

Mr Patrick Pearson  
Head of Financial Markets Infrastructure  
European Commission  
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1000 Brussels  
Belgium

Mr Steven Maijor  
Chair  
ESMA  
103 rue de Grenelle  
75007 Paris  
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23 August 2019

Dear Mr Pearson, Mr Maijor,

**Re: Implementation of EMIR 2.2**

We write to you regarding the implementation of the EMIR Review file on the cross-border supervision of central counterparties (CCPs).

The World Federation of Exchanges (WFE) is the global trade association for regulated exchanges and clearing houses. We represent over 200 market infrastructure offerings, spread across the Asia Pacific region (~37%), EMEA (~43%) and the Americas (~21%). This includes over 100 distinct CCP clearing services, with everything from local entities in emerging markets to stand-alone CCPs based in major financial centres.

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 in a manner that supports the objectives of economic policy and financial supervision.

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

We believe that the G20-endorsed approach of regulatory deference should be a guiding principle in the area of cross-border supervision of CCPs. Approaches of regulatory deference have a long history of allowing market participants across the globe to effectively and efficiently hedge their business risk. G20 leaders have strongly endorsed this approach, embodied in the September 2013 declaration "*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.*"<sup>1</sup> Speaking about the regulatory framework for clearing activities (including location policies for CCPs), CPMI-IOSCO has warned "*in some cases the manner in which reforms have been implemented may have led to some fragmentation.*"<sup>2</sup> In addition, the Financial Stability Board (FSB) has noted that market fragmentation as one of its top priorities and has recently published a report describing its upcoming efforts.<sup>3</sup> As with any jurisdiction, we also acknowledge the legitimate interests

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<sup>1</sup> [G20 Leaders' Declaration](#), September 2013.

<sup>2</sup> CPMI-IOSCO, [Market Fragmentation & Cross-border Regulation](#), June 2019.

<sup>3</sup> FSB, [Report on Market Fragmentation](#), June 2019

of the European Union (EU) in ensuring the systemic stability of the Union and those of the European Central Bank and other EU central banks in transmitting their policy throughout the euro area and Member States.

International comity is of the utmost importance in fostering safe and efficient financial markets. We welcome the establishment of Crisis Management Groups to facilitate information-sharing amongst interested supervisors in the event of market stress. We have furthermore supported the significant efforts that went into establishing the regime for EU-US cooperation in respect of CCPs with cross-border activities. And we recognise that new considerations have arisen with the proposed withdrawal of the UK from the EU.

However, we are concerned that the framework proposed by ESMA to implement changes in the EU's approach to the oversight of Third Country (TC) CCPs (i.e. EMIR 2.2) risks unduly fragmenting global markets, increasing costs for end users and exacerbating tensions in international relations, without due consideration of the relevant international agreements already in place. To that end, we write to suggest principles we believe would support the objective of the EMIR 2.2 level 1 legislative text to concentrate supervisory efforts on TC-CCPs that have a systemic importance to the stability of the EU or one of its Member States, while limiting potential negative impacts associated with international regulatory dissonance.

## *Executive Summary*

We recognise that the EMIR 2.2 legislative text has sought to balance the principle of regulatory deference with authorities' objectives related to financial stability. We believe that for most of the TC-CCPs, there will not be a case for triggering the extraordinary measures associated with Tier 2 status. Our suggestions are made in the spirit of the objectives of the primary legislation: minimising the disruption for the large cohort of clearly non-systemic TC-CCPs, while ensuring that those under consideration for Tier 2 status enjoy a regime that is fair, transparent, predictable and non-distortive with respect to market dynamics nor the competitive environments in which the market infrastructures operate.

We respectfully ask that you consider the following principles in implementing the level 2 policies:

- Introduce safeguards to promote fairness and due process;
- Concentrate the determination of Tier 2 CCP status on those TC-CCPs with a direct nexus to the financial stability of the EU (based on their clearing of financial instruments denominated in EU currencies relevant to the transmission of EU monetary policy and/or significant exposure to financial institutions domiciled in the EU);
- Clarify the relative importance of indicators in the determination of systemic importance to the EU and the potential triggers for Tier 2+ status (i.e. de facto location policy);
- Enhance the predictability of determinations of systemic importance to the EU; and,
- Approach determinations regarding comparable compliance based on their achieving comparable (i.e. similar) outcomes.

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## *Fairness and due process*

Jurisdictions around the world have rightly made considerable efforts to identify systemically important financial institutions and to put in place regimes to address associated risks. The regimes managing such risks may involve regulatory add-ons, increased oversight and other material conditions, resulting in a significant compliance differential between designated and non-designated financial institutions. This will clearly be the case for Tier 2 CCPs. Because of the implications these regimes can have in terms of cost, competitive dynamics, shareholders' property rights and management responsibilities, it is essential that the process for determination of systemic importance is characterised by predictability, fairness and due process. We believe that such an approach would reflect international best practice.<sup>4</sup>

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<sup>4</sup> Note, for example, Metlife Inc.'s right of appeal following the US's Financial Stability Oversight Council's determination of the firms as a systemically important financial institution, where the court ruled that the process was "arbitrary and capricious." [Metlife, Inc. v. Financial Stability Oversight Council, Civil Action No. 15-0045 \(Rmd\)](#), accessed July 2019.

