



Alternative Investment
Management Association

AIMA's summary of comments on concerns regarding the third country provisions of EMIR

The European Commission in September 2010 published its European Market Infrastructure Regulation (EMIR) proposal, which seeks to implement the G20 commitments on clearing and reporting of OTC derivatives, in a similar (but not same) style to Title VII of the Dodd-Frank Act.

AIMA supports the main aim of EMIR, the reduction of counterparty credit risk in the OTC derivatives market; however, AIMA is particularly concerned with, and wishes to bring to the CFTC's attention, Article 23 of EMIR, which deals with the recognition of third country CCPs (including those established and regulated in the United States), and potentially providing clearing services to European entities. Article 23 provides that "A CCP established in a third country may provide clearing services to entities established in the [European] Union only where that CCP is recognised by ESMA", and that to gain such recognition:

- The CCP must be subject to 'equivalent' regulation in its home country;
- The CCP must be subject to 'effective' supervision in its home country; and
- The CCP's home country must sign a cooperation agreement with the European Securities and Market Authority (ESMA).

Although the EMIR negotiations have not been finalised, there are some developments in the negotiation process that we wish to draw to your attention, as discussed in our meeting. AIMA believes that the third country provisions are of potential concern for two primary reasons:

1. Process of recognition of third country CCPs

Werner Langen, the European Parliament rapporteur on EMIR, has proposed that third country CCPs comply with **all of the EMIR authorisation requirements** (including Article 13, which requires, as a condition of authorisation with a Member State competent authority, that the CCP complies with all requirements of EMIR). This is a departure from the principles of recognition of CCPs based on the equivalence mechanism as proposed by the European Commission.

Furthermore, given the potential for divergence of the EMIR provisions from the current regulatory framework contemplated in the US (by the Dodd-Frank Act) and other financial centres, even the equivalence mechanism as proposed by the European Commission may not be sufficient to ensure access to non EU CCPs by European entities. A variety of examples have been raised where an equivalence decision may not be given by ESMA to third country CCPs, which include differences in:

- CCP requirements and criteria for participation (e.g., in relation to the required capital commitment - control by individual institutions vs. a principle of greater mutualisation of losses);
- treatment of client margin, and segregation requirements or options regarding that margin;
- treatment and possible exemption from clearing for intra-group transactions;
- operational requirements (e.g., composition of CCP risk committees and buy-side involvement or representation in those committees); and
- ex ante commitments by central banks to provide CCPs with liquidity support (strongly advocated for by many Member States and MEPs).

Potential impact: The requirements of EMIR are designed to deal with CCPs in Europe. Many of the global CCPs, including non-derivative CCPs (and emerging market vehicles), are likely to be unable to comply with all of the requirements of EMIR due to inconsistent, differing and/or conflicting provisions. As such, depending on how ESMA and the European Commission interprets, structures, or generally executes "equivalence" recognition, there is a danger that some global CCPs may not be recognised.

Proposed solution: Ensure that it is the equivalence mechanism as proposed by the European Commission rather than a full compliance with EMIR or duplicative authorisation with local EU Member States competent authorities which is the process whereby third country CCPs are authorised to provide clearing services to European entities. Clarify the equivalence mechanism so that the focus of recognition is on reaching equivalent effects or regulatory objectives, rather than demanding identical or near identical regulatory criteria.

2. Scope

- The provisions in the European Commission draft **applies to all CCPs** - those clearing OTC derivatives, but also those connected to national exchanges clearing exchange traded derivatives, equity securities, bonds and other financial instruments. Some MEPs and EU Member States are arguing for a narrower scope, but there is an equally strong group of EU Member States and MEPs favouring this wider scope.

Potential impact: the European Commission and ESMA would need to undertake a lengthy process of recognising all global CCPs, not just OTC derivative CCPs, wherever EU entities may trade.

- The provisions apply to third country CCPs providing services to **entities established in the European Union** - thus, potentially, even when trades are conducted outside of Europe by European entities, their clearing requirements can only be met by third country CCPs that meet EMIR's requirements and are recognised by ESMA.

Potential impact: EMIR would impose requirements on EU entities such that wherever they trade in the world (including on US markets), EMIR would set rules about which CCPs they may or may not use.

Proposed solution: *Either restrict the scope of the entire Regulation to OTC derivatives, or restrict the scope of the provisions related to the equivalence mechanism. Redraft the equivalence provision so that it applies to CCPs intending to provide clearing services in the European Union.*