Position Paper: The relevance of regulatory harmonization on OTC derivatives markets and the need for prioritization of Brazil in international discussions

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Introduction: the 2008-09 crisis and the regulatory reform

When the 2008-09 international financial crisis erupted, several vulnerabilities of the global financial system were revealed. After two decades of financial deregulation, globalization, and introduction and diffusion of financial innovations, the most important financial systems, from the U.S. to Europe and Asia, showed the financial fragility that had been inherent to their development.

This diagnosis was endorsed by the G20, the group which gathers the leaders from the 20 biggest developed and/or emerging economies around the world, and that assumed a prominent role in leading and coordinating the post-crisis reform agenda:

> During a period of strong global growth, growing capital flows, and prolonged stability earlier this decade, market participants sought higher yields without an adequate appreciation of the risks and failed to exercise proper due diligence. […] Policy-makers, regulators and supervisors, in some advanced countries, did not adequately appreciate and address the risks building up in financial markets, keep pace with financial innovation, or take into account the systemic ramifications of domestic regulatory actions.[1]

One of the fundamental actions of the G20, reflecting this interpretation of the global debacle, was to set as a priority the implementation of a deep financial reform, aiming at strengthening financial markets and regulatory frameworks, and reversing the financial liberalization process that began in the 1980's. This reform was not promoted at a local level, by national regulators, but at the international level, mirroring the process of financial globalization and with the purpose of harmonizing the different regulatory frameworks adopted in each jurisdiction[2].

In this context, from the G20's designation, multilateral bodies and forums gained prominent relevance in reviewing and setting new rules, standards and principles as reference to national or regional regulators. The Financial Stability Board (FSB), the Basel Committee on Banking Supervision (BCBS), the Committee on Payments and Settlement Systems (CPSS) and the International Organization of Securities Commissions (IOSCO), in particular, were responsible for moving ahead the reform agenda, based on the G20 Action Plan.

The G20 Action Plan set forth some common principles for reform: strengthening transparency and accountability, enhancing sound regulation, promoting integrity in financial markets, reinforcing international cooperation, and reforming international financial institutions.

[1] G20. (2008). Declaration of the Summit on Financial Markets and the World Economy. Washington DC, November 15, 2008. Available at: http://www.g20.utoronto.ca/2008/2008declaration1115.html.

[2] "Regulation is first and foremost the responsibility of national regulators who constitute the first line of defense against market instability. However, our financial markets are global in scope, therefore, intensified international cooperation among regulators and strengthening of international standards, where necessary, and their consistent implementation is necessary to protect against adverse cross-border, regional and global developments affecting international financial stability." (G20, 2008).

Hence multiple lines for reform were open, involving different markets, assets, activities, operations, and institutions.

The reform on spot: OTC derivatives, financial market infrastructures and Basel III

Among these multiple fronts, it is important to stand out the over-the-counter (OTC) derivatives markets reform, the revision of the principles for financial market infrastructures and Basel III, which sets a revised and extended banking regulation framework.

The first front has the objective of changing the main features of derivatives markets, characterized by bilateral operations carried outside regulated markets (over-the-counter), especially in the main financial centers. The G20, at the 2009 Pittsburgh Summit and the 2011 Cannes Summit, set forth five pillars of reform: mandatory reporting of all derivatives contracts to trade repositories, mandatory clearing on central counterparties for some contracts, electronic trading on exchanges and trading venues, stricter capital requirements, and margin requirements for derivatives cleared out of central counterparties (the last one was included in the agenda in 2011).

The report/registration of all derivatives contracts has the aim of increasing transparency in the OTC segment and improving supervisory capacity, giving visibility to counterparties, contract features and details as well as the conduct of financial institutions. Moreover, mandatory reporting is linked with the creation of a new type of financial market infrastructures, trade repositories (TRs), which are in charge of collecting and consolidating information on derivatives contracts and making it available to supervisors.

