Mr Patrick Pearson
Head of Financial Markets Infrastructure
European Commission
Rue de Spa 2
1000 Brussels
Belgium

2 November 2017

Dear Mr Pearson

Re: Feedback on the European Market Infrastructure Regulation (EMIR) Proposal Regarding Authorisation and Recognition of CCPs

The World Federation of Exchanges (WFE) is the global trade association for exchanges and clearing houses. With 66 full members[1], WFE represents more than 200 Market Infrastructure Providers, of which more than 100 are Central Counterparties (CCPs) and Central Securities Depositories (CSDs). Our members include exchange groups and standalone CCPs.[2]

The assured and central role that CCPs played in the Global Financial Crisis demonstrated to global policymakers the systemic risk management benefits that CCPs provide. Since then, G20 countries and other jurisdictions have been implementing market reforms to encourage more centralised clearing of financial instruments in order to make the financial system safer.

As operators of critical market infrastructure, we share regulatory authorities' goals of ensuring the safety and soundness of the global financial system, which is critical to enhancing the confidence of investors and citizens, and promoting economic growth. This includes ensuring a sound and robust regulatory regime for CCPs.

The WFE welcomes well-designed international efforts to enhance the resilience of the financial system and supports proportionate initiatives contributing to that objective. Markets are increasingly global and regulatory architecture and practices should reflect this fact.

We believe society derives significant benefits from integrated financial markets. It is therefore important to have strong common principles, and coordinating mechanisms to promote financial integration and market integrity. This is fundamental to well-functioning and safe markets at local and global levels.

Mutual recognition arrangements are amongst the most effective tools in achieving common regulatory outcomes. We believe that such arrangements are an appropriate and necessary vehicle for authorities to guard against risk and misconduct without impeding cross-border market activity.[3] Our upcoming publication "*Financial Markets and International Regulatory Dissonance*" will present an in-depth, globally comparative argument in this regard.

We welcome the opportunity to feed back on the European Commission's proposals for further amendments to the European Market Infrastructure Regulation[4] ("further amendments to EMIR")[5].

[1] Of WFE's members, 88% are incorporated in third countries.
[2] WFE members operate the full continuum of Market Infrastructure in both developed and emerging markets. 41% are in the Asia-Pacific region, 40% in EMEA and 19% in the Americas. WFE exchanges are home to nearly 45,000 listed companies, and the market capitalisation of these entities is over $67.9 trillion; furthermore, around $84.18 trillion in trading annually passes through the infrastructures our members safeguard [as at end 2016].
[3] WFE, 'RE: IOSCO Task Force on Cross-Border Regulation Consultation Report CR09/2014,' (February 2015).
[4] European Commission, "Further amendments to the European Market Infrastructure Regulation (EMIR)," (June 2017).
[5] This submission represents the views of the third country Market Infrastructure Providers within the WFE membership.

Executive Summary

We share the European Commission's objective of ensuring all CCPs that EU participants access are safe, resilient and appropriately supervised. The work that the Commission has done through MiFIDII/MiFIR, EMIR and the amendments to EMIR proposed in May 2017 are, in the whole, laudable.

However, we are concerned that aspects of the proposals diverge from broader international principles of mutual recognition and regulatory deference[6] - which have been consistently endorsed by global policymakers and successfully promulgated through the CPMI-IOSCO Principles for Financial Markets Infrastructure (PFMI) - and which would have a particularly adverse effect on emerging markets.

Specifically, we note concerns that proposals to apply EMIR requirements to the entirety of the clearing business[7] of Tier 2 Third Country CCPs (TC-CCPs) - including those parts of the CCP's business without an EU nexus - are unjustified and disproportionate to the extent the TC-CCP is established in a jurisdiction that applies a comparable regulatory standard.

Furthermore, we consider the potential implications of the direct application of EU standards in such a way would undermine the economic benefits of a global derivatives market. These may not only impact the EU businesses and financial institutions that transact and manage risk in these markets, but also create potential implications for markets themselves, particularly those in emerging economies.

This submission is the product of consultation with WFE members regarding the anticipated primary and secondary effects of enacting the proposed further amendments to EMIR on the third country Market Infrastructure they operate.

