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of International Financial Centers

How international financial centres can help drive international regulatory cooperation post-Covid-19

IMPRINT

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This paper aims to suggest ways of strengthening the processes around regulatory cooperation in order to deliver positive change and explore how international financial centres can play a critical role in driving these processes.

International regulatory cooperation is the process through which regulators from different countries exchange information, ideas, experiences and best practices. It helps regulators adopt better behaviors by consulting more frequently; engaging more regularly and consistently with industry; and applying proportionality and cost/benefit analysis before crafting and implementing regulations. It can also facilitate regulatory convergence and common understanding, removing unintended obstacles to trade in financial and professional services.

Considerable progress has already been made in developing international regulatory dialogue and exchange, and, crucially, in ensuring that market participants can play a role in such dialogues. For example, in the case of global, systemically important banks, the supervisory authorities of the countries in which the institution is active already meet at college of supervisor gatherings. While the individual institution is often the primary topic of discussion here, such gatherings provide all participants with a deeper insight into the regulatory systems of the other countries concerned, promoting mutual understanding and confidence. Such exchanges form a strong foundation that can be built on.

Although raising questions around regulatory process might seem less urgent in a time of crisis than pushing for substantive regulatory reforms, getting processes right is a precondition for achieving substantive change. Before regulators can agree on common approaches, they first need to meet regularly, discuss sensitive issues with one another and other stakeholders, and develop mutual trust.

It is important to note that regulatory cooperation is not simply a technical matter for regulators. It also depends on political will and governments' recognition that cooperation can serve wider policy objectives. Governments decide if financial activities or firms should be regulated and delegate regulation to independent supervisors, responsible for prudential regulation and market conduct. But governments retain an overall economic interest in seeing that financial services are provided competitively and are consistent with regulatory objectives, and that regulation in their jurisdiction does not function as covert (or overt) trade protectionism that fragments international markets and prevents businesses and consumers from securing the competitively-priced financial services they need. Governments and regulators should both see regulatory cooperation as an important tool for addressing both regulatory and economic interests to aid post-Covid-19 recovery.

The paper is divided into five sections, followed by a conclusion. It will start by explaining why increased regulatory cooperation is so important after Covid-19; follow by outlining goals for regulatory cooperation; proceed to consider forums in which regulators could best meet to exchange ideas; and explore how IFCs can support international regulatory forums. The final section will set out principles for how to achieve better regulatory cooperation.

Why is regulatory cooperation important after Covid-19?

Regulatory cooperation is important because most barriers to trade in services have their origin in regulatory divergence. The differences between financial regulations in different jurisdictions can make it difficult for financial services providers to supply products from one jurisdiction to another at a reasonable cost. Businesses cannot properly benefit from economies of scale, and businesses and consumers alike suffer as cross-border capital flows decline, capital and liquidity pools shrink and the cost of capital rises. Companies as well as consumers have less access to financial products.

Some regulatory divergence results from countries differing in their public policy priorities. But much divergence is accidental, as different country authorities seek similar outcomes but structure regulations differently and use different means to achieve the same end. Unfortunately, such situations can inadvertently introduce major barriers to trade. Regulatory cooperation can remedy against this. It can also create more consistency and predictability in the international trade of financial services, supporting sustainable growth around the world.

While regulatory cooperation has long been important for the industry, it is critical in the post-Covid-19 recovery period. Following Covid-19, the reach and range of financial market interventions from governments and regulators around the world has expanded rapidly, and sometimes in an uncoordinated fashion. Many countries have moved quickly to adopt new regulations and subsidy measures to support businesses through the crisis.

Governments were right to act to stabilize their economies. However, as countries emerge from Covid-19, there is a risk that some countries will react to others' crisis response measures differently, interpreting them as constituting barriers to trade or serving anti-competitive purposes. In the pre-Covid-19 era, there were rising trade tensions – even significant trade disputes – between the US, EU, China and others due to concerns about some countries pursuing anti-competitive and trade distorting behavior.

