

# Financial Stability through International Regulatory Coherence: A Statement from the World Federation of Exchanges

*“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.” - G20 Leaders, Pittsburgh, 2013*

*“An open and resilient financial system, grounded in agreed international standards, is crucial to support sustainable growth.” - G20 Leaders, Buenos Aires, 2018*

Global exchanges and CCPs have strongly supported the post-crisis regulatory reforms, which have made financial institutions and markets safer for their customers and society at large. We acknowledge regulators’ legitimate interests in managing systemic risk and ensuring proper oversight of their markets, including through the tailoring of international standards to local requirements.

The members of the World Federation of Exchanges have worked with authorities, market participants and investors to deliver the G20’s program of reform. They have also witnessed how, in some cases, the implementation of post-crisis regulatory reform has resulted in an unnecessary fragmentation of financial markets, and liquidity, on a cross-jurisdictional basis. This trend continues to be observed in some contemporary policy proposals.<sup>1</sup>

Financial markets are both global and national, serving the needs of the national economies whilst also allowing access to global capital and investors. Despite the successes of international standard-setting bodies (ISSBs) in delivering a global framework for regulation, avoiding fragmentation in national implementation has proven more difficult. The tools available to international standard setters give relatively little power to achieve a good balance between safeguarding of national systems and maximising cross-border efficiency. This is in the gift of national authorities and regulatory coherence has not always been prioritised, despite evident implications for the users for financial markets and for financial stability. In this context, the ISSBs can nonetheless play an important role, pursuing ex ante policy co-ordination and monitoring national divergence from international standards (whether the divergence is justified or not).

Addressing this trend will be a challenge. The current tenor of political debate in many jurisdictions appears to work against institutional co-operation at the international level. The globalist approach to trade and regulatory co-operation has come under scrutiny—and indeed, in some areas, criticism—in many jurisdictions, though without necessarily taking into account the potential negative impact this may have on capital flows. Ambition and creativity will be required to achieve progress the Japanese G20 presidency’s priority to tackle financial market fragmentation.

We call for a renewed political impetus for rules-based regulatory co-ordination based on deference, accompanied by radically increased transparency as regards process and a renewed embrace of stakeholder engagement from institutions contributing to international policymaking and implementation.

## The Challenge of Fragmentation

Achieving international regulatory coherence is important because financial markets are critical for economic growth and sustainable development. Fragmentation adds costs, slows innovation, impedes competition and reduces choice and risk diversification for investors. It entails cliff-edge effects in liquidity which could give rise to market dislocations, as and when measures increasing fragmentation take effect, for instance when jurisdictions change the wider economic basis on which they interact. It may also lessen the resilience of financial markets as a whole, by isolating them from a more diverse array of participants which allows for risk diversification. As an example, CCPs benefit from being able to diversify their customer base and the related credit risk. In that context, deference – where it is appropriate – can potentially play a facilitating role.

The global frameworks put in place by international standard setters should be capable of meeting the needs of different jurisdictions while upholding robust, politically agreed norms. While it is right that jurisdictions manage risks through rules tailored to the specificities of the local financial system, the means of doing this should be consistent with agreed global frameworks. Nevertheless, we observe a lack of coherence in the implementation of internationally agreed policy at the national level—including instances of proscribing foreign access because of line-by-line comparisons of legislation rather than an appropriately outcomes-focused

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<sup>1</sup> A detailed exploration of fragmentation in financial regulatory policy with accompanying case studies can be found in the WFE paper [“Financial Markets and International Regulatory Dissonance”](#), November 2017.

approach. Furthermore, there have been instances of threatened geographic fragmentation in the implementation of certain international standards, e.g. the share trading obligation, where standards are objectively equivalent.

For understandable reasons, public authorities have focused post-crisis regulatory reform efforts on ensuring the stability of the financial system within their own jurisdictions. Having put in place crucial new rules to make financial institutions safer individually, as well as macro-prudential measures designed to address their collective risk profile, authorities are now analysing the consequences and calibrating public policy. We believe the G20's priority to address unwarranted financial market fragmentation is complementary to, and supportive of, these post-crisis reforms.

## Accounting for innovation at the international level: the crypto case

As the development of distributed ledger technology has progressed over the last decade, public policy challenges have surfaced. The anonymity of crypto transactions has given rise to concerns about money laundering and terrorist financing, as well as KYC issues. Some applications of crypto do not fit neatly in the regulatory frameworks that apply to currencies, securities and/or commodities. Many platforms for trading crypto assets have been compromised, to material investor detriment.

The fact that crypto assets are still developing presents a unique opportunity to develop forward-looking international regulatory standards to tackle these challenges at an early stage, rather than patching together a series of disparate and possibly conflicting standards ex post facto. Taking such action would improve investor protection, reduce the possibility of regulatory arbitrage, and allow for competition on a level playing field. The WFE advocates particular focus on ensuring that crypto platforms take responsibility for market integrity and investor protection and demonstrate how they enforce common rules.

While circumstances may appear politically inopportune, international standard-setting bodies (ISSBs) are better placed than ever before to make a difference, partly because they are simply better resourced. They should study and promote mechanisms and criteria for recognition of foreign regimes, including any instances where multilateral (many-to-many) recognition might be appropriate. Confidence in the ability of rules-based, intergovernmental institutions to effectively address our shared challenges remains key.

Renewal is therefore needed and, at the same time, achievable.

## Transparency, engagement and accountability

Over the years, a great deal of effort has been expended to devise solutions to the financial market fragmentation that arises from a lack of international regulatory coherence. These prescriptions remain valid:

- Standards for comparability assessments;
- Ex-ante co-ordination of rules;
- Improved mechanisms for the ongoing assessment of regimes, as rulemaking and implementation progresses (e.g. more frequent and timely peer reviews and implementation assessments);
- Improvements to the system of transitional reliefs.

Standards for assessing comparability could start with the regulatory objective(s) for specific pieces of legislation, whether relating to systemic risk management, market integrity or investor protection. As regards ex-ante co-ordination, it would simplify the process if initiatives were based on robust quantification of the risks being addressed.

Also relevant will be:

- Regard for whether jurisdictions meet fundamental, threshold standards, i.e., measures such as those on AML, CTF, KYC and investor protection (which have not always been upheld in the field of digital assets);
- Cost-benefit analyses for pieces of legislation at national (or, where relevant, regional) level that include an assessment of the cross-border activity;

Fragmentation persists. The political direction to faithfully enact the above policies will only be forthcoming with a new approach to transparency, engagement and accountability from international standard setters and their constituent policymakers. We welcome the commitments of the incoming FSB chair Randal Quarles to enhance the transparency of that institution and call on G20 Leaders to extend progress in this vein.

We propose the following specific actions:

- Enshrining transparency and due process in an international agreement, alongside a commitment to overcoming international regulatory divergence, avoiding regulatory competition and censuring politically motivated dissonance;
- Creating flexible new mechanisms for the escalation and resolution of regulatory dissonance;
- Embedding international regulatory coherence in the mandates of national authorities;
- Reporting by international standard setters on progress addressing financial market fragmentation; and
- Enhancing dialogue between international standards setters, national policymakers, stakeholder groups and civil society through a structured framework.

## Conclusion

Efficient markets engender greater rigour in the allocation of capital, increase the availability of capital, and spur competitive forces among financial institutions. Cross-border regulatory co-ordination and deference to comparable standards improves supervision and reduces systemic risk.

International standard setters can achieve meaningful improvements to financial market fragmentation. G20 leaders can enable them to do so.