7 September 2017

Feedback from FIA on European Commission EMIR Review Proposal – Part 2 (authorisation and recognition of CCPs)

1. Executive Summary

FIA[1] supports the overall goal of ensuring that those third-country clearing houses ("**CCPs**") that European Union ("**EU**") market participants are accessing are appropriately and proportionately supervised. As set out in our letter of 6 June 2017 to Vice-President Dombrovskis[2], we acknowledge the legitimate desire of the European Commission to improve the current supervisory arrangements relating to systemically important third-country CCPs. The EU has been a global leader in developing equivalence regimes for third countries, and one of the great strengths of today's EMIR equivalence regime is that it contains a mechanism to avoid duplicative and conflicting rules on clearing, reporting and risk mitigation requirements.

Whilst fully recognising and agreeing that the European Central Bank ("ECB"), central banks of issuance for the currencies of non-Eurozone EU Member States and the EU itself each have valid monetary policy and regulatory interests in the financial stability of CCPs that provide services to EU counterparties, FIA believes that an appropriately calibrated enhanced supervision regime would be a highly effective way to protect financial stability.[3] The euro is one of the world's great reserve currencies. To preserve this status, it is necessary for euro-denominated derivatives to remain capable of being traded and cleared freely and openly, under rules that support a global level playing field and avoid geographical distortions to competition.

We set out below a number of positive recommendations to further enhance the changes proposed[4] by the Commission with respect to the CCP equivalence and recognition process under EMIR.

Forced Relocation

FIA considers that the most proportionate way to (i) address the legitimate concerns of the EU, the ECB and others regarding the clearing of derivatives through the most systemic third-country CCP Services; and (ii) ensure the EU has adequate oversight thereof, is for such systemic third-country CCP Services to be subject to the application of EMIR standards and to direct supervision by ESMA with the ability for ESMA to grant comparable compliance, rather than force the relocation of such activities deemed to be of substantial systemic importance for EU financial stability.

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1 FIA is the leading trade organisation for futures, options and centrally cleared derivatives markets, with offices in the US, Europe and Asia. FIA's membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from more than 48 countries as well as technology vendors, lawyers and other professionals serving the industry.

2 https://fia.org/sites/default/files/content_attachments/2017-06-06_FIA_response_euro_clearing_policyFINAL.pdf

3 Page 66 of the Impact Assessment: "*For some classes of financial instruments (Interest Rate Derivatives for example) this could lead to a market fragmentation detrimental to EU counterparty as the bulk of the transactions are traded between non-EU counterparties…It could also lead to a competitive disadvantage for EU counterparties regarding non-EU counterparties*" and page 67 thereof: "*In particular a generalised location policy would be excessively fragmenting and disrupting for financial markets, thereby potentially generating substantial costs as described above*."

4 Proposal for a Regulation amending Regulation (EU) Np 1095/2010 establishing a European Supervisory Authority (European Securities and Markets Authority) and amending Regulation (EU) No 648/2012 as regards the procedures and authorities involved for the authorisation of CCPs and requirements for the recognition of third-country CCPs.

Recognition at the level of a CCP Service or Product

FIA recommends that the proposal be clarified to state that recognition can be granted *at a CCP service or product level where appropriate*, rather than the entire CCP legal entity. Not all CCP services or products within a single CCP legal entity will be systemically relevant to the European Union nor have the same impact on financial stability in the European Union.

Use of comparable compliance

FIA recommends that the oversight process for Tier 2 CCPs be streamlined and made more proportionate to the systemic importance of the CCP. This could be achieved by the European Commission and ESMA adopting the presumption that comparable compliance should be available in all third countries where the Commission has adopted an equivalence decision and that decision is still in effect. ESMA should give due consideration and deference to existing equivalence decisions, so as to limit the scope for market uncertainty and disruption. ESMA could also be given further tools to enable it to adjust its supervisory intensity accordingly.

ESMA role as a joint supervisor of third-country CCPs and the determinant of any conditions to recognition

The European Central Bank (ECB) and non-Eurozone EU central banks have valid and legitimate desires to ensure that the EMIR third-country CCP regime is appropriately calibrated and operated in order to meet their responsibilities and achieve the objectives of the European System of Central Banks. In order to avoid duplicative or conflicting requirements being created by those central banks or those central banks becoming quasi-regulators in addition to ESMA, FIA recommends that those central banks should feed into ESMA's processes for granting recognition and overseeing third-country CCPs on an on-going basis, rather than directly imposing additional requirements or conditions outside of ESMA's processes. ESMA should jointly supervise the most systemic of third-country CCPs in coordination and collaboration with the national competent authorities in that third-country.

Transitional arrangements

FIA recommends that the transitional arrangements be further improved, so that CCPs, their members and clients have sufficient time to transition to new regulatory and supervisory arrangements in a timely and orderly manner.

The need for enhanced transparency in ESMA processes

FIA encourages further enhancement of the transparency of the equivalence and recognition process. This could be achieved by ESMA engaging in public consultations before declaring a CCP or CCP service as "Tier 2" or determining to not recognise it and by making ESMA's annual report to the Commission on third-country regulatory developments publicly available.