Further trade disputes could stifle the green shoots of post-Covid-19 recovery. It is critical that governments and regulators discuss their crisis measures at international forums and try to reach shared understandings of what constitutes appropriate Covid-19 related regulations or economic support measures, as opposed to anti-competitive measures. Such shared understandings could help prevent significant trade disputes and a drift towards protectionist measures and ensure a more coordinated international economic response to Covid-19. They could also promote a more coordinated effort to ensure that international economic recovery takes place on a sustainable footing by providing investors and businesses with greater transparency about global markets.

What should be the goals of regulatory cooperation post-Covid?

It is important to be clear on what regulatory cooperation can achieve. What is its purpose? Why undertake efforts into deliver effective mechanisms for cooperation?

One clear purpose is to avoid regulatory fragmentation. Such fragmentation can result in:

- duplicative and inefficient practices for providers and users of capital
- failures in synchronizing key measures, including Basel III implementation
- challenges to creating sustainable and robust bank structures, stable financial systems, and efficient allocation of equity capital
- divergent rules on bank resolution which create obstacles for cross-border banks in particular, and give rise to supervisory challenges
- technical and legal inconsistencies in over-the-counter (OTC) derivatives regulation.

International regulatory dialogues should aim to tackle such challenges, and help:

- avoid new and reduce existing unnecessary restrictions to trade and investment, especially restrictions arising from post-Covid-19 economic recovery efforts
- promote the development of international standards through dialogue, particularly in critical areas such as environmental, sustainability and governance (ESG) standards
- improve regulators' engagement with stakeholders, including regulators' engagement with their local governments on prudential regulatory issues.
- make communications between regulators:
  - more disciplined and transparent
  - more timely and accountable
  - aim at better-coordinated results
  - more focused on discussing regulatory problems in advance, rather than tackling them after they have arisen.

Where can regulatory cooperation take place post-Covid?

Regulatory cooperation cannot take place in a vacuum. Regulators and governments need forums for discussion. Existing international forums like the G20, FSB, Bank of International Settlements, IMF, IOSCO and IAIS provide ideal locations to discuss post Covid-19 regulatory and subsidy measures.

The G20 has an especially important role to play: it brings together the governments of the world's leading economies. Most importantly, the G20 as a platform has demonstrated its effectiveness in tackling global regulatory challenges following the 2008 global financial crisis. It is important to link the G20 discussions on post-Covid-19 regulations with ongoing discussions on the impact of regulation taking place in other intergovernmental organisations, including the World Trade Organization (WTO) Joint Statement Initiative on Domestic Regulation and the work of OECD.

Coordination at international bodies is a first step for regulatory cooperation. But it should not be the only step. Following the financial crisis, there was much agreement around post-crisis regulatory objectives at the global standard setting body level, but cooperation sometimes broke down, with fragmentation at the national level, once governments acted to interpret and implement high-level international standards in the form of national laws. The same fragmentation at the national level could occur in the post-Covid-19 era.

More in-depth discussions around the details of regulatory cooperation therefore also need to take place at the bilateral or regional level as well as at multilateral forums. Fortunately, as regulators explore how to develop more bilateral forums for regulatory engagement in the post-Covid-19 era, they can draw on experience from the last decade, which has seen many positive examples of detailed bilateral regulatory cooperation.

How can IFCs support regulatory cooperation?

International regulatory dialogues benefit from input from a wide range of regulators and from private sector and other relevant stakeholders. International financial centres and business membership organisations, which can convene industry perspectives and reflect industry concerns, are often well placed to advise on international regulatory discussions. Industry representatives can advise regulators on how regulatory issues might adversely impact issues such as cross-border trade and ascertain which regulatory issues on the horizon are most likely to become future problems. Industry representatives can also set out how proposed regulatory approaches are likely to be operationalized by firms. Without industry feedback and support, dialogues between regulators can become detached from commercial realities; but with such dialogue, they can produce better outcomes.

Ideally, industry representatives should be involved in dialogues in a regular, consistent way so that they are able to propose items for agendas and possible solutions. In order to support dialogues properly, industry representatives should be consulted in advance so that they have time to develop ideas for how the forthcoming dialogue could support regulatory objectives, and so that regulators have time to consider any industry proposals that are made. In the same way that consulting the industry on changes to domestic regulation is considered a good regulatory practice, so is engaging the industry in international regulatory discussions.