The obligation to use central counterparties (CCPs) for more standardized contracts aims to mitigate counterparty credit risk incurred by market participants and increase market transparency. This measure is accompanied by efforts in the standardization of derivatives contractual terms and to promote electronic trading, in order to help in providing more liquidity to some contracts. One should notice that, after the reform, exchanges and CCPs will concentrate much more contracts and operations, thereby concentrating much more risk than before.

Finally, the two last pillars of the OTC derivatives markets reform set higher capital and margin requirements for non-centrally cleared contracts. These requirements works as a mix of incentive mechanisms and prudential regulation instruments, in order to assure that the objectives proposed in the second pillar are effectively reached.

The FSB was in charge of developing general principles for reform to be followed by local/regional regulators[3] encompassing the two first pillars, while BCBS and IOSCO were in charge of establishing the standards for additional capital and margin requirements.

Taking into account this new context for the operation of financial market infrastructures (FMIs), with a greater concentration of operations and risks in exchanges and CCPs, it was necessary

[3] Financial Stability Board (FSB). (2010). Report on Implementing OTC Derivatives Market Reforms. Available at: http://www.financialstabilityboard.org/publications/r_101025.pdf.

to review some of the guiding principles in the regulation of these entities. Particularly, due to the systemic importance of these entities, it was necessary to strengthen and improve risk management standards to be applied by them. In addition, in the case of TRs, there was a need to set the basis to their constitution and operation. In this context, the CPSS and IOSCO released, in 2012, a new set of principles for FMIs (PFMIs), updating the standards in force.

Complementarily, banking regulation, through Basel III[4], set stricter standards for the capitalization of exposures to derivatives and to FMIs. The new Accord, beyond introducing unprecedented liquidity and leverage ratios, refined capital requirements in order to treat more properly the counterparty credit risk originated in bilateral derivatives operations, through the introduction of credit-valuation adjustments (CVA) to account for changes in creditworthiness of counterparties. In relation to CCP-cleared operations, the new Basel III framework incentives clearing through CCPs, but also recognizes the risks posed by CCPs in the post-reform context.

Additionally, it is worth mentioning the interrelations between the Basel III requirements and the PFMIs: as a way to discourage financial institutions to expose themselves to FMIs that employ, among other things, poor risk management practices, the BCBS has associated capital requirements to the compliance of market infrastructures to the revised PFMIs, “penalizing" the institutions that operate with entities that do not follow the principles.

In this case, the risk-weighing factor applied to exposures to PFMI-compliant (qualified) CCPs is 2%[5], while exposures to non-qualifying CCPs should reproduce the risk weight factors of each specific exposure, which can varies from 0% to 100% (as a rule assuming the 100% value). Moreover the risk-weighing factor applied to exposures to default funds of non-qualifying CCPs reaches 1.250%[6].

The adoption of the threefold reform in the U.S. and Europe and cross-border impacts

The set of changes described above represents an attempt to create a harmonized global framework for OTC derivatives markets, encompassing (i) the features and conditions for derivatives clearing; (ii) the resilience of OTC-derivatives-FMIs, and (iii) the proper capitalization/collateralization of institutions which are active in this market. This “threefold” reform is also accompanied by the creation of mechanisms and arrangements with the aim to strengthen

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[4] Basel Committee on Banking Supervision (BCBS). (2011). Basel III: A global regulatory framework for more resilient banks and banking systems (revised June 2011). Available at: http://www.bis.org/publ/bcbs189.pdf.

[5] Basel Committee on Banking Supervision (BCBS). (2012). Capital requirements for bank exposures to central counterparties. Available at: http://www.bis.org/publ/bcbs227.pdf.

Basel Committee on Banking Supervision (BCBS). (2013). Capital treatment of bank exposures to central counterparties. Consultative Document. Available at: http://www.bis.org/publ/bcbs253.pdf.

[6] Although the Basel Committee sets forth some common criteria for the characterization of QCCPs, the requirements to obtain the status of QCCPs may vary among different jurisdictions with some specificities, especially, with respect to foreign CCPs.

the supervision capacity of market authorities, also expanding their control over market participants and operations performed on the OTC derivatives markets.