2. There are significant costs and other downsides to forced relocation, which may significantly outweigh its benefits

The European Commission has proposed that where safeguarding financial stability in the EU cannot be addressed through the recognition process of third-country CCPs, then ESMA, in agreement with the relevant EU central banks, have the power to recommend to the European Commission, that such CCP should not be recognised. In such event, the European Commission may then take a decision that such CCP should not be recognised and that if it wishes to provide clearing services in the EU, then it should be authorised and established in an EU Member State.[5]

5 New paragraph (2c) of Article 25

Everyone, including the European Commission, agrees that forced relocation would fragment liquidity[6] and raise the costs for end users, especially EU27 end users that use the relevant CCP to manage their risk through derivatives cleared at such CCP. As we outlined in our June letter to Vice-President Dombrovskis, FIA believes that forced relocation of euro-denominated cleared derivatives would be a disruptive and expensive approach to overseeing third-country CCPs. Further should this be implemented through the derecognition of a CCP or a CCP Service as a whole, this would impact European market participants ability to clear non-euro denominated derivatives too. EU end users likely would suffer a significant increase in cost and loss of liquidity as a result of any forced relocation, as they may end up accessing the smaller part of the bifurcated euro-denominated (and non-euro denominated) derivatives market. In addition, there would be fragmentation between euro-denominated derivatives cleared in the EU, and non-euro denominated derivatives, which are likely to continue being cleared as they currently are outside the EU. This fragmentation of the market would have an adverse effect on systemic risk, for example by negatively impacting a CCP's ability to successfully port or auction client positions of a defaulting clearing member or by reducing access to alternative locations for clearing.

FIA agrees with the 5 drivers identified by the European Commission in its Impact Assessment regarding the costs and other negative consequences relating to the application and enforcement of a CCP location policy.[7] We note that the European Commission only sought to numerate the costs for one of those 5 drivers in its Impact Assessment – loss of margin offsets. The quantum of negative impact resulting from the other four drivers, in particular from market fragmentation and loss of liquidity, are also substantial and should be carefully accounted for in any impact assessment on the decision to recognise a third-country CCP. While a range of different views have been publicly expressed on the actual cost of forced relocation, *all* estimates point to an increase in costs for users of derivatives markets, especially EU end users.

FIA considers that the incremental supervisory gains in forcing CCPs or some products to relocate to the EU using this derecognition approach are unlikely to outweigh the upfront and on-going costs and market distortion resulting from the implementation of such a requirement.

As we outline in more detail in Section 6, we strongly support the approach taken in the proposed regulation of allowing comparable compliance by Tier 2 CCPs. This approach recognises that third-country CCPs are in many areas likely to already be subject to comparable requirements in the third-country to the requirements in EMIR, and promotes internationally agreed standards for CCP oversight and incentivises regulators to adopt such standards.

Other regulators, such as the CFTC, do not require forced relocation but do operate FIA's recommended approach of direct regulating and supervising the most-systemic foreign CCP Services (e.g. LCH.Clearnet Limited's SwapClear service). The CFTC has satisfied itself as to its ability to enforce its rules against CCP services in those third countries and has established coherent cooperation arrangement with domestic competent authorities to facilitate that regulation and supervision.

> **Recommendation: That the most systemic third-country CCP Services be subject to the direct application of EMIR and to direct supervision by ESMA with the ability for ESMA to grant comparable compliance, rather than forced relocation of their activities.**

6 Page 65 of the Impact Assessment: "*As explained above, two markets could coexist without bridges between them, a less liquid and therefore potentially more expensive market would cater for the limited needs of EU counterparties and a more liquid market would continue to exist outside of the EU*"

7 Per pages 62 to 67 of the Commission's Impact Assessment: transaction costs, legal costs, loss in margin efficiencies, operational costs (including capital costs) and liquidity costs

3. Third-country equivalence decisions

As FIA noted to the Commission in the above-referenced letter to Vice-President Dombrovskis[8], the EU has been a leader in developing equivalence processes, which have served the mutual benefit of both the EU and third-country financial markets and institutions.

One of the great strengths of today's EMIR equivalence regime is that it contains a mechanism to avoid duplicative and conflicting rules on clearing, reporting and risk mitigation requirements.

FIA recognises the need for the EU to oversee important activities that impact its markets, and understand the desire of the EU to enhance its supervision of systemically important third-country CCPs that may affect EU financial stability. We set out below a number of recommended changes to the proposed regulation, which we believe will result in an enhanced but proportionate regime for third-country CCPs.

The third-country recognition regime under EMIR has been successful in improving the standard of regulation in third countries and in ensuring that EU market participants are only able to access well-regulated and well-supervised CCPs.

A number of changes have been proposed to Article 25 of EMIR to enhance the equivalence determination process for third-country CCP regimes. These changes include:

- potentially re-assessing existing equivalence decisions;
- providing the Commission with the ability to adopt conditional equivalence decisions with respect to jurisdictions with non-systemically important CCPs (Tier 1 CCPs);
- requiring ESMA to annually monitor developments in third countries; and
- generally broadening the powers available to the Commission and ESMA in the equivalence determination and monitoring process.

a. Existing equivalence decisions

Now that equivalence determinations have been made for most major jurisdictions, re-opening the equivalence decisions could create uncertainty about the ability of EU market participants to continue to access third-country CCPs. The European Commission should clarify how it intends to use this power and whether it is expected to result in a wholesale reconsideration of existing equivalence determinations. We understand that existing CCP equivalence assessments adopted by the European Commission will continue to be in force. We would encourage the European Commission to not make changes to these existing equivalence assessments in the short-term, unless there have been material changes to the third-country regulatory regimes. If such a re-opening and review is decided upon, the European Commission should grant a transitional time for a CCP to go from an existing recognition arrangement to a directly supervised entity arrangement. Such time period should allow for law changes in the home country jurisdiction if such changes are warranted. We predict that this timeframe could take years. We caution that the re-opening of existing decisions could create significant disruption.