Uncertainty for Third-Country CCP Operators, Clearing Members and Jurisdictions

We believe the proposed amendments raise questions about the future availability of global netting pools and introduce ambiguities for CCPs outside of the EU. In particular:

Availability of global netting pools

We note the current process of obtaining ESMA recognition as a TC-CCP under EMIR has been burdensome and time-consuming for many of the WFE's developed and emerging market members. Many have experienced significant delays to recognition compared to anticipated timescales; some are still awaiting a decision more than four years after first starting the process. This includes CCPs based in jurisdictions that have substantially similar requirements compared to jurisdictions that have been granted equivalence to date.

Ambiguities and extended timescales in the process have undermined the ability of these non-EU CCPs to provide clearing services to EU clients on reasonable and certain terms. This is important to EU banks and investment firms given capital treatment is tied to their use of recognised TC-CCPs. These capital implications take on even more importance for emerging economies' financial markets, which are most reliant on the participation of large EU banks and investment firms to provide liquidity.

---

[6] Financial Stability Board, "Jurisdictions' ability to defer to each other's OTC derivatives market regulatory regimes," (September 2014).

[7] The proposal applies to the entirety of the CCP rather than to the provision of clearing services to EU trading venues, or the provision of OTC clearing services to EU clearing members or clients. This differs from the approach of other jurisdictions which apply their licensing framework to the OTC clearing services of EU CCPs that are provided to local clearing members or clients, or the clearing services of EU CCPs that are provided to local trading venues.

Whilst acknowledging the proposals provide the flexibility for ESMA to continue to recognise and treat TC-CCPs under the *status quo ante*, the proposed review and potential designation as a Tier 2 TC-CCP[8] will introduce further uncertainty, particularly for those larger emerging market CCPs who – in the absence of certainty to the contrary - have reasonable concern that such a designation may be made.

We have reason to believe these uncertainties may cause some non-EU CCPs to reassess whether the burdens of applying for, or maintaining, recognition outweigh the benefits. It is possible that CCPs currently in a recognition application process would pause, pending further clarity about the EU's regime. Furthermore, there is a risk that the proposed direct application of EU rules, supervision and enforcement may result in some TC-CCPs taking a decision to vacate their EMIR recognition altogether.

Any of these commercial decisions would disrupt access to the global clearing pools for EU market participants.

Implications for international relations

The proposals introduce policies we believe may undermine or threaten the hard-won cross-border agreements that have led to jurisdictional equivalence and TC-CCP recognition to date[9].

In particular, the scope of the application of EMIR requirements to Tier 2 TC-CCPs is inconsistent with the well-established principles of mutual recognition and regulatory deference which global authorities have advocated post-crisis. This will likely be highly disruptive and appears contrary to the objective of financial stability the policy seeks to mitigate.

In the event of retaliatory measures by third country policymakers on equivalence decisions, EU CCPs may themselves decide to vacate their licences in jurisdictions outside of the EU, disrupting access of some non-EU market participants to EU CCP services, whilst reducing the benefits of global netting for remaining clearing members in these newly fragmented pools.[10]

When similar clearing products and services need to be offered in different jurisdictions, this inevitably raises costs through lost netting benefits, increased margin/collateral requirements and increased CCP membership fees and guaranty fund contributions. This not only risks undermining the ability of EU financial institutions and end-users to manage their risk in the most efficient manner possible, but may also reduce the economic viability of third country venues and CCPs more generally. Ultimately, this may slow the development of emerging market economies and come into conflict with EU and World Bank development programmes aimed at poverty reduction in emerging markets.

Further uncertainties

We further note ambiguities and uncertainties contained within the proposals; these may act to disrupt market infrastructure operators, market participants and markets themselves. For instance:

- There is a lack of guidance as to what criteria may be used by ESMA to conclude an existing TC-CCP is likely to *become* systemically important;[11]

- The period in which a newly determined Tier 2 CCP's jurisdiction is attempting to demonstrate comparable compliance may create a window of operational disruption related to the imposition of EMIR requirements, and market uncertainty about the future availability and terms of clearing services;[12] and

---

[8] See Paragraph (12) of Article 2, European Commission, "Further amendments to the European Market Infrastructure Regulation (EMIR)," (June 2017).
[9] Christopher Giancarlo, "Future of CFTC-EU Regulatory Coordination in the Financial Sector," (September 2017)
[10] Ibid.
[11] See new Article 25, Paragraph 2a in Paragraph (9b) of Article 2, European Commission, "Further amendments to the European Market Infrastructure Regulation (EMIR)," (June 2017).
[12] See new Article 25a ("Comparable compliance") in Paragraph (10) of Article 2, European Commission, "Further amendments to the European Market Infrastructure Regulation (EMIR)," (June 2017).