We believe that fairness and due process could be enhanced by introducing in the level 2 text a series of formal milestones for communication and decision-making:

**Prior to tiering process:** We believe that there will be a large cohort of TC-CCPs that can be determined as Tier 1 CCPs on a prima facie basis.<sup>5</sup> Subjecting these TC-CCPs to the complete rigours of the tiering process, particularly as ESMA has proposed, would represent an undue burden. Certain TC-CCPs, for whom the business case for undergoing the original EMIR equivalence process was marginal, might decline to undergo a further full tiering process. This would result in detriment for EU clearing members, EU end-users and EU markets, as well as third-country jurisdictions, commensurate with the amounts of clearing undertaken and the substitutability with services offered available to EU users and intermediaries (or, indeed, the likelihood of such substitute services arising in the EU and the associated economics). When a TC-CCP is being considered for designation, there ought to be an early discussion with the TC-CCP and its home supervisor.

**During tiering process:** Previous processes related to EMIR recognition determinations have placed a considerable resource burden on TC-CCP staff and management. It is therefore desirable that clear communication about expectations and timelines be set out for the TC-CCP and its home supervisor, so that workflows can be appropriately managed and shareholders and staff can be kept up-to-date. Requests for further information or clarification of stipulated information should generally be made in a reasoned manner and with appropriate timescales; TC-CCPs should have the possibility to raise process concerns with EU authorities.

**Following designation:** The designation of a TC-CCP as a Tier 2 CCP ought to be accompanied by a communication outlining the relevant factors taken into consideration in said determination. Should a TC-CCP believe that the process leading to designation be flawed, there ought to be a right of appeal on the basis of an error of law or fact.

We furthermore are concerned about how the ESMA supervisory budget and fees may distort the market for clearing services, including competition in the provision of these services. Believing as we do that most TC-CCPs will be Tier 1, the budget for supervision will fall on a small number of Tier 2 TC-CCPs and will represent a material expense for these institutions. This could in turn represent a significant difference in the cost basis of a TC-CCP versus an EU-domiciled competitor. To the extent the provision of certain services is rendered uneconomical, the outcome would be at odds with wider policy goals that aim to promote access to clearing services and the resilience of the cleared ecosystem. Consideration should be given to the extent to which such negative impacts could be minimised, for example by calibrating Tier 2 TC-CCP fees according to revenue derived from EU clearing members.

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## *Direct nexus to EU*

Under the EMIR 2.2 level 1 legislative text, the designation of a TC-CCP as systemically important is specified to be undertaken by reference to its potential impact on the stability of the EU or one or more of its Member States. As the imposition of Tier 2 CCP requirements represents a substantial departure from the international principle of regulatory deference, departing from this principle should only be countenanced in the case of financial stability rationale with a clear nexus to the host-authority jurisdiction. Consequently, the basis for determining that a TC-CCP is a Tier 2 CCP and as such, systemically important to the financial stability of the EU or one of its Member States, should be based on it having a substantial nexus to the EU. We believe such nexus should be primarily based on the TC-CCP's clearing of financial instruments denominated in EU currencies relevant to the transmission of EU monetary policy and exposure to EU-domiciled clearing members that could reasonably be seen to give rise to direct, substantial and foreseeable financial stability effects.

We do not believe that the factors proposed in the tiering consultation pay due regard to this crucial element. Furthermore, we do not believe that capturing a TC-CCP's clearing of financial instruments on an aggregate basis, across products and clearing members, as well as total collateral held and required, to be demonstrably

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<sup>5</sup> Much of the relevant information is available in the [PFMI disclosure framework](#).

relevant to the determination of a TC-CCP's impact on the financial stability of the EU or one of its Members States. Therefore, we would suggest more transparent granularity is necessary to achieve a more meaningful outcome and to ensure any determinations do not distort market and competitive dynamics.

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### *Relative importance of indicators*

The ESMA consultation on tiering lists a very large number of indicators, and related considerations, that may be evaluated in a tiering determination. Some of these factors appear to have a limited connection to determining the systemic importance of a TC-CCP to the EU or, moreover, evaluating the TC-CCP's risk management practices. The relevance of ownership structure, corporate structure and affiliated businesses and cyber resilience is, for example, unclear. To introduce such considerations without a clear rationale risks undermining the integrity of the tiering process.

