

23rd February 2015

**EACH response to IOSCO consultation report
'IOSCO Task Force on Cross-Border Regulation'**

1. Introduction

The European Association of CCP Clearing Houses (EACH) represents the interests of CCPs in Europe since 1992. EACH currently has 20 members from 16 different European countries. EACH is registered in the European Union Transparency Register with number 36897011311-96.

EACH welcomes the opportunity to provide our views on the IOSCO consultation report '**IOSCO Task Force on Cross-Border Regulation**'.

EACH supports mutual recognition between jurisdictions based on the CPMI-IOSCO Principles for Financial Market Infrastructure ("PFMIs") and an outcome-based approach to recognising the regulatory framework in foreign jurisdictions. Such approach will ensure that market participants have access to the services of CCPs, regardless of the jurisdiction where they are established and it will also enhance cross-border access as well as preserving competition. As it is clear that CPMI-IOSCO standards are not detailed, EACH would support more comprehensive international standards that are implemented consistently in the various jurisdictions.

There are various recognition and exemption frameworks that regulators currently use to grant foreign CCPs access to domestic markets. Generally, this cross-border access has been granted through substituted compliance which relieves foreign CCPs of some host-country compliance requirements based on an assessment against home-market regulation with *de facto* the same effect. Substituted compliance typically requires the establishment of bilateral memoranda-of-understanding (MOUs) and information-sharing agreements between the home and host relevant authorities. Recognitions and exemptions have helped connect market participants globally thereby increasing market liquidity and efficiency.

2. Current Challenges in cross-border recognition of exchanges and CCPs

CCPs seeking recognition or exemptions to offer services to market participants in foreign jurisdictions often face very divergent initial application and recognition processes, as well as ongoing obligations. The implementation of the G20 reforms on the OTC derivatives markets has also created not only new challenges, but real difficulties for CCPs seeking to access multiple foreign markets or continue to offer services to existing participants, located in different jurisdictions where prudential rules for CCPs have been implemented differently, and which could *de facto* have extraterritorial effects. As a result of this, entities that previously were not regarded as "doing business" in a foreign jurisdiction could now fall

under that jurisdiction's regulatory regime and may have to comply with their standards in addition to their respective standards in their home jurisdiction. The negative impacts of this approach have been well-articulated by a number of significant financial market stakeholders.¹ This additional compliance implies that CCPs that desire to operate in several jurisdictions now have to be found "compliant" not just with one global standard but numerous rules from different jurisdictions.

Cross-border recognitions have been tied to other aspects of regulation such as bank capital rules under Basel III or the definition of products under other market regulations, which have become increasingly important in the wake of the G20 reforms. Delays and complexity around cross-border recognition create uncertainty for markets and all market participants including commercial end users that depend on derivatives markets to effectively manage price risk.

3. CCP examples

Recognition and equivalence

CCPs from jurisdictions around the world are also facing pressing challenges relating to recognition and equivalence while reciprocity needs to be ensured. Under the new Basel III rules, CCPs need to obtain QCCP status in order to offer favourable capital treatment to clearing members and clients for their exposure to CCPs and remain viable from a bank capital perspective. EACH members acknowledge and welcome the significant contribution that the European Market Infrastructure Regulation (EMIR) has made to increase the stability in derivatives markets. We however note that the delays in the EMIR equivalence and recognition process cast some doubt about the potential to fully enjoy the benefits of the EMIR, as the capital treatment of a QCCP under the EU rules is tied to recognition of non-EU CCPs under EMIR.

It should also be noted that the Basel document 'Capital requirements for bank exposures to central counterparties'² contains a very clear statement regarding the approach of national regulators to determining a QCCP status i.e. they should do it according to the national rules consistent with the PFMI regulation (See Annex 4, section I,A).

Concerns about the criteria for recognition have been raised in the EU and U.S., as well as in other jurisdictions of Asia Pacific, where in some cases CCPs are encountering opaque application and/or recognition criteria in other regions as well, including the Asia-Pacific. It is proving difficult for many CCPs, including those from both mature and emerging markets, to comply with multiple sets of standards in order to access foreign markets or retain existing clients.

Collateral segregation rules

A related challenge for CCPs is that collateral segregation rules may be incompatible between jurisdictions due to differences in local bankruptcy laws. This incompatibility requires the pragmatic use of targeted exemptions for clearing members to provide different collateral protection options under different regimes. Additionally, although the CFTC in the US provides

¹ For example, see GFMA, AFME, ASIFMA, SIFMA letter to IOSCO dated 13 March 2014 Re: Recommendations on Foundational Principles for Global Coordination in Cross-Border Regulation.

² <http://www.bis.org/publ/bcbs282.htm>

clear rules for foreign CCPs clearing foreign futures markets for US customers, to date, they have relied on individual No-Action relief rather than creating a comprehensive framework for recognising foreign CCPs for clearing swaps.

Margin standards

Although margin standards for cleared CCP derivatives under EMIR and comparable legislation in other jurisdictions, such as the US Dodd-Frank or the Russian Regulation for CCPs (CBR Regulation 2919) are consistent with the PFMI, they are not identical. Prudential rules, i.e. provisions on margin standards in different jurisdictions may not satisfy an equivalence test if judged on a line-by-line basis. Thus, it is important to take a holistic, outcomes-based approach to assessing equivalence of margin standards to avoid a weaker margin coverage for the CCP from clearing participants and end customers. This could result in margin arbitrage for identical products offered by systemically important CCPs which offer cross border services and potentially result in a flow of business currently cleared in the EU (but also European countries implementing prudential requirements for CCPs identical to EMIR) to other jurisdictions.

The net result of a lack of harmonised international margin requirements will be to encourage the precise type of margin arbitrage that prudent regulators and clearing house operators have long and appropriately avoided.

Trade reporting

The requirements on trade reporting for CCPs are not consistent between EMIR, Dodd-Frank/CFTC and other jurisdictions. EMIR requires all derivatives contracts (i.e. listed and OTC) to be sent to trade repositories, while the scope of the reporting provisions in Dodd-Frank and in the legislation in some other jurisdictions is limited to OTC derivatives contracts only.

4. Uncertainty

The challenges described above generate uncertainty for market infrastructure and market participants possibly leading to a decrease in efficiency:

- Delays in recognition have created uncertainty of market participants and have already lead to regulatory arbitrage in certain cases.
- A lack of cross-border market access influences decisions of market participants. Liquidity is constrained and investors and end users may have to alter their investment or risk management activity.
- Although international standards such as the PFMI have set a base-line for regulatory requirements, different jurisdictions have gone further to apply additional standards. If every jurisdiction applies its additional standards beyond the PFMI as conditions to recognition, it will lead to the implementation of excessively complex and costly regulatory requirements around the world for markets and market participants.

5. Conclusion

The quasi extra-territorial approach applied in some jurisdictions may have negative impact on foreign CCPs' ability to conduct business in such jurisdictions.

Therefore EACH supports the development of international standards that are consistent across different jurisdictions with regard to their approaches to cross-border recognition and recognition procedures on regulator-to-regulator basis. In this respect it is clear that CPMI-IOSCO standards are not detailed, in areas such as liquidation period for margin standards, to be a meaningful baseline for equivalence. **EACH therefore recommends that international standards are more comprehensive, and implemented consistently in the various jurisdictions.**

We support well-developed standards that will promote a level playing field for markets and provide market participants with access to market infrastructures globally. This will contribute to a reduction in market fragmentation create a cost-efficient environment for both market infrastructure and participants, and mitigate the risk of regulatory arbitrage.

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