borders. These restrictions range from strict localization requirements that force companies to locally store and process the data generated inside a country, to specific conditions that need to be met in order to move data abroad.

    By way of example, China, India, Indonesia, Malaysia and Vietnam all have data localization requirements that vary in scope, depending on whether the requirements are introduced in general cyber security or data protection regulations or are specific to certain electronic or financial services. In the E.U., the new General Data Protection Regulation (GDPR) does not include data localization requirements but requires that recipient countries outside of the E.U. offer an adequate "level of protection" — as determined by the European Commission — or that certain legal clauses are introduced into the private contracts that underlie the data transfers. In practice, this is leading to some companies and countries around the world to follow GDPR as a kind of global standard. However, in the current context of increased privacy and national security concerns as well as increasing frictions around global trade, restrictions to the international movement of data are clearly on the rise.[28]

    For the financial system, and particularly for global financial institutions, these restrictions limit the internal sharing of data for risk management, cybersecurity and regulatory (e.g., AML/CFT) purposes, as well as the development of global technological and outsourcing solutions. This is particularly relevant for cloud computing technologies, which provide both cost and technological benefits for organizations which adopt such solutions to enhance product and service offerings to customers, since the interconnected data centers are generally distributed in different jurisdictions. Cloud computing not only leads to greater efficiency gains in the forms of economies of scale but also helps to mitigate traditional IT risks such as capacity or resiliency. If something goes wrong in a particular data center, workloads can be easily re-balanced towards other unaffected data centers as long as data can be shared across data centers in different jurisdictions.

    Although national divergences in data-related regulations can be reasonably justified by different policy goals or well-grounded security concerns, international coordination would help to avoid the unnecessary and costly levels of fragmentation and restrictions that impact the ability to supervise. In particular, international coordination should focus on interoperability and how to develop streamlined procedures for companies to carry on international data transfers.

[27] Deloitte 2017. "Does MiFID II impact APAC?: Extra-territoriality of MiFID II"

[28] ECIPE 2017. "Restrictions to Cross-Border Data Flows: a Taxonomy" November 2017

11. ***Cyber Security:*** There is an increasing amount of regulation aimed at strengthening cyber-resilience across the financial services industry. Although regulation can be an important tool in bolstering cyber-resilience, it can also inadvertently increase cyber-risk if regulatory approaches are conflicting, or resource draining, and more so if there is a lack of a unified approach to addressing cyber-risk management for the overall financial services sector. Cyber-related fragmentation occurs when financial institutions must comply with different regulations in the same or in different jurisdictions that are similar (but not identical), conflicting, and in some cases well-intentioned, but do not actually enhance cyber-resilience. All this might be a consequence of differences in their approach (rules-based versus risk-based), in the way that terms are defined, or even fundamental cultural or regional differences around the usage and sharing of data.

    In October 2017, the FSB published a "stocktake" on cyber security regulatory and supervisory practices, which highlights the fragmentation in this space. The report found that the FSB's 25-member jurisdictions have 85 different schemes of regulation and guidance, and 35 different supervisory practices. The report also indicated that 72% of its member jurisdictions would plan to revise or introduce new cybersecurity frameworks in 2018.[29]

    Fragmentation is a considerable concern to the financial services industry, especially for firms that operate in multiple jurisdictions. Complying with myriad regulations and guidelines is complex, costly and diverts resources away from other effective cybersecurity related activities. Rather than enhancing overall cyber-resilience, uncoordinated regulations can pose a risk to financial stability, especially when testing critical systems multiple times or creating unnecessary duplication of sensitive information.