In the United States, these changes were incorporated, basically, in the Dodd-Frank Wall Street Reform and Consumer Protection Act (DFA), released in 2010, which reforms the U.S. financial system in several aspects. The Title VII - Wall Street Transparency and Accountability of the DFA implements, through Subtitle A, the basic elements of the OTC derivatives markets reforms agreed in the G20 in the U.S. swaps and security-based swaps markets.

Sections 727-729 address derivatives reporting, while Section 723 is dedicated to clearing requirements and Section 736 to margin requirements[7]. These provisions were complemented by several rules promulgated by U.S. regulatory agencies, namely the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC), which established more granularity on new requirements. In addition, the rules related with additional capital requirements were incorporated in the U.S. banking regulatory framework by the triad – the Office of the Comptroller of the Currency (OCC), the Federal Reserve System (FED) and the Federal Deposit Insurance Corporation (FDIC) - reflecting Basel III[8].

Section 722(d) of DFA modified the Commodity Exchange Act (CEA) by adding Section 2(i), which extends – and simultaneously limits – the regulatory perimeter of U.S. agencies: accordingly, the swaps provisions of the DFA also apply to cross-border activities when certain conditions are met, namely, when such activities have a ‘‘direct and significant connection with activities in, or effect on, commerce of the United States’’ or when they contravene CFTC (or SEC) rules or regulations.

On the one hand, the new section opens room to extend the regulatory authority of the CFTC and the SEC over cross-border operations, provided they have connections with the U.S. markets. On the other hand, it limits this authority to activities that have effective impacts on the American markets. Therefore, new requirements applicable to U.S. institutions (and swap dealers) and to swaps operations carried out in the U.S. are also applicable to activities and institutions located abroad.

To clarify the cross-border application of swaps requirements, the CFTC released in July 2012 a proposal on the “cross-border application of the swaps provisions of the CEA”. The difficulty to achieve full harmonization among jurisdictions is recognized in the proposal, and the CFTC cross-border rule – and subsequently the SEC cross-border rule – establishes some tools and comparability criteria in order to account for different regulatory frameworks, namely the so-called substituted compliance.

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[7] 111th Congress of the United States of America. (2010) Dodd-Frank Wall Street Reform and Consumer Protection Act. Available at: http://www.gpo.gov/fdsys/pkg/BILLS-111hr4173enr/pdf/BILLS-111hr4173enr.pdf.

[8] Department of the Treasury – Office of the Comptroller of the Currency (OCC); Federal Reserve System (FED); Federal Deposit Insurance Corporation (FDIC). (2012). Regulatory Capital Rules: Standardized Approach for Risk-Weighted Assets; Market Discipline and Disclosure Requirements. Available at http://www.gpo.gov/fdsys/pkg/FR-2012-08-30/pdf/2012-17010.pdf.

The concept of substituted compliance is related to a specific approach to treat regulatory discrepancies between distinct jurisdictions. Its applicability depends on four elements: (i) the location where the counterparty is domiciled; (ii) the formal relationship between non-U.S. person counterparties and U.S. persons (whether it is a branch, affiliate, etc.); (iii) the place where the swaps are entered into; (iv) the "origin" of the guarantees (whether a non-U.S. person is guaranteed by one U.S. person or not). Moreover, the proposal establishes that the feasibility of a substituted compliance arrangement depends on a detailed analysis about each rule in force in a foreign country based on each specific objective to be pursued by each CFTC requirement.

Following the proposal, the participants of swaps markets and foreign regulators expressed numerous concerns and doubts, in particular with respect to the duplication of regulatory requirements, the violation of customer information secrecy rules, and even the legal uncertainty which may harm deals between non-U.S. persons and U.S. persons. After one year of discussions, the CFTC released in July 2013 the final version of the cross-border rule but without settling all concerns related to regulatory harmonization[9]. To illustrate this statement one can mention the discussions on electronic trading and the registration of trading systems of foreign jurisdictions as swap execution facilities (SEFs) that occupied the agenda of regulators in the first quarter of 2014[10].