- The current lack of guidance as to the criteria ESMA may use to conclude that a TC-CCP is of such systemic importance that compliance with the Tier 2 requirements[13] does not sufficiently ensure the financial stability of the Union (or one of its member states) i.e. that it should be subject to an establishment requirement.

Extended Application of EU Rules, Supervision and Enforcement

We note that revisions to the current recognition framework – revisions we understand to be designed to account for a single UK CCP clearing large volumes of Euro-denominated interest rate swap (IRS) transactions – may change the regulatory structure for TC-CCPs globally, including those in non-EU jurisdictions that clear neither OTC derivative nor Euro-denominated products.

We acknowledge that new regulatory mandates to clear financial instruments have given rise to renewed attention to the systematicity of CCPs. There are already in existence examples of cross-border reach in other major jurisdictions, including CFTC rules on OTC derivatives and what amount essentially to CCP location requirements in Japan.

In our view, the Commission proposals risk exacerbating the negative impacts of these two examples by extending them into exchange-traded derivatives.

As well as calling for a direct application of EU rules, the further proposals to EMIR mandate what is effectively joint supervision of certain TC-CCPs, alongside broad-ranging rights for ESMA and EU central banks over these TC-CCPs. Without a clear understanding of which TC-CCPs might be subject to Tier 2 status, we struggle to see how such an onerous policy would be justified by equally weighty financial stability rationales where those TC-CCPs are already subject to robust oversight in their home jurisdictions.

Whilst acknowledging the proposals do not expressly provide the authorities powers to require establishment and ultimately it will be on the CCP to decide, they are widely regarded - in effect - as a location policy[14]. We appreciate the departure of the UK from the EU has raised new questions about the clearing of Euro-denominated IRS swaps outside the EU, and the attendant monetary policy and systemic stability implications for the Union. This unique case should carefully be tailored for in legislation.

Further, we note that the proposals to empower ESMA to perform unannounced (to the CCP)[15] inspections of Tier 2 TC-CCPs' premises outside the EU, alongside associated additional supervisory powers[16], will likely exceed the law enforcement powers of most regulatory agencies, including the home supervisors of many TC-CCPs. Indeed, we observe these powers are typically reserved for competition authorities; extension to financial regulatory authorities must be justified by transparent monetary policy or financial stability rationales. There is a strong risk the direct application of such powers could be interpreted as an impingement on TC-CCP home regulators' duties and result in retaliation.

Finally, we consider it possible powers relating to the removal of records and data from a CCP, or prevention of a CCP's staff from accessing the CCP to undertake their most important functions, may exacerbate market turbulence and pose a risk to financial stability. Such serious remedies must be transparent in application, carefully analysed and justified.

[13] See new Article 25, Paragraph 2b in Paragraph (9b) of Article 2, European Commission, "Further amendments to the European Market Infrastructure Regulation (EMIR)," (June 2017).
[14] It is difficult to see how such a policy could be legally effectuated in any other manner
[15] See new Article 25e ("On-sight inspections") in Paragraph (10) of Article 2, European Commission, "Further amendments to the European Market Infrastructure Regulation (EMIR)," (June 2017).
[16] See new Articles 25c ("Information gathering"), 25d ("General investigations") and 25e ("On-Site Inspections") in Paragraph (10) of Article 2, European Commission, "Further amendments to the European Market Infrastructure Regulation (EMIR)," (June 2017).

The Negative Impact on Emerging Market CCPs

The WFE's diverse and global membership represents both established and emerging markets. Whilst the concerns we raise are relevant to most WFE member markets, they are raised as particularly concerning for emerging markets. Capital markets are at varying stages of growth and development, and their dependency upon external capital flows and market participants varies. International financial institutions and international capital flows often play a particularly important role in emerging economies' financial markets. Disrupted access to large overseas financial institutions carries unique risks and costs for emerging market exchanges and CCPs.

The impact of fragmentation on emerging markets

In general terms, imposing regulatory barriers on businesses seeking to transact on international markets can lead to a rapid depletion of liquidity as capital fragments between jurisdictions. Such regulatory barriers reduce the positive network effects associated with global markets. Any measures that have this effect must therefore be justified by overriding financial stability rationales.