    The FSB's recently published cyber lexicon provides a common language and will be helpful for industry and policy makers as they engage on cyber risk management.[30] A single, agreed upon lexicon that is also aligned with the Financial Sector Profile—which can be used as a foundation for a common supervisory framework—would facilitate cross-jurisdictional coordination and harmonization of cyber regulations.[31] The IIF encourages the FSB, in collaboration with other authorities, to find ways to continue efforts to promote a more consistent and coordinated regulatory landscape around cyber security.[32]

12. ***AML/CFT:*** Similarly, the risk to the financial system from fragmentation in AML/CFT policies is acute and a threat to overall financial stability and systemic integrity. The proper management of risk in AML/CFT efforts and the avoidance of fragmentation can be improved by better information sharing, both domestically and internationally. Such exchange is important to well-functioning AML and CFT policies which fulfill the goal of protecting global finance from criminal incursion. Without adequate insights by banks, law enforcement, and intelligence agencies into the funding of these activities, efforts in stopping money launderers, terrorists, and rogue states from inflicting further damage globally will be inhibited.

    To overcome this, further efforts are needed to address challenges to operative sharing of AML/CFT information – including mitigating such issues as inconsistent legal frameworks for data protection, management of SAR-type information, privacy and bank secrecy – across different jurisdictions. We applaud the FATF for the work it has undertaken thus far on this critical issue. Important strides have been made in offering both Guidance and updating the FATF Recommendations in this area.[33] However, further work should be undertaken through the FATF and the FSB to help facilitate information exchange, particularly as it relates to combatting the financing of the proliferation of weapons of mass destruction.

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[29] FSB 2018. "Stocktake on cybersecurity regulatory and supervisory practices" October 2018

[30] FSB 2018. "Cyber Lexicon" November 2018

[31] Financial Sector Coordinating Council (FSSCC) 2018. "Financial Services Sector Cybersecurity Profile" October 2018.

[32] IIF 2018. "Addressing regulatory fragmentation to support a cyber-resilient global financial services industry" April 2018

[33] FATF 2012. "The FATF Recommendations". February 2012 and updated in 2017 and 2018

Specifically, work should focus on ensuring that secrecy and privacy laws, and tipping-off or similar provisions, do not inhibit the exchange of relevant information, including SARs and associated underlying information, across borders between entities in different group enterprises and between enterprises and governments, in both directions, for the purpose of managing financial crime risk.

In conclusion, the regulatory and supervisory framework that is currently in place results from the substantial regulatory overhaul that followed the financial crisis. While the regulatory agenda has tackled holistically the causes of the financial crisis through a number of new regulations and measures, there should be further scope for specific measures to address the fragmentation, and to enhance international cooperation among authorities.

A detailed analysis of the crisis management tools and how their efficiency has been enhanced by recovery and resolution plans, capital, liquidity and TLAC buffers, reduced interconnectedness through CCPs, generalization of initial and variation margins, improved governance and accountability, including remuneration reforms and incentives, would be warranted in order to reassure national authorities that ring-fencing may not be justified anymore. A roadmap for "ring-fencing disarmament" could be designed to ensure concerted steps are taken in the appropriate sequence on both finalization of reforms and removal of cross border regulatory and supervisory obstacles.

4. APPROACHES TO MITIGATE FRAGMENTATION

The examples above describe four categories of fragmentation that need to be addressed by all stakeholders in the global financial system. As the FSB and G20 are prioritizing market fragmentation and enhanced global regulatory cooperation, there are multiple measures that can be considered that would help promote a level playing field and reduce opportunities for regulatory arbitrage. These measures can be considered in two broad policy areas for further actions: (i) assessing the overall impact of fragmentation; and (ii) enhancing international cooperation among authorities.

A. Specific IIF Recommendations to Address Market Fragmentation

First, the FSB and other global standard setters should continue assessing the degree to which each jurisdiction is implementing internationally agreed standards within a consistent and timely manner and identify where there is fragmentation among national regulations and supervisions. As mentioned above, divergence and or fragmentation itself does not always harm the global financial system, but the consequences can be detrimental when such fragmentation negatively impacts cross-border activity of global financial institutions. Standard setters could take three helpful actions to reduce the negative impact of fragmentation: (i) define where cross-border alignments are needed; (ii) make necessary alignments in national regulations with clearly re-defined international standards; and (iii) fill the gap between national rules and international standards. Below are current measures in process and our recommendations:

- **Refine monitoring of implementation of internationally agreed standards.** It is important that the G20 and FSB continue to underscore the importance of implementing internationally agreed standards consistently. The Basel Committee's Regulatory Consistency Assessment Programme (RCAP) provides a twice-yearly assessment of each jurisdiction's progress towards implementation of post-crisis reforms. This framework is currently exclusively rule-based and fails to recognize that the same letter of a rule may have different outcomes, depending on the context in which the rule applies. This approach does not allow the necessary flexibility in the implementation of international rules across the spectrum of

G20 economies and financial systems. Therefore, the criteria for the measurement of convergence between jurisdictions must be discussed. Current "rule based" implementation criteria must give way to "outcome based" criteria.