Recommendation: Clarify whether amendments are proposed to be made to existing equivalence decisions. If so, provide a significant time period to enable timely and compliant transition to a new regime by the applicable CCP, its members and its clients.

8 https://fia.org/sites/default/files/content_attachments/2017-06-06_FIA_response_euro_clearing_policyFINAL.pdf

b. Conditional equivalence decisions

The proposal to grant equivalence determinations subject to conditions is a potentially significant power only used so far in relation to systemically important US CCPs, and could turn the European Commission and ESMA into the de facto joint supervisors for third-country Tier 1 CCPs that have been deemed to be not systemically important in the EU. It is not clear how the Commission would propose to use such a power, nor whether existing equivalence decisions could be amended to impose conditions on them.

Recommendation: Provide more detail of the factors that may result in the adoption of a conditional equivalence decision and the types of conditions that may be imposed by the European Commission.

c. ESMA annual report on third-country regulatory developments

The regulation proposes to require ESMA to provide an annual confidential report to the Commission on the regulatory and supervisory developments in third countries. It is not clear to us why such a report is proposed to be kept confidential. The report should be in a standardised format so as to provide an efficient reporting mechanism to the European Commission. Given the importance of equivalence, further transparency of this assessment is merited.

Recommendation: The annual report from ESMA to the Commission on third-country regulatory developments should be made public and should be in a standardised format so as to provide an efficient reporting mechanism.

4. ESMA and the new CCP Executive Session

The proposed establishment of the CCP Executive Session within ESMA, including the granting of additional powers and the addition of 49 supervisory staff, represents a significant change in how CCP supervision is undertaken in the EU. While FIA support the establishment of an independent group of experts to make significant supervisory decisions, we believe the European Commission needs to carefully consider the impact of the establishment of such a group on the ongoing oversight of EU and third-country CCPs, for the reasons set out below.

a. Membership of the CCP Executive Session

The new powers that are proposed to be granted to ESMA are concentrated in the CCP Executive Session. While FIA support the approach of an independent body to make important supervisory decisions independent of the Board of Supervisors, the proposal needs to more carefully consider the make-up of the CCP Executive Session. Given the important decisions the CCP Executive Session will be making, the membership will need to be of sufficient seniority and with substantial experience and knowledge of central clearing. Further, any decisions of the CCP Executive Session must be made *solely* on the basis of proper risk management. We therefore strongly support the proposed Article 48a(2) of the ESA Regulation, which requires members of the CCP Executive Session to be independent and not hold any other official position.

In deciding on the membership of the CCP Executive Session, EU authorities should also be required to consider the geographic balance of the members. The Commission may wish to explicitly allow non-EU financial markets or regulatory experts to sit on the committee, as this would add a useful perspective to the important decisions being made by the CCP Executive Sessions. There should also be a balance between members from Eurozone and non-Eurozone EU member states. In addition, there should be a balance in the background experience of the members, for example between industry, regulators and academia. In the

event that academics are appointed to the CCP Executive Session, they should be required to meet all the same requirements for independence as the other members.

Recommendation: Provide more detail on the types of individuals who are to be considered for appointment to the Executive Session (noting their need to be independent), on the geographical balance of members taken as a whole, and the balance of career experience of the members.

b. Transitional arrangement prior to the appointment of the members of the CCP Executive Session

Proposed Article 76(2a) empowers the ESMA Board of Supervisors to carry out the functions of the CCP Executive Session until such time as the Head and Directors of the CCP Executive Session have been appointed.

The Board of Supervisors should not be able to make such important supervisory decisions prior to the appointment of the CCP Executive Session Members. This will ensure any supervisory decisions will be made by the independent and qualified members of the Executive Session and less likely to be subject to subsequent re-evaluation once those members are appointed.

Recommendation: The ESMA Board of Supervisors, in carrying out the powers of the CCP Executive Session, should not be permitted to designate a third-country CCP or CCP service as Tier 2, nor make a decision that a CCP or CCP service is of such substantial systemic importance that it should not be recognised, prior to the appointment of the CCP Executive Session members.

c. Quorum requirement for the CCP Executive Session

A quorum requirement should be implemented at the CCP Executive Session, so that the absence of members does not allow a single member to make decision on behalf of the entire CCP Executive Session.

Recommendation: A minimum quorum of members of the CCP Executive Session should be required before any significant decisions can be made given the CCP Executive Session is only made up of three people.

d. Transparency of CCP Executive Session

The CCP Executive Session will be given an important set of responsibilities over systemically important CCPs. Given this, there should be increased transparency and opportunities for public input into decisions made by the CCP Executive Session. As we outline in the following sections, ESMA should consult publically prior to making decisions on designating a CCP as Tier 2 or so systemically significant that it should not be recognised. As with meetings of the ESMA Board of Supervisors, the CCP Executive Session should publish outcomes from its meetings so stakeholders know what issues are under consideration with respect to CCP oversight. ESMA should make public clearly and upfront the scope of any comparable compliance granted to a Tier 2 CCP, rather than requiring a CCP to communicate such information to its members and clients.