Regulators have increasingly come to recognize the value of industry engagement in international regulatory discussions in recent years. Some prominent examples of how this can occur include:

- The US-UK Financial Regulatory Working Group brings together senior representatives from central banks, finance ministries and regulators in both markets to explore in-depth financial regulatory cooperation. TheCityUK and its main US partner, the Securities Industry and Financial Markets Association (SIFMA) launched the British American Financial Alliance in September 2020, a grouping of industry trade associations in the UK and US, to feed into the Financial Regulatory Working Group and support its objectives.
- The US-Canada-Mexico Financial Regulatory Forum was established in 2018 to facilitate close financial regulatory cooperation between the three countries. This Forum's founding agreement permits regulators to meet and engage 'with relevant stakeholders consistent with applicable law and domestic practices on the activities of the Forum', which marks a significant step towards formally acknowledging the need to include business in international regulatory dialogues.
- Key bilateral regulatory dialogues such as the Joint EU-US Financial Regulatory Forum, Joint EU-Japan Financial Regulatory Forum and the EU-Asia-Pacific Forum on financial regulation have all benefited from consultation with industry and industry input.
- The ASEAN Capital Markets Forum is a high-level grouping of capital market regulators from all 10 ASEAN jurisdictions. The Forum recently engaged with capital markets participants as it developed its recent action plan to ensure that it fairly reflected industry concerns.
- All three European supervisory authorities (ESAs) – the European Banking Authority (EBA), the European Securities and Markets Authority (ESMA) and the European Insurance and Occupational Pensions Authority (EIOPA) – have stakeholder committees whose members are market participants who discuss the interpretation and application of the current supervisory law and the future regulation with national supervisors and European institutions.

A key question now is whether, building on the advances of such forums, more regulators will be willing to recognize the benefits of consultation with private sector stakeholders during international regulatory discussions.

Which principles should govern regulatory cooperation post-Covid-19?

There are many ways in which regulators can engage in dialogues with one another, and there is no one optimal way to secure regulatory cooperation and promote regulatory convergence. In addition, governments and politics will often have to take the respective binding decisions. But here there are benefits if the regulatory authorities prepare the relevant decisions on the basis of trust-based mutual exchange, as their advice and expertise is usually sought by governments before they issue new regulations. Beyond regulatory harmonization (i.e. the creation of a common rulebook operated by different jurisdictions in a specific regulatory area), below are some principles which can guide regulatory cooperation:

Equivalence: regulators accept one another's regulator's rules as valid on the grounds that they are "equivalent" to their own, i.e. substantially the same in terms of outcomes in practice, if not necessarily identical in form.

Recognition: Host country regulators recognize the home country regulator's standards as valid because both have high standards and seek the same outcomes, even if they try to achieve them differently ways. If both regulators recognize each other's regulations at the same time, this is known as mutual recognition.

Exemptive relief: Host country regulators grant institutions or financial services from another country exemption from compliance with some of their regulations because the home country regulatory regime is deemed sufficiently similar to that of the host country on the issue in question.

Mutual deference: Home country authorities are accountable in their jurisdiction for the resilience of financial institutions and services under their supervision.

Substituted compliance: Host regulators permit foreign regulated institutions and services whose activities might bring them within the scope of the regulator's jurisdiction to show compliance with their home jurisdiction regulations as a substitute for compliance with the host country's regulations.

Reciprocity: Exemptions from rules granted by one country to financial institutions from another home country must also be granted by the host country to institutions from the other country.

There are different considerations when evaluating each approach. Harmonization and equivalence can be easy for financial institutions to navigate. But countries may be wary of adopting such measures in case they amount to less policy flexibility, which might in turn make it harder to sustain such cooperation. It is therefore sometimes worth exploring the benefits of more flexible mechanisms like recognition and substituted compliance, which let countries retain policy flexibility and enable cooperation even in the absence of complete policy alignment.