The FSB and G20 should thus evaluate the opportunity to revisit the RCAP framework currently in place at the BCBS to monitor implementation. While we are supportive of the RCAP, the assessment could be further refined to assess overall compliance, including the stringency of how specific standards are implemented. The RCAP could also be expanded to allow for an explanation of any diversions from the Basel approach. The Japanese FSA also has called on standard setting bodies to complement the RCAP process by starting to consider how the standard setting could incorporate considerations for timely implementation across jurisdictions, including by proposing standards that are simpler and clearer.[34]

- **Encourage greater comparability of regulatory regimes through mutual recognition and equivalence rather than line-by-line comparability.** When global standards are not implemented consistently, regulators and supervisors have a number of different methods to address cross-border regulatory challenges including national treatment, recognition and passporting.[35] These are important and effective tools that should be encouraged to address market fragmentation.

  Under mutual recognition, cross-border activities can take place within the domestic and foreign jurisdictions on agreed terms, which commonly involve the use of regulatory relief, enhanced cooperation with, and reliance on, the foreign regulator's supervisory oversight when it is justified by the foreign regulatory regime or parts thereof. This type of cooperation exits in the E.U. in the form of "equivalence" and in the U.S. there is the concept of "substituted compliance," which allows foreign firms an exemption of some U.S. requirements for institutions coming from jurisdictions that are comparable to U.S. regulatory requirements. But on the whole mutual recognition and equivalence could be used more often by home and host supervisors to recognize the oversight in jurisdictions where regulation has a comparable outcome. Greater and effective adoption of national treatment, by which entities domiciled in or operating from foreign jurisdictions are generally treated in the same manner as domestic ones in terms of domestic entry and ongoing regulatory requirements, should be encouraged. This of course would not impede, when necessary alternative treatment, exemptions or other regulatory accommodations may be granted.

  Similarly, when national treatment is not an option, greater use of recognition and equivalence should be encouraged. The G20 and FSB can play an important role in specifically targeting fragmentation by defining a consensus approach and overall framework for these various types of cross-border regulatory cooperation and coordination. To this end, greater use of equivalence recognition, passporting and similar tools need to be considered further, without affecting regulatory sovereignty. Here too, the assessment process could focus on more of an outcome-based approach that avoids line-by-line compliance and facilitates comparability.

  Finally, to help address issues around extraterritoriality, jurisdictions should be encouraged, when drafting new regulations, to consider any potential spillover effects and the impact they might have on cross-border activities and in other jurisdictions themselves, as for example regarding OTC Derivatives, the U.S. Volcker Rule and MIFID II in the E.U.

- **Anticipate the extent and impact of national discretions.** National discretions are often allowed under global standards but can have significant impacts on institutions that operate across jurisdictions. It would be worthwhile for global standard setters to coalesce around an expectation of the extent to which national discretions will be introduced, and what their impact could be on banking groups and

[34] Japanese FSA 2018. "Market fragmentation" October 2018

[35] IOSCO 2014. "IOSCO Task Force on Cross-Border Regulation Consultation Report" June 2014

cross-border activity. In discussing the application of national discretion in an international forum, it should be noted that not all banking products or risk types are consistent around the globe. However, markets such as trade finance, derivatives and wholesale banking, require a sufficient level of consistency. Given the differences in underlying risk drivers, one solution could be, in certain circumstances, to develop international minimum standards that target reasonably defined international activities, rather than internationally active banks.