In the European Union (EU), the OTC derivatives markets reform was implemented through the European Market Infrastructure Regulation (EMIR) and the Capital Requirements Regulation (CRR), part of the Capital Requirements Directive (CRD) IV package. In its turn, the European Securities Markets Authority (ESMA) is responsible for establishing technical standards[11] regarding the report of derivatives transactions to TRs, the clearing obligation for certain classes of OTC derivatives, the risk-mitigation techniques for OTC derivatives not cleared by a CCP, and the general and prudential requirements for CCPs with respect to all derivatives classes.

Similarly to U.S. rules, the European OTC derivatives markets requirements apply to both European and foreign market participants. For instance, EMIR sets out that "in view of the global nature of financial markets, ESMA should be directly responsible for recognising CCPs established in third countries and thus allowing them to provide clearing services within the [EU], provided that the Commission has recognised the legal and supervisory framework of that third country as equivalent to the [EU] framework". In addition, EMIR regulations apply to contracts with a "direct, substantial and foreseeable effect" within Europe, namely the contracts in which one third country party benefits from a guarantee provided by an EU financial counterparty and the derivatives entered into by European branches of third country financial counterparties[12].

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[9] The same applies to SEC rules for *security-based swaps* and *security-based swap dealers*.

[10] ANBIMA (2014). "Negociação eletrônica de derivativos gera embate entre autoridades europeias e americanas" ["Electronic trading of derivatives generates a clash between American and European authorities"]. Radar ANBIMA nº 9. Available at: http://portal.anbima.com.br/informacoes-tecnicas/estudos/radar/Documents/201404_radar.pdf#page=4.

[11] These standards are assessed and endorsed by the European Commission and the European Parliament.

[12] European Commission (2014). Commission Delegated Regulation (EU) No 285/2014 with regard to regulatory technical standards on direct, substantial and foreseeable effect of contracts within the Union and to prevent the evasion of rules and obligations. Available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2014:085:0001:0003:EN:PDF.

In the European context, EMIR also establishes harmonization arrangements, not substituted compliance, but equivalence of a third country regulatory framework in relation to the EU rules: if the regulatory objectives incorporated in the foreign rules are considered to be compatible with the objectives of EMIR, the rules of the third country are considered sufficient to comply with the European rules, allowing foreign entities and counterparties to comply only with local regulations. One should notice the difference between this mechanism with the one adopted in the U.S., which is based on a more granular approach, in a case-by-case basis.

A concrete example: the issue of qualified central counterparties

Article 25 of EMIR sets that third country CCPs should be assessed and recognized by ESMA in order to provide clearing services to EU clearing members or trading venues. In the case of a third country CCP providing clearing services to European financial counterparties, which includes foreign branches of EU financial counterparties, EMIR requires its "qualification" by ESMA, requesting the submission of an application.

The recognition of a third country CCP by ESMA also requires the adoption of an equivalence determination with respect to this third country by the European Commission, which is based on the soundness of legal and regulatory frameworks ruling the operation of this CCP. So cooperation arrangements between ESMA and equivalent-third country regulators need to be effectively built for the purpose of recognition.

In this context, in the case of a European financial counterparty operating through a branch, the membership in a third country CCP that is not able or willing to apply for recognition should be winded up. This CCP will then be deemed as a non-qualifying CCP.

The European Basel III rules set in CRR link the concept of qualifying CCPs (QCCPs) and EMIR recognition to capital requirements. Mirroring Basel III standards, CRR rules provide a favorable 2% risk weighing factor for exposures to QCCPs. In the case of non-qualifying CCPs, this risk weighing factor varies, resembling specific exposures, and, as mentioned above, the factor applied to exposures to default funds of these entities reaches 1.250%.

This means that any exposure of a third country branch of a European financial counterparty to non-qualifying CCPs, when accounted in a consolidated basis, will be extremely capital consuming, putting the operations of this institution in that country at risk. This consequence could create market fragmentation, with the relocation to local markets of transactions of a European financial counterparty with counterparties in a third country and of foreign counterparties within the EU, i.e., balkanization.