Recommendation: Further clarify the governance arrangements related to the CCP Executive Session and increase the transparency of their decision making. ESMA should publish the comparable compliance decisions in respect of Tier 2 CCPs.

e. Additional supervisory resources for ESMA

The proposed new supervisory arrangements would involve ESMA taking on an additional 49 staff at an annual cost of over €9 million, with the cost being recovered from industry. The proposal does not clearly explain what the role of these 49 staff would be: whether their focus will be on third-country CCPs (which is where most of the additional powers to ESMA are being granted in the proposal) or whether they will also play a role in the oversight of EU CCPs. If their role will be focused on third-country CCPs, this is a substantial number of staff for what is likely to be a relatively small number of systemically important Tier 2 CCPs, which will already be subject to oversight in their home jurisdictions. If the additional staff will have a role in the oversight of EU CCPs, it should be explained how those supervisors will coordinate with the national competent authorities response for those CCPs.

In the proposed Article 21c, the CCPs shall pay fees associated with the applications for authorisation, recognition and annual fees associated with ESMA's tasks in regulation and supervision of the CCPs. The current draft allows for wide latitude for charging fees to third-country CCPs. The draft regulation should further explain the role of the additional ESMA staff and how they will coordinate with the third-country responsible authority. To the extent fees are charged to EU CCPs, the draft regulation should further explain the role these additional ESMA staff will play alongside staff at existing national competent authorities. ESMA needs to further justify what these additional staff would specifically be tasked with achieving.

Recommendation: The addition of 49 new staff at an annual cost of over €9 million needs to be further justified. The responsibilities of these staff members, and what role they will play given the existing national competent authorities, needs to be better explained. Provide more detail regarding the cost recovery mechanism for the additional CCP staff at ESMA and how ESMA determines the number of staff needed for CCP oversight.

5. Designation and Oversight of Tier 2 CCPs

While the European Commission has proposed a clear framework for the oversight of these CCPs, FIA propose a number of recommendations to further improve the transparency and operations of the proposed Tier 2 designation process, as set out below.

Additional powers granted to ESMA and EU central banks to oversee Tier 2 CCPs need to be carefully calibrated to ensure that conflicts between the EU and third-country authorities are avoided as far as possible. Over the last decade where CCP oversight globally has been significantly increased, a number of lessons have been learned about how to ensure that subjecting a CCP to multiple regulatory regimes does not create conflicting sets of rules. At its extreme, conflicting rules could result in an inability for CCPs to be authorised in multiple jurisdictions, which would result in a fragmentation of liquidity pools. The recommendations we set out below will help ensure that Tier 2 CCPs are subject to appropriate oversight in the EU, while avoiding conflicts of rules and laws.

a. Criteria for Tier 2 CCP designation and timing

The European Commission has proposed an initial four factors for determining whether a CCP should be categorised as being "Tier 2". We support this approach, and the list of factors used to make the Tier 2 determination. There should not be hard-wired quantitative factors used, as these would not allow for changes in the market or the vital judgement and experience of the CCP Executive Session. It would further be helpful for the regulation to set out more clearly what factors may make a CCP "likely to become

systemically important", including over what time period a CCP would be expected to become systemically important.

Under the proposal, the European Commission is only given 6 months to adopt a delegated act to further specify the criteria that ESMA will use in determining if a CCP is a Tier 2 CCP. These criteria will be important as they will provide importance guidance to ESMA and stakeholders on which CCPs are likely to be designated as Tier 2 CCP. Additional time should therefore be allowed for the European Commission to develop this criteria and the European Commission should consult both with ESMA and publically prior to adopting the delegated act.

Recommendation: The European Commission should be given 12 months (rather than the proposed 6 months) to adopt a delegated act to further specify the criteria that ESMA will use in determining if a CCP is a Tier 2 CCP. The Commission should be required to consult both with ESMA and publically prior to adopting the delegated Act.

b. Tier 2 designation of a CCP at the service level

It is not clear in the proposal whether the Tier 2 designation would be done at the level of an entire CCP, or of a particular service. While proposed Article 25m allows the withdrawal of recognition for a particular service, it is not clear whether the Tier 2 CCP designation could be made in the first instance at the level of a particular service, rather than the whole CCP.

The EU has generally taken a legal entity approach to CCP authorisation and recognition, although services must be specified within an authorisation, and extension into new services requires approval by the CCP college. On the other hand, other jurisdictions that have required third-country CCPs to seek authorisation, such as in the United States and Australia, have authorised the CCP for particular CCP services, rather than requiring the registration and oversight of the entire CCP. We believe this is the correct approach as it would avoid unnecessary oversight by the EU of services that are not systemically important in the EU and is thereby more proportionate in its application.

For example, if ESMA decides that LCH.Clearnet Ltd.'s SwapClear service is systemically important, it should deem the SwapClear service Tier 2, rather than LCH.Clearnet Ltd as a whole.

Recommendation: Rather than having to determine the entire legal entity of a third-country CCP as Tier 2, it should be possible to make such designation at the level of a specific CCP service, where only a particular service or services of that CCP are systemically important in the EU.

c. Need for public consultation prior to Tier 2 CCP designation

The decision to designate a CCP as Tier 2 is a significant one. It is likely to change the oversight arrangements for the CCP and result in changes to the CCPs rules and arrangements. Given the significance of such a decision, ESMA should consult publically on the designation of the CCP as a Tier 2 CCP. This consultation should include a proposal from ESMA that a particular CCP or CCP service will be designated as a Tier 2 CCP. This proposal should include an explanation from ESMA of why the CCP is being proposed to be designated. This would ensure that the CCPs, its participants, and impacted third-country authorities will have the opportunity to provide any relevant issues to ESMA prior to the designation being made.

