30 October 2017

To: European Commission (EC)

Re: Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 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 authorization of CCPs and requirements for the recognition of third-country CCPs

Dear Sirs or Madams,

The Global Financial Markets Association[1] (GFMA) thanks the European Commission for the opportunity to respond to the proposal of 13 June 2017 regarding the procedures and authorities involved for the authorization of Central Counterparties (CCPs) and requirements for the recognition of third-country CCPs.

GFMA supports the objectives to enable European Union (EU) authorities to more efficiently monitor and mitigate risk of a CCP by streamlining the supervision of CCPs established in the EU and to enhance arrangements for supervision of third-country CCPs. As the proposal is considered by the European Parliament (EP) and the Council of the European Union (Council) GFMA calls upon the European Commission to communicate the importance of policymakers to foster the efficient cross border access to clearing and to evaluate the impact of the proposal on the incentives for clearing[2]. Please also consider the economic risk of causing markets to fragment and the importance of maintaining a level playing-field for market participants when designing the authorization and supervision framework for third-country CCPs. GFMA is supportive of policymakers developing enhanced supervisory standards that support global market efficiency, financial stability and end-user choice.

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[1] The Global Financial Markets Association (GFMA) brings together three of the world's leading financial trade associations to address the increasingly important global regulatory agenda and to promote coordinated advocacy efforts. The Association for Financial Markets in Europe (AFME) in London and Brussels, the Asia Securities Industry & Financial Markets Association (ASIFMA) in Hong Kong and the Securities Industry and Financial Markets Association (SIFMA) in New York and Washington are, respectively, the European, Asian and North American members of GFMA. For more information, visit http://www.gfma.org.

[2] FSB Press Release, "The FSB, working with standard-setting bodies, will use its new post-implementation evaluation framework [. . .] to assess the interaction of the reforms on incentives to centrally clear OTC derivatives and will publish the results from this work in late-2018." June 2017, http://www.fsb.org/2017/06/fsb-reports-on-reforms-to-otc-derivatives-markets/.

In the near-term, an equivalence determination by the EC and recognition of third-country CCPs is vital to ensure the continuity of derivative markets, especially for existing contract portfolios. Specifically, the recognition of CCPs authorized in the United Kingdom (UK) on Day One of Brexit is integral to avoid significant market disruption. Absent action by the European Commission to find UK CCPs equivalent, under current EU regulations UK CCPs will no longer be considered Qualified CCPs (QCCPs) for the purposes of Capital Requirements Regulation (CRR). As a result, EU27 credit institutions and investment firms would be required to apply a prohibitive higher capital treatment to their exposures to UK CCPs. EU counterparties would be in breach of regulatory requirements due to maintaining mandatorily clearable positions in UK CCPs that would no longer be recognized under EMIR. UK CCPs would be prohibited from providing clearing services to EU clearing members or EU trading venues. This could create cliff effects, preclude end-users from managing their risk effectively and increase the cost of clearing. Therefore, to avoid market disruption on Brexit Day One we would urge the Commission to provide recognition or transitional arrangements to UK-based CCPs until such time as the relevant determination has been completed under the Amended Regulation.

In the long-term, as policymakers amend the authorization and supervision of CCPs under EMIR, a bifurcated market triggered by a location policy as proposed has the potential to significantly increase financial stability risks. Post-crisis derivatives reforms have led to improved risk management through netting and collateralization, increased transparency and heightened resilience. These benefits would be reduced if markets were caused to fragment. The financial services market would therefore have to manage additional operational and legal complexity. A successor, or a group of successor EU27-located CCPs, could have fewer or more correlated members across which to mutualize losses. Liquidity pools would be split, reducing access to market liquidity, especially during times of stress. EU clients would also have to weigh the increased cost to clearing versus economic benefits of hedging commercial risks. Such potential cross-border fragmentation would weaken the benefits of the G20 objectives to improve the over-the-counter derivatives markets[3].