- **Promote impact assessments and include stakeholder involvement.** Reforms must remain fit for purpose amidst changing circumstances. The FSB should ensure a holistic evaluation of reforms, taking into account: (i) cumulative effects and conflicting incentives; (ii) a transparent methodology; and, (iii) greater use of market data. Ideally these assessments would be both ex-ante/ex-post and include stakeholder involvement. The IIF supports the FSB's initiative to evaluate the impacts of overall regulatory reforms. Examining effects and potential unintended consequences is crucial in enabling regulatory fine-tuning and ensuring that reforms contribute to optimal outcomes for society. In evaluating the effects of the reforms, it is important to consider the costs incurred by the lack of international consistency (e.g., gold-plating, relief or additional new requirements). These evaluations should be coupled with further enhanced transparency and accountability of the international bodies developing new rules and regulations. The FSB has also published four annual reports on the implementation and effects of the G20 financial regulatory reforms, highlighting the progress made in the reform agenda as the FSB pivots towards implementation and rigorous evaluation.[36]

  In addition, as we believe the FSB's work in the area of post-crisis reform review is of critical importance, we continue to suggest it should go further and on a faster pace. With its framework finalized in July 2017, the FSB has set what can be considered a modest ambition of just one to two confined projects per year. To provide comprehensive analysis, this initiative needs greater ambition, embracing cumulative impact analysis, perhaps with the support of additional resourcing from other parts of the Bank for International Settlements and member jurisdictions.

- **Ensure consistency of regulatory and supervisory frameworks across the new competitive environment.** The principle of "same activity, same risk, same rules, same supervision" should be the foundation of any framework in this rapidly evolving digital marketplace. In the digital space, where boundaries across sectors are fading, the regulatory and supervisory frameworks should focus on the activity undertaken and the risk it brings for customers and financial stability, and not exclusively on the nature of the entity. When assessing fragmentation, it would be welcome to include the activities of new entrants, as well as traditional banks.

B. Specific IIF Recommendations to Enhance International Cooperation Among Authorities

When regulators and supervisors favor local considerations over global and systemic considerations, the result can be forced subsidiarization, ring-fencing, and the trapping of capital and liquidity, which can have a negative impact on the global financial system and economy. As the global regulatory agenda moves from the development and implementation of post-crisis reforms to assessment of these reforms, it is especially important to ensure full regulatory cooperation. Below are current measures in progress and our recommendations:

- **Formulate specific objectives toward greater cooperation among regulators and policy makers.** It is important that jurisdictions and global standard setters work together through an improved governance of the global standard-setting and implementation process. Regulatory cooperation already exists through supervisory colleges, within crisis management groups (CMGs) and through global standard

[36] FSB 2018. "Implementation and Effects of the G20 Financial Regulatory Reforms: Fourth Annual Report" November 2018

setting bodies but new processes should be encouraged to enhance cooperation. For example, the Japanese Financial Service Agency has proposed that in cases of conflicting national regulations and supervisory actions, where a bank might face conflicting requests from two regulators, it could be useful to create a structural mechanism to cumulate evidence of fragmentation and its potential solution.[37]

- **Facilitate increased trust among supervisors, especially around resolution.** As noted earlier, although the G20 post-crisis reforms since Pittsburgh have made the global financial system significantly more resilient, the IIF and its members observe that this progress has not translated in restoring trust among the regulatory and supervisory community, and on the contrary, we are seeing increasing cases where local authorities introduce obstacles to cross-border banking, through local rules or local supervisory powers without proper coordination with foreign jurisdictions, with the view of maintaining control of financial activities performed in their jurisdiction and preserving local stability of markets.

  CMGs can also play an important role in the work that remains to be done: (i) to ensure local ring-fencing of resources (capital and liquidity) does not endanger the CMG's recovery and resolution strategy; and (ii) to prepare communication and decision-making within the CMG in a crisis. Indeed, it could be worth to revisit the Basel Concordat, first issued in 1975 and revised several times since, that tries to make clear the supervisory responsibilities and interests of host and parent (home) authorities, and to ensure that supervision is adequate and consistent across member jurisdictions.[38]

- **Promote information and data sharing among regulators.** International regulators should define and implement a more cooperative approach to financial data collection and sharing, which should include data and information sharing for purposes of combating financial crime and improving cyber security where national players are faced with common global challenges and adversaries.