Recommendation: Before a third-country CCP or CCP service is designated as Tier 2, ESMA should conduct a public consultation.

d. Proportional supervisory intensity for Tier 2 CCPs with different levels of EU systemic importance

The proposal should better recognise that there can be different levels of systemic importance across Tier 2 CCPs. Under the proposal, once a CCP is deemed Tier 2, the only way ESMA is required to differently treat Tier 2 CCPs is the extent to which comparable compliance is granted. Therefore the proposal does not allow for any differentiation between different Tier 2 CCPs that may have substantially different levels of systemic importance within the EU.

Recognising that there can be significant differences in systemic importance of Tier 2 CCPs, the proposal should be amended to allow for ESMA to determine different levels of oversight are necessary across the CCPs. This may include increased or decreased regularity of on-site and off-site reviews, different levels of involvement in rule changes (including depending on the significance of the rule change), and the level of joint oversight with third-country regulatory authorities. This would ensure that the EU can appropriately tailor its level of oversight depending on the significance of the CCP service, and focus on those CCPs or CCP services that are the most systemically important in the EU.

Recommendation: The regulation should further differentiate the systemic importance in the EU of differing third-country CCPs and CCP services. The regulation should therefore allow ESMA to adjust its oversight intensity based on the systemic importance of the CCP or CCP service. This could include more active and regular reviews and on-sight inspections of third-country CCPs and CCP services that are considered more systemically important.

e. Role of the EU central bank of issue for Tier 2 CCPs

The proposal grants substantial power over Tier 2 CCPs to the relevant EU central bank of issue. In particular, a significant power is given to the central bank of issue to place conditions on a Tier 2 CCP and to determine if those conditions are being met. This power effectively makes the central bank of issue a co-supervisor of the CCP along with ESMA, as they have the power to place any conditions in their discretion on a Tier 2 CCP, and then have sole authority to determine if those conditions are being met. This could allow a central bank of issue, in the most extreme case, to exercise an effective veto over the recognition of a Tier 2 CCP by setting conditions that a CCP is unable to meet.

The EU supervisory structure for third-country CCPs should clarify that ESMA is the sole supervisory authority, with the sole discretion to grant or deny recognition to third-country CCPs under any conditions it deems necessary. This is the justification for the substantial increase in ESMA staff needed to supervise third-country CCPs. Granting central banks of issue with effective veto powers over recognition decisions confuses the supervisory lines applicable to third-country CCPs.

The appropriate way for the central bank of issue to be involved is through participation in the CCP Executive Session, as has been proposed. If the central bank of issue considers that conditions should be placed on a Tier 2 CCP, it should propose those conditions in the CCP Executive Session, for ESMA to then decide whether, and to what extent, such conditions should be imposed. Only ESMA should have the power and responsibility to determine whether a CCP has met any such condition so specified.

Recommendation: The central bank of issue should present to the CCP Executive Session the proposed details of, and rationale for, any proposed condition to be imposed on the recognition of a third-country CCP or CCP service. In order to avoid the central bank of issue becoming a de facto supervisor of third-country CCPs, the CCP Executive Session should be *solely* responsible for specifying the requirements for, and any conditions of, the recognition of a Tier 2 CCP. There should be safeguards to ensure that the central bank of issue is not able to overrule the CCP Executive Session.

6. Comparable Compliance

We strongly support the approach taken in the regulation of allowing comparable compliance by Tier 2 CCPs. This appropriately recognises that third-country CCPs are in many areas likely to already be subject to comparable requirements in the third-country to the requirements in EMIR. It also appropriately promotes internationally agreed standards for CCP oversight and incentivises regulators to adopt such standards. International standards serve as a guidepost for policymakers and regulators when adopting regulations. We however have a number of recommendations to streamline the comparable compliance process and ensure ESMA has the ability to defer to third-country requirements where possible.

a. Deference through comparable compliance must be applied where possible

As we have recommended above, we consider that the most extreme measure available under the regulation should be to require that a third-country CCP (or, as applicable, a clearing service thereof) be subject to direct supervision by ESMA and direct application of EMIR. This should only be considered for the most systemic CCPs/clearing services.

While we believe the comparable compliance approach is sound, we believe the proposed process is quite burdensome in requiring the CCP to make an application for comparable compliance before ESMA can deem certain areas to be comparable. This is an unnecessarily complex process, given ESMA has already undertaken equivalence assessments of all major third-country jurisdictions, and the Commission has adopted equivalence decisions.

The presumption should be that comparable compliance is available in all third countries where the Commission has adopted an equivalence decision, and that decision is still in effect. Rather than needing to apply for comparable compliance, ESMA should use the existing equivalence determinations with an update from the relevant regulator if necessary. In all but the most extreme circumstances, comparable compliance should be granted on the basis of deference to the comparable regulatory requirements of third countries.

If something has changed or the EU found that a certain rule or CCP was not equivalent previously, then the EU rules should apply. However, the CCP and the third-country authority should then be given the opportunity to demonstrate, if they wish, that the third-country regime is equivalent, prior to ESMA making a decision on comparable compliance.

Recommendation: The Level 1 text should enhance the provisions around comparable compliance available to Tier 2 CCPs. ESMA should give due consideration and deference to existing equivalence decisions, so as to limit the scope for market uncertainty and disruption. Only in the most extreme circumstances should a Tier 2 CCP be subject to direct supervision by ESMA and to direct application of EMIR.

b. Need for transitional provisions prior to direct application of EU rules to Tier 2 CCPs

Under the proposal, it appears that as soon as a Tier 2 CCP designation is made, the CCP will be required to meet the requirements of EMIR. Only at that point is the CCP able to make a request for comparable compliance, and then ESMA will make an assessment on that request in due course. This means a Tier 2 CCP will be required to comply with EMIR at the point of designation, but can have its third-country requirements deemed comparable at a later date. This gives no time for a CCP to demonstrate its existing regulations are comparable to those in EMIR.