Conclusion

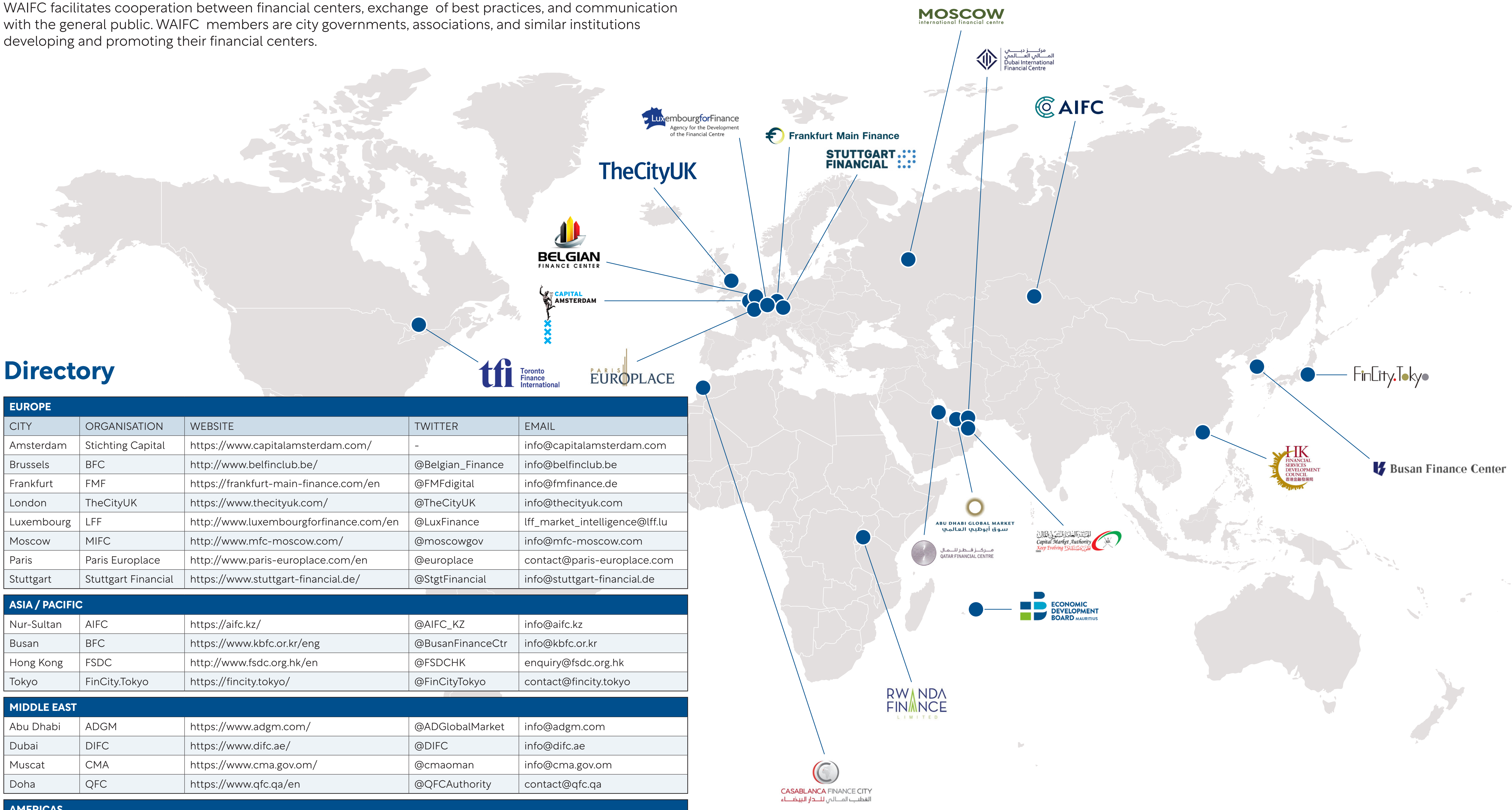
Covid-19 has not made international regulatory cooperation important – it was already. But the adoption of new regulations and economic support measures that followed in its wake have made regulatory dialogues much more urgent.

If countries work together to deliver a coordinated economic response to Covid-19 that embraces open trade and regulatory cooperation, the benefits for global progress and economic growth will be considerable.

It is time for all countries and all stakeholders to work together to seize this opportunity. International Financial Centers and the WAIFC, as a key co-ordinating body of a range of IFCs from around the world, are willing to contribute to a strengthened international regulatory dialogue.

WAIFC worldwide

WAIFC facilitates cooperation between financial centers, exchange of best practices, and communication with the general public. WAIFC members are city governments, associations, and similar institutions developing and promoting their financial centers.



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