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FIA and ISDA response to the Bank of England’s approach to tiering incoming central counterparties under UK EMIR Article 25

Introduction

FIA and ISDA (together “**the Associations**”) welcome the opportunity to provide feedback on the Bank of England’s (“**BoE**”) proposed approach to tiering under UK EMIR 2.2. Overall, we support the spirit and goals of the BoE’s approach to regulatory deference and co-operation for the reasons set out. However, we have some additional thoughts and concerns about the absolute level and methodology used for the systemic risk thresholds in the proposal, which we elaborate on below. We look forward to engaging throughout the consultation phase and remain at the BoE’s disposal to discuss any elements of the response or to provide additional input as needed.

FIA and ISDA members support the goal of ensuring that clearing services in the United Kingdom (“**UK**”) and globally are appropriately regulated and supervised. The UK currently holds a central role in global derivatives clearing and the BoE’s approach recognises the need for open, global and inclusive markets. The BoE has been a global thought leader in developing a robust clearing framework. We welcome that the BoE aims to put deference and comparable compliance at the centre of its approach.

FIA and ISDA members have long advocated that the most optimal way to manage financial stability risks is to have supervisory and regulatory co-operation, working together, and making sure that authorities have the information that they need to protect the markets that benefit all participants and the real economy.¹

The BoE’s approach to tiering

Location policy

While the ability to utilise the tool of a location policy remains a feature of UK EMIR 2.2, we commend the BoE for stating clearly that it remains committed to open wholesale financial services and that it is the BoE’s policy approach to not recommend the use of location regulations or classification of any CCP as Tier 3 at this stage. We believe this is the appropriate approach given that the use of relocation regulations could lead to fragmentation, significant concentration of risks and increased costs to market participants.

¹ FIA principles for Cross-Border Regulation, published in September 2021: <https://www.fia.org/sites/default/files/2021-09/FIA%20White%20Paper%20on%20Cross-Border%20Regulation%20%28September%202021%29.pdf>



Risk-based assessment

As a general observation, we recognise that the BoE's proposals are designed to address the on-shored EMIR, which has been transposed into the UK legal framework, but which also creates some limitations.

The Associations appreciate the BoE's efforts to establish risks-based tests for determining the systemic importance of incoming CCPs (i.e., non-UK CCPs), while considering principles of international comity.

However, FIA and ISDA members understand the potential for a reduction in legal certainty for third-country CCPs ("**TC-CCPs**") as part of the BoE's redefining of their approach to the cross-border regulation of CCPs, which may unnecessarily risk disruption to the stability and efficiency of global derivatives markets.

Under the proposal, incoming CCPs will be assessed to establish whether they might pose systemic risks to the UK by initially being assessed against a set of margin and default funds thresholds which appear significantly lower than the thresholds applied in the European Union ("**EU**"), although we note, that the requirements in the EU and UK versions of EMIR 2.2 are not fully aligned. For example, the EU version of EMIR 2.2 refers to different metrics such as the maximum notional amount outstanding²³.

The methodology for applying these initial triage thresholds may also appear concerning because it uses peak collateral held (i.e., not required) by the CCP which: i) has implications for, and discourages the posting of, excess collateral; ii) does not take into account practices around net versus gross margining; and iii) is overweight towards shorter time windows where margins may increase. A concern for some members is that incoming CCPs may be inappropriately categorised as Tier 2 CCPs, which is in contrast to the EU's approach where they would fall into a Tier 1 category.

Some members are concerned that the initial triage thresholds coupled with the BoE's reliance on subjective criteria that do not clearly establish a nexus for an incoming CCP's systemic importance to the UK could inappropriately result in a CCP being deemed Tier 2. For example, Annex 1 includes a number of factors for assessment that do not relate to a CCP's clearing for UK market participants or contracts denominated in the British Pound. The low threshold levels without any actual relationship to the systemic risk to the UK coupled with the subjective nature of this assessment creates legal uncertainty for all market stakeholders, while subjecting an incoming CCP to the uncertainty of a full assessment if it breaches one of the initial triage thresholds. This could ultimately result in a situation where a CCP that is not systemically important to the UK is nonetheless deemed a Tier 2 CCP.

