

24 August 2015

Jonathan Hill, Lord Hill of Oareford
Commissioner
Financial Stability, Financial Services and Capital Markets Union
European Commission
Rue de la Loi / Wetstraat 200
1049 Brussels
Belgium

Dear Lord Hill,

RE: Further delays in EMIR equivalence determinations threatens access to well-regulated emerging markets

The World Federation of Exchanges (“WFE”) is a global trade association that represents 64 publicly regulated stock, futures, and options exchanges, as well as the CCPs operated by our member exchanges. WFE promotes the development of fair, efficient, and transparent markets, and we work with policy makers, regulators, and standard-setters around the world to support the development of effective rules and standards for exchanges and market participants.

WFE’s diverse membership represents both established and emerging markets. Many of these exchanges operate CCPs that have applied to the European Securities Market Authority (“ESMA”) for recognition under EMIR as “Third-Country CCPs” (“TC-CCP”). Our member exchanges, along with our clearing members and market participants, are very concerned with the delays and lack of transparency associated with the European Commission’s (“Commission”) equivalence determinations for many jurisdictions. As you are aware, these determinations are required before ESMA can grant recognition to any individual TC-CCP applicant and, within the EU, the granting of qualified central counterparty (“QCCP”) status for purposes of the specific capital allocation requirements applicable to EU financial institutions under Basel III depends on their recognition by ESMA as a TC-CCP.

Currently, ten CCPs from four jurisdictions (Australia, Hong Kong, Japan, and Singapore) have been recognized as TC-CCPs. However, an additional 31 CCPs from 14 jurisdictions – including emerging markets – are currently awaiting such recognition. Many of these CCPs are based in jurisdictions that have substantially similar or even stronger prudential requirements than the jurisdictions that have been granted equivalence to date. The uncertainty surrounding these markets’ access to European clients and subsidiaries on clear, reasonable, and certain terms is creating significant challenges in these markets.

WFE supports the use of mutual recognition arrangements on the basis of equivalent regulatory outcomes, and believes that such arrangements are an appropriate vehicle for authorities to guard against risk and misconduct without impeding cross-border market activity.¹ However, delays in granting TC-CCP recognition are having a negative impact on CCPs seeking to maintain or grow their relationships with European financial institutions. Furthermore, the delays are threatening to further fragment liquidity in OTC derivatives, which will soon be subject to EMIR clearing obligations. On behalf of its members WFE urges the Commission and other European authorities to expedite these equivalence determinations in order to avoid these negative impacts.

¹ See WFE’s responses to the *IOSCO Task Force on Cross-Border Regulation’s* Consultation Report (23 February 2015) and Roundtable (11 June 2014).

The negative impact of uncertainty and extraterritoriality on third-country CCPs

The concerns mentioned above are relevant to all WFE member markets but are of particular concern for emerging markets. Capital markets are at varying stages of growth and development and their dependency upon external capital flows varies. International financial institutions and international capital flows often play important roles in emerging economies' capital markets. As a result, disrupted access to large overseas financial institutions carries unique risks and costs to emerging market exchanges and CCPs. The imposition of regulatory barriers to foreign businesses seeking to transact in third-country markets (and vice versa) can lead to a rapid depletion of liquidity as capital moves to jurisdictions that are not subject to the same barriers. This effective regulatory arbitrage may result in a reduction of inward foreign exchange flows, which can be very costly to all markets, but particularly jurisdictions that do not have deep and resilient domestic capital markets that can backstop sudden shortfalls. For emerging markets to develop their capital markets, their exchanges and CCPs must be able to maintain, develop and grow their links with financial institutions all over the world. However, the current recognition process means that European participants are uncertain about the regulatory status of many TC-CCPs and their consequent ability to engage in these markets, having a deleterious impact on 'business-as-usual' for these CCPs. The delayed equivalence decisions are therefore compounding the macro-economic risks challenges that these markets already face.