Instead, the CCP should be given an opportunity to seek comparable compliance, and ESMA should make such a decision on comparable compliance, prior to the EMIR requirements becoming directly applicable to the CCP.

Recommendation: Include transitional provisions, to provide sufficient time for a newly determined Tier 2 CCP or CCP service to demonstrate comparable compliance with EU rules, and for its members and clients to adjust to any changes needed at the CCP to come into compliance with any new requirements as a Tier 2 CCP.

c. Conflicts of laws

As part of the comparable compliance assessment by ESMA, careful due diligence must be conducted, in co-operation with the CCP and its third-country authority, to ensure that application of EU rules will not create a conflict of law issue with the third-country. This includes EU requirements that, if applied to the Tier 2 CCP, would cause the CCP to breach a legal requirement in its third-country. Careful consideration needs to be given where a Tier 2 CCP is authorised in multiple jurisdictions, as multiple legal regimes will need to be assessed to ensure there are no conflicts of laws. Where there is a conflict of law issue, the authorities should work it out so the industry is not forced to break the law of one jurisdiction.

Recommendation: Careful due diligence should be conducted during any comparable compliance assessment to identify and manage any material conflict of laws.

d. Taking account of existing co-operative oversight arrangements

The post-financial crisis reforms have seen substantial energy put into the development of supervisory colleges for the oversight of FMIs. We believe these colleges are the most effective way to oversee large and complex FMIs that are subject to regulation in a number of jurisdictions. They allow for a coordinated supervisory approach through the joint work of the members of the college, rather than a fragmented regulatory approach through the application of overlapping or duplicative rules set by individual authorities.

A model for joint oversight that appears to work effectively is the CLS Oversight Committee. While the U.S. Federal Reserve System regulates and supervises CLS Bank, the CLS Oversight Committee comprises 22 central banks (including the ECB and five Eurozone central banks) that collectively oversee CLS Bank pursuant to an agreed Protocol. We believe the CLS model achieves a number of important outcomes: it allows many interested authorities to be actively involved in the oversight of CLS and ensures that the authorities apply a consistent set of standards for CLS's global operations.

This framework means that authorities can come together and agree on the supervisory priorities for CLS, and make sure they are implemented. This structure removes the concern that a risk or risk mitigant identified by one particular authority cannot be implemented because it is outside the remit of that

authority. The co-operative oversight approach means that any risk that is identified can be managed through the joint arrangement. In addition, in the context of a CCP, such a framework would enable enhanced transparency between CCP and the authorities in all interested jurisdictions as well as allowing approaches to complex risk management and/or default scenarios to be agreed on an ex-ante basis between supervisors, further reducing the risk of pro-cyclical actions occurring to the detriment, or perceived detriment, of some parties.

We recognise the concern sometimes raised in the official sector that non-EU central banks do not have a mandate to maintain financial stability in the euro area and therefore, in a crisis, may take decisions giving priority to their domestic interests over EU's interests and not giving sufficient attention to the possible impact of their decisions on the euro area.[9] Concerns have also been raised that liquidity swap agreements between EU and non-EU central banks do not achieve the same outcomes as the direct provision of liquidity by EU central banks given the number of steps involved for the swap lines to be activated in a crisis. We believe that co-operative oversight arrangements can and should mitigate these risks and cover matters such as how a possible euro crisis would be handled, how decisions would be taken and who would make the final decisions. As we have outlined above, there are various examples of co-operative oversight arrangements that are in place and deal with such risks.

Recent global supervisory standards for CCPs have emphasised the importance of co-operation between authorities. Responsibility E of the CPMI-IOSCO PFMIs emphasises the need for co-operation, while stating that at least one authority should accept responsibility for "establishing efficient and effective cooperation among all relevant authorities". More recently, the 2017 FSB Guidance on CCP Resolution and Resolution Planning stated the need for CCP supervisors to establish crisis management groups to coordinate the resolution planning and resolvability assessments.

While we recognise that similar approaches have not been implemented for all CCPs, where it has been implemented, it should be carefully considered by ESMA in the determination of the intensity level of oversight that is needed. Where effective co-operative arrangements are in place, they can improve the oversight of systemically important CCPs without creating overlapping or conflicting rules. ESMA should be empowered to establish and participate in joint oversight arrangements, and take these arrangements into account when deciding its supervisory approach for Tier 2 CCPs.

Consistent with CPMI-IOSCO and FSB standards, it is vital that the ESMA's oversight of Tier 2 CCPs supports co-operative oversight arrangements. In overseeing Tier 2 CCPs, ESMA should participate in these arrangements and ensure that its oversight of these CCPs does not create any conflicts or laws in CCP oversight, and recovery and resolution arrangements.

> **Recommendation: In addition to granting comparable compliance based on the third-country arrangements, ESMA should consider adjusting its oversight intensity where supervisory colleges act as an effective means to oversee the CCP or CCP service. The proposal should include a requirement for ESMA to participate in co-operative oversight arrangements and/or crisis management groups.**

9 For example https://www.tresor.economie.gouv.fr/Ressources/File/431987

7. CCP Relocation Requirement

As we emphasised above and in our letter to Commissioner Dombrovskis on 6 June, FIA strongly believes that the forced relocation of a CCP would be severely detrimental to the economic interests of the EU, particularly if implemented in such a way that causes bifurcation of liquidity, increases cost and creates an un-level playing field between market participants.