  Regulators have traditionally shared information within colleges of supervisors and in other multilateral and bilateral settings. But information and data sharing has become more critical in recent years because many banks across multiple jurisdictions are facing similar adversaries, especially when it comes to financial crime and cyber security. To cooperate successfully in these areas requires constant and real-time collaboration, which is more efficient for both authorities and for the banks themselves, and probably more likely to be successful as it gives authorities broader and faster actionable information.

- **Enhance transparency and accountability of international bodies developing rules and regulations.** We would encourage a greater degree of transparency for both global standard setters and from local regulators. All stakeholders should be consulted early in the process of evaluating reforms in a structured and transparent manner. Banks in particular can provide data, industry knowledge, and share practical experience. The objective should be to ensure continued relevance and maximum effectiveness of the policies.

  Indeed, the FSB could consider an annual (or semi-annual) working group or conference to discuss issues of mutual concern on a commonly agreed agenda and provide a status update.

- **Enhance accountability in adoption of previously agreed global standards.** The FSB or a similar body should assess and report on the state of adoption by all member jurisdictions of the various global reference data and reporting standards that have been created: for example, LEI, Unique Transaction Identifier, Unique Product Identifier and the Critical Data Elements. Jurisdictions that have not adopted such standards should be identified and urged to make progress on implementation. The FSB, through

[37] Japanese FSA 2018. "Remedies for Conflicting Regulatory Demands" in Eurofi Magazine. September 2018

[38] Basel Committee 1975. "Report on the supervision of banks' foreign establishments – Concordat" September 1975

the Standing Committee on Standards Implementation (SCSI), could broaden the scope of its monitoring to effect change in this area.

- **Place additional emphasis on supervision and promote supervisory coordination among home and host**. Supervisors play an increasingly important role in a rapidly changing environment to ensure that financial institutions are safe and sound. Supervisory agencies need to be able to supervise implementation of often complex regulatory requirements as well as to address new risks and new actors in the financial markets. This enhanced supervision should be conducted in coordinated ways. As shown in the BCBS Consultation on Stress Testing Principles, for example, there should be minimal supervisory coordinated standards in Pillar 2. An international standard should be kept minimal and at high level, allowing a wide range of practices and approaches while building trust among supervisors and promoting transparency and comparability.

  More importantly, better interplay between home and host supervisors is necessary to avoid conflicting trends in supervisory practices that can lead to fragmentation. The home supervisor, focused on the financial condition of the consolidated group, has a natural extraterritorial focus while the host supervisor seeks to control the risks located in its territory. This conflict comes from the existing gap between global banks' scope of operations and supervisors' scope of responsibility which is limited to a territory. From this perspective, the current response, through the Supervisory College, may be insufficient. Therefore, there should also be a more comprehensive discussion on the respective roles for home and host supervisors, to ensure both have sufficient oversight according to their respective responsibilities and also to ensure that the efficiency of a branch operating model, and the ability to serve local clients, is maintained.

5. CONCLUSION

Efforts by the international community and in particular global standard setters in assessing both the overall impact of fragmentation and enhancing international cooperation among authorities should be supported and further enhanced. As the negative effects of market fragmentation become increasingly evident, urgent coordinated action should be pursued.

As the post-crisis reforms continue to be implemented and reviewed for their effectiveness, we encourage the G20 and FSB to make an assessment of the degree of existing market fragmentation, where it is occurring, and what the ultimate impact is on markets, respective economies, and the cross-border flow of financial services. Simultaneously, consideration of specific practical measures to prevent fragmentation (by enhancing regulatory and supervisory cooperation) and to correct its negative effects should be developed.

The IIF welcomes the opportunity to collaborate to this process with the analysis included in this report and the recommendations for consideration. As the FSB develops its analysis and completes its report to the G20, we encourage it to maintain an open and ongoing dialogue with the private sector and other stakeholders on this crucial topic for financial markets and the global economy.