So the total impact of harmonization issues on activities of European financial counterparties in Brazil could be significantly punitive and may even result in firms having to withdraw from certain market segments and closing entire lines of business, reducing dramatically the presence of European institutions in Brazil.

The same occurs in the U.S. case. The qualification of U.S. financial market utilities (CCPs) depends on several specific requirements, namely, daily and total collateral requirements of CCPs' counterparties, sound financial conditions, and the adherence to risk-management standards, which are based on the recognized international standards developed by CPSS-IOSCO (PFMIs).

In the case of foreign CCPs, U.S. authorities consider, in addition to those requirements, the supervision of national authorities in the foreign jurisdiction and the compliance or overcoming from third country's risk-management standards with respect to the U.S. standards and the PFMIs. Moreover these CCPs should provide U.S. banks and regulators with necessary information and parameters in order to help in the calculation of capital requirements by U.S. financial institutions.

In other words, CCPs can be classified as QCCPs depending on the compliance with PFMIs and other specific criteria, however noticing that, in the U.S., the assessment of a CCP is conducted by each counterparty, which need to justify its designation before the OCC-FED-FDIC. In the absence of the designation of a CCP as a QCCP in the U.S. the situation posed is similar to the European Union: exposures to CCPs will be extremely capital consuming and market fragmentation may follows.

The relevance of regulatory harmonization in the OTC derivatives market

The example mentioned above illustrates the relevance of regulatory harmonization to the regulation of OTC derivatives markets – although it is not limited to these borders and is applicable to any other segment. In fact this seems to be the main issue when treating the OTC derivatives reform, as one can see the relevance attributed by regulators and multilateral organizations to this issue: IOSCO created a dedicated task-force, as set out in a statement released in April 2013[13]; the OTC Derivatives Regulators Group (ODRG) also published, in March 2014, a communication exclusively dedicated to this issue[14].

To restrict ourselves to the issue of qualifying CCPs, one can associate several positive effects of adopting regulatory harmonization arrangements that allow the classification of Brazilian FMIs as QCCPs under European and American regulations. This classification:

- Permits that Brazilian FMIs provide registration/clearing services to foreign institutions, allowing the direct access of foreigners to the Brazilian OTC derivatives market;
- This extends the monitoring capacity of Brazilian supervisors over transactions and foreign institutions, given that they also have impacts on Brazilian markets;
- Allows Brazilian financial counterparties, both from local origins as the ones with foreign headquarters, especially, in the U.S. and EU, and third country counterparties that have

[13] IOSCO (2013). IOSCO to progress reform agenda under new leadership. Media Release, 11/2013. Available at: http://www.iosco.org/news/pdf/IOSCONEWS273.pdf.

[14] ODRG (2014). Report of the OTC Derivatives Regulators Group (ODRG) on Cross-Border Implementation Issues. Available at: http://www.cftc.gov/ucm/groups/public/@internationalaffairs/documents/file/odrgreport033114.pdf.

exposures to Brazilian FMIs to mitigate capital allocation for the purposes of Basel III requirements;

- Seals the use of PFMIs by Brazilian authorities in the main global financial centers, as released in the Policy Statement no. 25097/14 from the Central Bank of Brazil (BCB)[15], reinforcing the soundness of the Brazilian regulatory framework before the G20 and other countries.

One should notice that the compliance with PFMIs by the Brazilian regulation and supervision does not automatically ensure their recognition by a third jurisdiction, namely, the U.S. and European Union. In fact in the Implementation monitoring of PFMIs Report released in May 2014[16], Brazil is deemed as "compliant" to all principles and responsibilities (the greater level of adherence with PFMIs), while the U.S. and the European Union are not compliant with all principles set forth by CPSS and IOSCO, in a more primitive stage of implementation. However it does not mean that Brazilian FMIs are deemed as equivalent or substituted compliant with, respectively, EU and U.S. regulations.