On a more practical level, the delays require TC-CCPs to set aside internal resources for an indefinite period to allow for timely responses to queries related to equivalence decisions. These are resources that are not available for other activities, including business development, and represent an unnecessary cost. Further, the lack of clarity and transparency regarding the process, combined with the absence of a transparent set of guidelines outlining the general TC-CCP recognition procedure limits the ability of applicant TC-CCPs to provide market participant with clear guidance. Finally, it is possible that the nature of the process may deter other third countries, especially emerging markets, intending to seek recognition from European authorities. Hence, not only are current applicants affected by the delay, but potential future applicants may become discouraged from seeking TC-CCP recognition given the present uncertainty.

In addition to delays that threaten market growth and business development efforts, the EU equivalence process has also been marked by the extraterritorial application of European rules to non-EU markets. This is problematic in any circumstance but it is especially inappropriate for well-regulated emerging markets that have implemented the CPMI-IOSCO Principles for Financial Market Infrastructures ("PFMIs") or other stringent market regulations and controls. The post-crisis derivative market reforms that have been led by the G20 were designed in response to the specific types of risk that were identified in developed markets, particularly the risks that built up in OTC markets and were not visible to either market participants or regulators. It is important to note that the types of risk that are present in emerging capital markets are not identical to those found in complex and mature markets. Therefore one-size-fits-all rules for CCPs that fail to consider the particular liquidity dynamics and types of market participants in emerging markets are not conducive to either mitigating risk or encouraging market development. It is therefore neither effective nor appropriate to apply the exact EU standards and rules for CCPs to well-regulated jurisdictions that otherwise adhere to the relevant international principles, including the PFMIs, and where the local rules have been precisely tailored to create the conditions for growth and development.

Fragmentation of liquidity in markets subject to the clearing obligation

The delayed equivalence process in Europe is also threatening to contribute to the fragmentation of liquidity in the global OTC derivatives markets. As discussed above, delayed equivalence will increasingly have the effect of cutting off TC-CCPs from European market participants. In addition, given that EU clearing obligations are expected in the first half of 2016 and EU entities are now making decisions about those clearing arrangements and obligations, it is problematic that many TC-CCPs from well-regulated jurisdictions are not yet eligible for use by EU counterparties.

This threatens to lead to a re-allocation of derivatives trading activity and liquidity away from markets that have not received equivalence determinations. The likely impact is that, without timely decision-making on equivalence, existing pools of liquidity in OTC products that are traded and cleared on a cross-border basis will fragment along the lines of equivalence jurisdictions. Such an outcome will lead to competitive distortions caused by a lack of effective and timely decision making, and would exacerbate the liquidity and foreign exchange risk that emerging market CCPs are facing. This could harm the stability and health of the global markets. Moreover, it would be undesirable from the perspective of the G20 mandates, which aim to promote clearing of standardized and liquid derivatives and to ensure that counterparties have access to well-regulated CCPs, and to coordinate these mandates on a cross-border basis to ensure their harmonized and non-disruptive application.

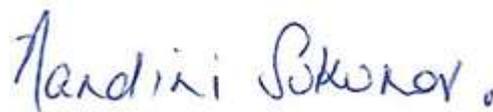
In summary, WFE's members are increasingly concerned about the European Commission's equivalence decision-making process relating to TC-CCPs. As a result of delays and the extraterritorial application of rules CCPs, and in particular emerging market CCPs, face challenges to the viability of their current and future operations. Moreover, the potential for liquidity fragmentation will generate capital flight risks for emerging markets and will present the global economy with less efficient and effective capital markets. As a result of these negative impacts, WFE considers that the European authorities should seek a prompt resolution of equivalence decisions relating to TC-CCPs' applications, on a reasonable, transparent, and certain basis, without the unnecessary imposition of EU requirements on an extraterritorial basis. Furthermore, WFE urges the European authorities to expedite this process, so that TC-CCPs that have applied for EU recognition can continue to clear trades for European clients and grow and develop their own markets.

We thank you for your consideration of these issues and would be pleased to discuss them in greater detail. Should you have any questions or comments, please do not hesitate to contact me at nsukumar@world-exchanges.org or +44 207 151 4156.

Sincerely,



Juan Pablo Cordoba
Chairman
The World Federation of Exchanges Ltd.



Nandini Sukumar
Chief Executive Officer
The World Federation of Exchanges Ltd.