While we reiterate our underlying belief that such an approach is undesirable, we wish to provide a number of technical comments on the proposed approach should the decision be made to retain such an option in the final regulation. FIA has the following recommendations designed to ensure that such a relocation decision will be made only following a transparent process based on clear criteria for the decision, and implemented in such a way that avoids additional disruption following the required relocation of a CCP or CCP service.

a. Unclear criteria for determining a third-country CCP should not be recognised in the EU

Our first recommendation relates to the criteria used for deciding that a CCP is so systemically important in the EU that it will not be recognised. The decision on whether a CCP is a Tier 2 CCP is guided by a number of criteria, which can be supplemented by technical standards. While we have recommended above that this criteria be set out in more detail in the regulation itself, we support the approach of being transparent about the criteria by which the systemic importance of a CCP will be judged.

In comparison, the proposed Article 25(2c) on derecognition has no such criteria, and only the general statement that a CCP may not be recognised where it "is of such substantial systemic importance that compliance with the conditions [for Tier 2 CCPs] does not sufficiently ensure the financial stability of the Union or of one or more of its Member States".

Given the importance of such a decision, we believe that criteria needs to be set out in the regulation of factors that would necessitate a CCP not being granted recognition. The factors should include:

- Under what circumstances the Tier 2 CCP conditions would not be sufficient to ensure financial stability in the EU;
- Whether there are risk mitigants in place that give the EU sufficient oversight over the CCP that forced relocation is not necessary, for example how TARGET2-Securities ("T2S") can provide reassurance to EU central banks of issue regarding transactions carried out in euro-dominated products or with European counterparties;
- What other options were considered prior to the decision to not grant recognition to a CCP;
- What the consequences and costs of such a decision would be to EU market participants; and
- Under what circumstances a CCP would be derecognised on the basis of a financial stability risk in just one or a small number of member states, if the cost of relocation to other member states would be substantial.

Such criteria should also be required to be expanded upon in technical standards. The regulation should also require an impact assessment be undertaken to determine the cost to the EU from such a decision.

Recommendation: More detail should be set out in the regulation itself (as expanded upon by way of technical standards) to specify the circumstances in which the forced relocation power might be used.

b. Derecognition decision should be available to be made at the level of a CCP service

As with the designation of Tier 2 CCPs, it is unlikely that a whole CCP would be so systemically important that it should not be recognised. Rather, such a decision would be more likely to apply to a product or one or a small number of services within a CCP. The regulation should specify that such a relocation decision would be made only in respect of services that are systemically important in the EU.

Recommendation: Rather than having to determine the entire legal entity of a third-country CCP as subject to relocation, it should be possible to make such designation at the level of a specific CCP service.

c. Consultation prior to derecognition decisions

The decision to require a CCP to relocate is a hugely significant one, causing substantial cost to EU market participants. The impact assessment accompanying the proposal notes that "it is of course not possible to quantify in a meaningful manner the costs related to relocation and potential market fragmentation", particularly ahead of a particular proposal for a particular CCP or service to be relocated. Therefore the only time a full and accurate determination of the costs and benefits of any such relocation can be done is when a concrete proposal for a relocation is on the table.

Under the proposal, there is not requirement for ESMA to consult with anyone (other than relevant central banks of issue) prior to making a decision to require the relocation of a CCP. It is essential that ESMA consult publically and widely prior to making any such decision. This consultation would allow for input by the impacted CCPs, market participants who would face increased costs as a result of the proposal, and third-country authorities who would be impacted by such a decision. Given the Commission recognises the challenge in accurately determining the cost of such a relocation in advance, it is essential that stakeholders be given the opportunity to provide input once a proposal is being considered. This proposal must provide sufficient time for a response and, in making a final decision on relocation, ESMA must take into account feedback it receives during the consultation process.

Recommendation: The decision to not recognise a CCP or CCP service must not be taken without prior public consultation.

d. Transitional provisions prior to the effective date for derecognition of a third-country CCP

The decision not to grant recognition and require a CCP to relocate is a significant one, which would have major impacts on the wider market. The regulation needs to provide powers to ESMA, through the implementing decision, to explain how the derecognition and transfer of the CCP would take place and under what timeframes this might occur. Without such power, a transfer will be even more disruptive that it would otherwise be.

The decision by ESMA should explain a number of elements on the mechanics of derecognition, including:

1. The date new trades cannot be entered into at the derecognised CCP and by which time all existing trades will need to be closed out, if indeed such trades are not grandfathered given that they have been cleared pursuant to the EMIR rules at the time they were originally accepted by the CCP; and
2. Which CCP services will be covered by the derecognition where one party is in the EU and, if so, how such a limitation would not lead to bifurcation of liquidity and distortion of competition.

Recommendation: The regulation should provide for transitional provisions, to provide sufficient time for CCPs, their members and their clients to implement all the operational, capital, legal and other changes required pursuant to such relocation. ESMA should clearly state the impact of any such derecognition on existing trades already cleared at such CCP.

e. Use *of an implementing act for derecognition decisions*

The proposal requires that any decision to refuse recognition must be made by ESMA, in agreement with the relevant central banks of issue, and endorsed by the Commission by an implementing act, which we expect would be subject to approval by the Council and Parliament. FIA support this approach, and believe it is important that ESMA, and only ESMA, should be *initiating* the decision to derecognise a CCP. This will ensure that the decision is made in the first instance by the independent, technical, experts at ESMA who are best placed to determine the systemic risk. That decision should then be approved by the European Commission, European Parliament and the Council of Ministers.