The same applies to the recognition of the Brazilian *general* OTC derivatives regulatory framework for the purposes of DFA and EMIR. Thus building harmonization arrangements with the U.S. and the EU avoids the duplication of regulatory requirements and supervision, permits the full compliance with client secrecy rules and exhausts any possibility of erroneous interpretations or violation of rules due to legal uncertainties. So market fragmentation and balkanization of the global OTC derivatives market can be avoided.

All these elements point to the relevance of regulatory harmonization in OTC derivatives markets and its necessity to the implementation and efficacy of the threefold reform decided by the G20.

The need for prioritization of Brazil in international discussions

If the adoption of harmonization mechanisms (substituted compliance or equivalence) is key to the effectiveness of the global regulatory reform, the need for prioritization of Brazil in international discussions is equally crucial in order to effectively implement the reform in Brazil.

The Brazilian position with respect to the regulatory framework is noteworthy because the country had already in force a lot of the new provisions described above. In the derivatives markets, the market structure desired by the global reform corresponds significantly with the market structure existing in Brazil: all derivatives contracts are reported to/subject to registration in TRs and

[15] The BCB Policy Statement no. 25097/14 communicates the utilization of PFMIs by the Department of Banking Operations and Payment System when monitoring and assessing the soundness, efficiency, integrity and reliability of settlement systems and other financial market infrastructures of the Brazilian Payment System (see BCB Policy Statement no. 25164/14), as well as registers and central deposits of financial assets and securities.

[16] CPSS-IOSCO (2014). Implementation monitoring of PFMIs: First update to Level 1 assessment report. Available at: http://www.bis.org/publ/cpss117.pdf.

the major part of the contracts is settled in CCPs (85% in December 2013, according to the Central Bank of Brazil (BCB)) and executed electronically (78%, *idem*). Moreover, higher capital requirements to OTC cleared out of CCPs were in force since 2007[17].

Regarding the resilience of FMIs, it is noteworthy that the guiding principles detailed in CPSS-IOSCO PFMIs were already admittedly followed by Brazilian FMIs, although not all obligations were formally covered/included in regulations. In this sense, the BM&FBOVESPA made some adjustments in the rules and procedures to be followed by its central counterparties, aligning the new regulations, endorsed by the BCB, with PFMIs and European and U.S. specific requirements. Among the changes which are in force since March 2014 the following are noteworthy:

(i) BM&FBOVESPA will contribute to default funds and its contributions will at least equal the overall amount provided by clearing members; BM&FBOVESPA contributions will be used after the exhaustion of defaulting members' contributions and before the use of non-defaulting members' contributions.

(ii) the introduction of rules limiting the total amount of contribution of clearing members to default funds during a particular period of time for the purpose of reconstituting their contributions;

(iii) new rules and requirements related with setoff rights, contractual netting and collateralisation agreements in the case of resolution of BM&FBOVESPA were defined; and

(iv) the minimum degree of confidence used in margin calculation models was increased from 95% to 99% for the equity CCP.

Regarding the supervision conducted by the BCB, although these activities were already guided by similar principles, the Policy Statement no. 25097/14 formalized the utilization of PFMIs to guide the BCB's oversight of Brazilian financial market infrastructures.

Moreover in the case of derivatives registration, the Brazilian framework is several steps ahead of G20 countries' ones and provides much more than the simple report of a transaction to a TR: the registration of contracts' parameters is accompanied by the checking of information consistency, the calculation and monitoring of pricing, cash-settlement, mark-to-market valuation, etc.

Finally, in Brazil, Basel III is at a final stage of adoption with regards to capital requirements, a fact recognized in the Regulatory Consistency Assessment Programme of the BCBS, which attributed to the Brazilian framework the status "compliant"[18]. Rules released in 2013 already incorporated the

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[17] BCB Circular no. 3360/07 establishes that exposures to counterparty credit risk due to transactions cleared in settlement systems of financial market infrastructures authorized by the BCB, interposing the FMIs as a central counterparty in terms of Law no. 10213/01, does not counts for the calculation of risk weighted exposures (i.e., in practice, the risk-weighing factor equals 0).