EU27 counterparties and financial institutions that would be unable to access third-country CCPs, would restrict them to a smaller liquidity pool without access to non-EU liquidity and creating potentially competitive distortion between EU27 and non EU27 market participants. In some cases, only one EU27-located CCP would be available to clear OTC mandatory clearable products, resulting in no alternative clearing venue available as a back-up. Splitting of portfolios would lead to larger initial margin and default fund requirements, particularly during any transition period. While estimates of the impact vary depending on underlying assumptions, significant costs would be borne

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[3] https://www.g20.org/Webs/G20/EN/G20/Summit_documents/summit_documents_node.html

by end-users and clearing members in the EU and beyond. Any incremental increase in costs would reduce incentives to clearing.

Any EU action that may lead to requiring the relocation of CCPs might give rise to similar actions from other jurisdictions, causing further fragmentation. For example, the CFTC's Chairman Giancarlo has noted that: "Given the closeness of the US and European derivatives markets, what Europe chooses to do on the supervision of CCPs undoubtedly will inform the evolution of US regulatory policy for cross-border swaps clearing."[4]

Many jurisdictions use enhanced oversight arrangements to provide for effective risk mitigation without fragmenting markets. We welcome the EC's proposals in this respect, and respectfully urge the Commission to make use of this approach as a priority in seeking to achieve its regulatory objectives. GFMA supports a model of joint supervision coupled with appropriate and proportionate forms of deference supported by the G20 and outlined by the Financial Stability Board[5]. Examples of the ways other oversight institutions organize the oversight of CCPs that have proven to foster stability include that the United States (U.S.) does not require CCPs clearing substantial volumes of USD-denominated products to be located in the U.S. Instead non-U.S. CCPs performing swaps clearing for U.S. persons register with the CFTC, in order to provide appropriate regulatory access and oversight. In addition, many Asia Pacific currencies are also successfully cleared at foreign CCPs, despite differences in time zone, language and law. For example, 89% of AUD interest rate swaps are cleared outside of Australia.

At the appropriate stage, in the event of a "substantially systemic" determination, the enhanced regulatory framework would need to provide for transition arrangements to avoid market disruption or abrupt loss of access to clearing services for clients. Clearing members and end-users would face legal, operational, and governance challenges in transferring positions. Sufficient time would be required to plan, communicate and implement to address the following, at least:

- Products: The successor EU27-located CCP may not offer or have authorization for the same contracts as the third-country CCP.

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[4] Remarks of Acting Chairman J. Christopher Giancarlo before International Swaps and Derivatives Association 32nd Annual Meeting, Lisbon, Portugal, May 10,2017
http://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo-22

[5] http://www.g20.utoronto.ca/2014/11%20Jurisdictions%20ability%20to%20defer%20to%20each%20others%20OTC%20derivatives%20market%20regulator%20regimes.pdf

- Membership: The successor EU27-located CCP may not have the same clearing members as the third-country CCP requiring new clearing arrangements to be negotiated.
- Coordination: The move would need to be coordinated across all market participants. Particular consideration should be given to how to deal with existing positions, to ascertain whether it is in the market interest to move these positions or allow them to roll off naturally, and over what timeframe. Transferring positions from one CCP to another would require trades to be closed out at the third-country CCP and reopened at a successor EU27-located CCP. Each counterparty would need to find offsetting positions to trade out of the existing CCP, and to reopen positions on the successor CCP. Systemic risk could increase for the duration of the transfer.
- Governing law and jurisdiction: Client consent would be required to move client positions. The transfer of client positions and clearing members' own positions from a third-country CCP to and EU27-located CCP whose rulebooks have different governing law and jurisdiction provisions, and contain differing rights and obligations, would be legally and logistically complex.
- Capacity: The successor EU27-located CCP must have capacity to accommodate an influx of positions. In addition, clearing members would also need to have capacity to accommodate the positions given the impact that relocation would have on their leverage ratio requirements.

The above transitional arrangements, are mitigants to address only the short-term risks of a "substantially systemic" determination, not the long-term risks of market fragmentation.

We value this opportunity to provide feedback to European Commission and remain available to provide further information on any of the above matters. Please contact Allison Parent, (aparent@gfma.org), with any inquiries.

Sincerely,

Allison Parent

Allison Parent
Global Financial Markets Association
Executive Director