Recommendation: The decision to derecognise a CCP or CCP service must be made by ESMA alone, on purely technical grounds. Once initiated, approve should be sought by ESMA by way of an implementing act that is adopted by the Commission, and which is subject to non-objection by the European Parliament and Council of Ministers.

Annex: Full list of FIA recommendations

1. That the most systemic third-country CCP Services be subject to the direct application of EMIR and to direct supervision by ESMA with the ability for ESMA to grant comparable compliance, rather than forced relocation of their activities.

2. Clarify whether amendments are proposed to be made to existing equivalence decisions. If so, provide a significant time period to enable timely and compliant transition to a new regime by the applicable CCP, its members and its clients.

3. Provide more detail of the factors that may result in the adoption of a conditional equivalence decision and the types of conditions that may be imposed by the European Commission.

4. The annual report from ESMA to the Commission on third-country regulatory developments should be made public and should be in a standardised format so as to provide an efficient reporting mechanism.

5. Provide more detail on the types of individuals who are to be considered for appointment to the Executive Session (noting their need to be independent), on the geographical balance of members taken as a whole, and the balance of career experience of the members.

6. The ESMA Board of Supervisors, in carrying out the powers of the CCP Executive Session, should not be permitted to designate a third-country CCP or CCP service as Tier 2, nor make a decision that a CCP or CCP service is of such substantial systemic importance that it should not be recognised, prior to the appointment of the CCP Executive Session members.

7. A minimum quorum of members of the CCP Executive Session should be required before any significant decisions can be made given the CCP Executive Session is only made up of three people.

8. Further clarify the governance arrangements related to the CCP Executive Session and increase the transparency of their decision making. ESMA should publish the comparable compliance decisions in respect of Tier 2 CCPs.

9. The addition of 49 new staff at an annual cost of over €9 million needs to be further justified. The responsibilities of these staff members, and what role they will play given the existing national competent authorities, needs to be better explained. Provide more detail regarding the cost recovery mechanism for the additional CCP staff at ESMA and how ESMA determines the number of staff needed for CCP oversight.

10. The European Commission should be given 12 months (rather than the proposed 6 months) to adopt a delegated act to further specify the criteria that ESMA will use in determining if a CCP is a Tier 2 CCP. The Commission should be required to consult both with ESMA and publically prior to adopting the delegated Act.

11. Rather than having to determine the entire legal entity of a third-country CCP as Tier 2, it should be possible to make such designation at the level of a specific CCP service, where only a particular service or services of that CCP are systemically important in the EU.

12. Before a third-country CCP or CCP service is designated as Tier 2, ESMA should conduct a public consultation.

13. The regulation should further differentiate the systemic importance in the EU of differing third-country CCPs and CCP services. The regulation should therefore allow ESMA to adjust its oversight intensity based on the systemic importance of the CCP or CCP service. This could include more active and regular reviews and on-sight inspections of third-country CCPs and CCP services that are considered more systemically important.

14. The central bank of issue should present to the CCP Executive Session the proposed details of, and rationale for, any proposed condition to be imposed on the recognition of a third-country CCP or CCP service. In order to avoid the central bank of issue becoming a de facto supervisor of third-country CCPs, the CCP Executive Session should be solely responsible for specifying the requirements for, and any conditions of, the recognition of a Tier 2 CCP. There should be safeguards to ensure that the central bank of issue is not able to overrule the CCP Executive Session.

15. The Level 1 text should enhance the provisions around comparable compliance available to Tier 2 CCPs. ESMA should give due consideration and deference to existing equivalence decisions, so as to limit the scope for market uncertainty and disruption. Only in the most extreme circumstances should a Tier 2 CCP be subject to direct supervision by ESMA and to direct application of EMIR.

16. Include transitional provisions, to provide sufficient time for a newly determined Tier 2 CCP or CCP service to demonstrate comparable compliance with EU rules, and for its members and clients to adjust to any changes needed at the CCP to come into compliance with any new requirements as a Tier 2 CCP.

17. Careful due diligence should be conducted during any comparable compliance assessment to identify and manage any material conflict of laws.

18. In addition to granting comparable compliance based on the third-country arrangements, ESMA should consider adjusting its oversight intensity where supervisory colleges act as an effective means to oversee the CCP or CCP service. The proposal should include a requirement for ESMA to participate in co-operative oversight arrangements and/or crisis management groups.

19. More detail should be set out in the regulation itself (as expanded upon by way of technical standards) to specify the circumstances in which the forced relocation power might be used.

20. Rather than having to determine the entire legal entity of a third-country CCP as subject to relocation, it should be possible to make such designation at the level of a specific CCP service.

21. The decision to not recognise a CCP or CCP service must not be taken without prior public consultation.

22. The regulation should provide for transitional provisions, to provide sufficient time for CCPs, their members and their clients to implement all the operational, capital, legal and other changes required pursuant to such relocation. ESMA should clearly state the impact of any such derecognition on existing trades already cleared at such CCP.

23. The decision to derecognise a CCP or CCP service must be made by ESMA alone, on purely technical grounds. Once initiated, approve should be sought by ESMA by way of an implementing act that is adopted by the Commission, and which is subject to non-objection by the European Parliament and Council of Ministers.