[18] BCBS (2013). Regulatory Consistency Assessment Programme (RCAP): Assessment of Basel III regulations in Brazil. Available at: http://www.bis.org/bcbs/implementation/l2_br.pdf.

new counterparty credit risk provisions and the capitalization of exposures to CCPs according to the new Basel III standards[19].

However the progress registered in each area of the threefold reform did not materialized in the effective recognition of Brazil by its G20 peers to the purpose of regulatory harmonization. According to the ODRG (2014: 3-4):

> Progress has been made in equivalence and substituted compliance assessments. In 2013, ESMA provided technical advice to the EC regarding the equivalence of the regulatory regimes for central counterparties and trade repositories, and of risk mitigation requirements, for Australia, Canada, Hong Kong, India, Japan, Singapore, South Korea, Switzerland and the United States. This advice is being considered by the EC as it is considering determinations of equivalence for these jurisdictions. Additionally, the EC has begun the process of gathering information from a further seven jurisdictions in order to begin assessing equivalence in respect of requirements for central counterparties.
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> In 2013, the CFTC approved comparability determinations to permit substituted compliance for Australia, Canada, the European Union, Hong Kong, Japan and Switzerland in respect of a number of entity-level requirements for swap dealers and approved comparability determinations for the European Union and Japan in relation to certain transaction-level requirements.

Till now, Brazil is not treated as a priority in the European and U.S. authorities' agenda. If the implementation of the reforms is at an advanced stage in Brazil, the same does not applies to the settlement of harmonization agreements. We recognize that this situation is not a consequence of inaction from the Brazilian authorities; on the contrary, we recognize the efforts being made to ensure some prioritization of Brazil in international discussions, especially by the Brazilian CVM in the OTC derivatives market arena.

However we would like to reinforce that we need to assure that substituted compliance and equivalence determinations are set and given more celerity to this process, in order to avoid any potential negative effects over Brazilian markets and institutions, both via duplication of requirements and via market fragmentation. We need to ensure that Brazil will have a position of greater priority, recognizing that the most relevant markets were already scrutinized, as quoted by the ODRG.

More urgently, and in order to avoid balkanization and market fragmentation, it is necessary that Brazilian CCPs are classified as QCCPs for the purposes of EMIR, which requires to put forward efforts from Brazilian authorities with the objective of reaching an equivalence assessment in relation to the EU with respect to the regulatory requirements applicable to CCPs.

[19] ANBIMA (2013). Basileia III no Brasil. [“Basel III in Brazil”]. Informe de Legislação [“Regulation Report”] nº 15/2013. Available at: http://www.anbima.com.br/informe_legislacao/2013_015.asp.

In September 2013 the BM&FBOVESPA submitted its application as a third-country CCP to ESMA. The Authority had 180 working days to finish the assessment of BM&FBOVESPA, however this depended on the positive recommendation of the European Commission regarding the equivalence of the Brazilian regulatory framework with respect to EMIR. Initially, it was planned that until June 15, 2014, European financial institutions could consider CCPs as qualifying without formal recognition from ESMA. On June, 5, 2014, this initial term was extended by the European Commission for 6 months, to December 15, 2014, but otherwise the negative effects on the Brazilian markets and institutions would have been felt already in the second half of 2014[20].

So, we would like to request additional efforts by Brazilian authorities to consolidate an equivalence designation of Brazil by the European Commission. The Brazilian financial and capital markets, represented here by the participants of the ANBIMA's International Regulation Working Group (GTRI), support all initiatives of the Brazilian authorities seeking greater prioritization of Brazil in international discussions on regulatory harmonization. GTRI is willing to assist and contribute to any development necessary for this purpose. It sees this as an essential step for the effective implementation of global reforms in Brazil and for the maintenance of Brazilian financial system's resilience.

[20] In the U.S. case, BM&FBOVESPA released in November 2013 a self-assessment document about the adherence of derivatives and stocks CCPs to PFMIs in order to help U.S. financial institutions in their assessments about qualification of these CCPs. U.S. banks are coordinating and it seems that BM&FBOVESPA CCPs are likely to be deemed as QCCPs.