² EU EMIR 2.2 thresholds: average aggregated margin requirement and default fund contributions is more than €25 bil which is significantly larger than the proposed UK thresholds which are UK IM > £10bn or UK DFC > £1 bn;

³ See <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32020R1303&rid=8>



Therefore, some of the Associations' members encourage an approach that is coupled with a more appropriate quantitative assessment of systemic risk, particularly with respect to the methodology used for determining the initial triage thresholds. These members of the Associations believe that the BoE's framework for incoming CCPs (i.e., non-UK CCPs) should be risk-based, which first, includes identifying incoming CCPs that are of systemic importance to the UK using appropriately sized thresholds and second, establishes an approach of regulatory deference for CCPs subject to comparable regulatory regimes in their home country that relies on supervisory co-operation arrangements. These members believe the BoE can accomplish this within the on-shored EMIR 2.2 framework, in a manner consistent with the framework that incoming CCPs operated under when the Recognised Overseas Clearing House regime was in place prior to EMIR.

Other members of the Associations believe that the BoE's approach on tiering already focuses successfully on regulatory deference and co-operation and is designed to create a more optimal way of approaching TC-CCP oversight in a holistic and proportionate manner.

This view notes and appreciates that under the principle of proportionality and informed reliance assessment even for systemic CCPs that might be initially classified as Tier 2 CCPs, they could be classified as Tier 1 CCPs. In particular, where the jurisdiction in question has a robust regulatory and supervisory framework and is clearly committed to meeting the BoE's expectations with respect to cooperation, trust and information sharing with respect to a truly systemic CCP, the BoE emphasizes its reliance on the informed reliance test and may deem that CCP as Tier 1. Therefore, such CCP would not fall under direct UK supervision, provided that its home regulator is delivering on the outcomes to protect UK financial stability on an ongoing basis (by ensuring that the home supervision protects financial stability generally). This means that a truly systemic CCP may initially fall into the Tier 2 category, when meeting the BoE's requisite requirements, it may be deemed and treated as a Tier 1 CCP following the principles of deference. Therefore, many members of the Associations support the BoE's approach as it provides a higher degree of flexibility that would allow the BoE to continue to defer to the incoming CCP home regulator, even if the CCP meets an appropriate threshold for systemic importance.

The proposal lacks certainty with respect to the initial triage thresholds when an incoming CCP is close to one or more of the thresholds. FIA and ISDA members recommend providing further clarification on the meaning of being close to one of more of the triage indicators (BoE CP, paragraph 4.9, page 12).

It is worthwhile exploring a comparison of the approaches taken in other jurisdictions, i.e., the CFTC does not require any registration, regulation, or supervision for foreign CCPs, offering U.S. customers clearing services for foreign ETD contracts. Instead, the CFTC relies on an ex-ante comparability determination for a third-country regulator or exchange and the firms it oversees. Today, under this framework, U.S. market participants can access the ETD markets in the UK, among others, without any requirement for U.S. oversight of those non-U.S. CCPs or markets.



Part 30 exemptions allow for outcomes-based, substituted compliance for UK brokers. This relief eliminates the requirement that the UK broker registers as a CFTC registered futures commission merchant (**FCM**) in the U.S. and does not require U.S. registration from either the exchange or CCP associated with the ETD contracts. This framework provides ex-ante certainty to the market around the regulatory status.

However, we note that the Part 30 exemptions are not applicable to OTC clearing and instead the CFTC has implemented a framework based on regulatory deference for non-U.S. CCPs that are serving U.S. persons that are customers who must clear their OTC derivatives via a registered US FCM on a registered Derivatives Clearing Organisation (DCO).⁴

The BoE's expectations towards supervisory cooperation (trust and information sharing)

The Associations' members would like to highlight the following additional issues and concerns with the BoE's approach on achieving supervisory co-operation in all cases:

- The BoE's requirements to participate in supervisory visits: while recognising the ability to carry out supervisory visits has always been part of UK EMIR 2.2, in some TC-CCPs cases, supervisory visits are already heavily supervised in some jurisdictions. There might be reservations from some authorities to accept and agree to a more active role of the host regulator in those visits given the operational burden already placed by existing supervisory practices in a TC-CCP's home jurisdiction. We encourage the BoE to ensure that no unnecessary burden is placed on a the CCP, and where possible, the BoE should rely on information it can obtain from the home regulator to the greatest extent possible.
- Setting priorities: Regulatory priorities do not generally diverge in their core values. Financial stability remains the top priority for all supervisory authorities. As such, we do not necessarily see immediate benefits and do not believe that the BoE's influence on the home regulator's priorities should be a requirement of this reliance assessment. Instead, we recommend placing the utmost reliance on co-operation agreements and relying on the entered Memorandum of Understanding as much as possible.
- Participation in the Crisis Management Group ("**CMG**"): Although we agree that sharing of information is fundamental to an effective regulatory cooperation, we find that participation in the CMG could be limited to a more formal establishment of sharing of information in a timely manner particularly during a crisis scenario and/or ad-hoc invitations extended to the Bank to participate in discussions.

^{4 4} See CFTC, Comparability Determination for the European Union: Dually-Registered Derivatives Clearing Organizations and Central Counterparties (March 2016), *available here*: <https://www.cftc.gov/sites/default/files/idc/groups/public/@lrfederalregister/documents/file/2016-06261a.pdf>; CFTC, CFTC, Registration With Alternative Compliance for Non-U.S. Derivatives Clearing Organizations (Oct. 2020), *available here*: <https://www.cftc.gov/sites/default/files/2020/10/2020-21306a.pdf>.



Definition of UK Clearing Member

The Associations' members believe the BoE's approach should be revised to exclude foreign subsidiaries of UK firms from the definition of UK clearing members to align with the treatment of foreign subsidiaries under the CFTC Cross-border Guidance. U.S. clearing members are defined in the Supplemental Proposal as "clearing member[s] organized in the United States or whose ultimate parent company is organized in the United States, or an FCM." Under CFTC Cross-border Guidance, however, subsidiaries of U.S. swap dealers are not considered U.S. persons simply by virtue of being a part of a U.S. banking group. Including subsidiaries in the definition would disincentivise non-UK clearing members from accepting significant levels of business from such subsidiaries to remain below the threshold, thus, putting UK banking groups at a competitive disadvantage. To ensure a consistent regulatory approach to the cross-border treatment of foreign subsidiaries and allow market participants continued access to global liquidity pools, the BoE should amend the proposed definition of UK clearing member to exclude foreign subsidiaries of UK clearing members.

Timeframe for calculations

We recommend clarifying that market turbulences, i.e. pandemic events (like Covid) should not be considered in the calculations.

Separately, we note that further consideration should be given as to how the BoE proposals will interact with the existing Temporary Recognition Regime ("TRR") for CCPs. The TRR enables eligible non-UK CCPs to provide clearing services and activities in the UK until 31 December 2023, so long as they continue to be eligible for the TRR. The duration of the TRR is extendable by HM Treasury in increments of up to twelve months each and we recommend extending the regime in cases needed.

Therefore, FIA and ISDA members point out that the timeframe available for finalisation and implementation of the rules looks compressed and recommend allowing sufficient time to finalise the framework with attention to optimal outcomes for TC-CCPs and clearing participants while preserving financial stability.

The BoE's approach to Comparable Compliance

We have no comments on the BoE's approach to Comparable Compliance.



About FIA:

FIA is the leading global trade organization for the futures, options and centrally cleared derivatives markets, with offices in Brussels, London, Singapore and Washington, D.C. FIA's membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from about 50 countries as well as technology vendors, law firms and other professional service providers. FIA's mission is to:

- support open, transparent and competitive markets,
- protect and enhance the integrity of the financial system, and
- promote high standards of professional conduct.

As the principal members of derivatives clearinghouses worldwide, FIA's clearing firm members play a critical role in the reduction of systemic risk in global financial markets.

About ISDA:

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 970 member institutions from 77 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org. Follow us on [Twitter](#), [LinkedIn](#), [Facebook](#) and [YouTube](#)