The impact of the proposals on jurisdictions lacking deep and resilient domestic capital markets, without the ability to manage the abrupt exit of foreign participants, may be particularly serious. For emerging markets to develop their capital markets, their exchanges and CCPs must be able to maintain and grow their links with financial institutions all over the world.

Compliance burdens for emerging markets

On a practical level, whilst designed with financial stability in mind, the proposals would require TC-CCPs to set aside internal resources for an undefined period to account for new processes and obligations whilst also setting aside resources to cover levies to fund ESMA supervision of TC-CCPs. These resources – especially precious in emerging market economies – may not be available for other activities such as business development or market surveillance. This has the potential to be an unjustified and harmful diversion of funds and human capital.

Impact on the adoption of globally-agreed standards in emerging markets

We consider it neither effective nor appropriate to directly apply EU rules on a line-by-line basis to the CCPs of well-regulated jurisdictions that adhere to the relevant international principles (such as the PFMI); in many cases additional local rules have been carefully tailored to facilitate the conditions for local growth and development. Imposing standards different from the globally agreed PFMI standards would risk reducing the value of those international standards and the incentive for jurisdictions to implement them.

Fragmentation of Market Liquidity

We are concerned the proposals will contribute to the fragmentation of global derivative clearing services, producing adverse effects in particular for emerging markets. We understand that important TC-CCPs will carefully evaluate whether the costs associated with being a Tier 2 TC-CCP justify the benefits. Should they not, TC-CCPs would likely relinquish their EU recognition under EMIR. It is also possible that – because of retaliatory action by jurisdictions outside of the EU – some EU CCPs may decide to vacate their own non-EU jurisdiction licences.

Because of this, similar risk management solutions and products that previously may have been offered in one place may ultimately need to be offered in different jurisdictions going forward. This would raise costs through lost netting benefits, increased margin/collateral requirements and increased CCP membership fees and guaranty fund contributions. This not only risks undermining the ability of EU financial institutions and end-users to manage their risk in the most efficient manner possible, it could, *in extremis*, threaten the economic viability of emerging market venues and CCPs. Ultimately, this would have the effect of slowing the development of emerging market economies, whilst coming into conflict with EU and World Bank development programmes aimed at poverty reduction.

Conclusion

The WFE shares regulatory authorities' goals of ensuring the safety and soundness of the financial system and welcomes well-designed international efforts to enhance its resilience. We are, however, concerned that aspects of the proposals may diverge from broader international principles of mutual recognition and regulatory deference, and risk undermining the economic benefits of a global derivatives market. In current form, we worry the ambiguities and implementation periods would exacerbate uncertainty from market participants[17] and market infrastructure operators.

In light of the concerns we have raised, we would urge the Commission take account of the following considerations:

- Recognition processes and decisions should be transparent and non-political;

- Further amendments to EMIR should not in any way impose additional obligations on TC-CCPs which otherwise satisfy wider international principles;

- The potential for clearing pool fragmentation may pose systemic risks to emerging economies' financial markets and should be avoided;

- EU banks' and investment firms' access to the full range of cleared derivatives may be threatened, reducing their risk management options and creating best execution challenges;

- Secondary effects of the proposals may entail EU CCPs having reduced access to the full range of clients they currently provide clearing services to because of retaliatory measures; and,

- The direct application of EMIR to certain Tier 2 TC-CCPs, and the associated supervisory empowerments, are considered to be inconsistent with general principles of substituted compliance and regulatory deference.

As a result of these observations and concerns, we suggest the proposals would likely be undesirable from the perspective of G20 Leaders, who have sought to promote clearing of standardised and liquid derivatives, and to ensure that counterparties have access to well-regulated CCPs, whilst coordinating these mandates on a cross-border basis to ensure their harmonized and non-disruptive application.

As such we consider the existing process for recognising and monitoring TC-CCPs should largely be retained, whilst concentrating efforts on pragmatic solutions to the issue of UK-based euro-denominated IRS clearing.

In the meantime, we urge the European authorities to expedite the existing recognition process, so that non-EU CCPs that have applied for EU recognition – in particular, those from emerging market economies – can clear trades for EU banks and investment firms, and grow and develop their own markets.

Yours sincerely

Nandini Sukumar.

Nandini Sukumar
CEO, WFE

[17] FIA, "Feedback on further Amendments to EMIR," (September 2017).