Accordingly, we recommend that the factors to be considered in the tiering process be substantially reduced and prioritised with a focus on evaluating the risks posed by a TC-CCP to the financial stability of the EU or its Member States. (In line with EMIR, such risks should be "direct, substantial and foreseeable".) We furthermore recommend that each indicator be justified with an explanation of its relevance to determining a TC-CCP's systemic importance to the stability of the EU or one of its Member States (including potential triggers for Tier 2+ status), as well as an indication of how the variety of potential responses would factor into such a determination and the relative importance of the given indicator.

We furthermore encourage a consideration of international agreements that pertain between regulatory authorities in respect of financial institutions and CCPs. These include, for example: memoranda of understanding (or similar information sharing agreements); specific agreements related to financial markets (e.g., the EU-US cooperation agreement in respect of CCPs); and resolution and resolvability planning and assessments (as provided for in relevant regulation). Such agreements may already address financial stability concerns and/or measurements of exposure between different jurisdictions.

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### *Predictability of determinations*

In line with our suggestions above, we would welcome greater predictability about the threshold for a Tier 2 CCP determination (grounded in the nexus of the TC-CCP to the financial stability of the EU or one of its Member States). Not least because of the large number of proposed indicators and the lack of clarity about their relative importance, the proposed system of tiering introduces substantial scope for a TC-CCP to be designated a Tier 2 CCP for unclear reasons or even ones arising from transnational disputes not directly related to financial stability. We believe such an outcome would undermine the spirit of the EMIR 2.2 level 1 legislative text and the reputation of the EU as a pillar of the rules-based international system. The predictability of determinations could be facilitated by the provision of a series of tests or indicative case studies to help guide the market in its understanding of the relevant threshold. When a CCP is being considered for Tier 2 status, this should be discussed with TC-CCP and its home supervisor before designation.

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### *Comparable outcomes*

The approach described in the ESMA consultation on comparable compliance is at odds with the EMIR 2.2 level 1 legislative text which provides a mechanism based on comparable regulation that could potentially allow a Tier 2 CCP to comply with EU rules by way of its compliance with the local laws and regulations to which it is subject. By contrast, ESMA's proposed method for determining comparability calls for an assessment on a requirement-by-requirement basis, rather than examining whether a TC-CCP's home jurisdiction's requirements produce comparable outcomes.

Furthermore, the approach appears to discard the principle of comparability in favour of one where the majority of requirements under EMIR, narrowly conceived, serve as a floor (again, despite what outcomes a holistic comparison of the legislation may engender). The EMIR 2.2 level 1 legislative text requires ESMA to

account for the European Commission's equivalence decisions, including relevant conditions, in determining comparability; the powers ESMA proposes to endow itself with are disproportionate in light of this. Only where the European Commission has made an equivalence decision subject to specific conditions would it be appropriate for ESMA to undertake a comparability process as extended as the one proposed, but only then in the assessment of the relevant conditions identified.

Further, ESMA's proposed approach contravenes the spirit of regulatory deference and fails to appreciate that distinct jurisdictions will have legal regimes and market structures and practices that, while different in some respects from those of the EU, are consistent with internationally agreed standards and comparable with EMIR.<sup>6</sup> We recommend that the comparable compliance process adhere more closely to the principle of regulatory deference by taking a truly outcomes-based approach, opposed to requirement-by-requirement, and determine if requirements between jurisdictions are comparable (i.e. similar), rather than equal or at least as strict / conservative. Notwithstanding that this approach would be consistent with G20 commitments agreed to by EU Member States, this approach could enable ESMA to significantly reduce the resource-intensity of these processes and therefore the level of fees payable by TC-CCPs, which would go some way to improving competitive distortions arising from a higher supervisory fee burden for TC-CCPs. We furthermore recommend work towards enshrining best practices for such assessments be undertaken at the international level, as the WFE has recommended in previous representations concerning international regulatory coherence.

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## *Conclusion*

We acknowledge the effort that has gone into the EMIR 2.2 level 1 legislative text and recognise the challenge in striking a balance that adheres to G20 commitment to regulatory deference while giving EU authorities the appropriate tools to support the financial stability of the Union and its Member States. However, we believe granting EU authorities the appropriate tools to support the financial stability of the EU, in line with the Federation's recommendations above, is compatible with G20 commitments. Under these recommendations, it is possible to strike a balance that preserves EU customers' access to clearing services; recognises the importance of global derivatives and securities markets; and allows EU authorities proportionate oversight. We are concerned, however, that the current proposals do not represent such a balance.

The WFE and its members stand ready to work with European authorities to achieve the goals in the EMIR 2.2 level 1 legislative text. The Federation would welcome the opportunity to arrange a discussion about our members' thinking and priorities in Brussels or Paris, and remains at your disposal should that be helpful.

Thank you for your consideration of the contents of this letter.

Yours sincerely,

A handwritten signature in blue ink that reads 'Nandini Sukumar'.

Nandini Sukumar  
Chief Executive Officer

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<sup>6</sup> See the discussion in: IOSCO, [Market Fragmentation & Cross-border Regulation](#), June 2019.