

Mr. Christopher Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

20 September 2019

Dear Mr Kirkpatrick,

Re: Proposal on the Registration with Alternative Compliance for Non-U.S. Derivatives Clearing Organizations (RIN 3038-AE87) and Proposal for the Exemption from Derivatives Clearing Registration (RIN 3038-AE65)

We write to you in respect of two proposals related to non-U.S. DCOs and their supervision. As the comments in this letter are relevant to policies common to the two proposals, it will be submitted to both comment files.

The World Federation of Exchanges (WFE) is the global trade association for regulated exchanges and clearing houses. We represent over 250 market infrastructure offerings, spread across the Asia Pacific region (~37%), EMEA (~43%) and the Americas (~21%). This includes over 100 distinct CCP clearing services, with everything from local entities in emerging markets to stand-alone CCPs based in major financial centres.

As operators of critical market infrastructure, we share regulatory authorities' goals of ensuring the safety and soundness of the global financial system, which is critical to enhancing the confidence of investors and citizens and promoting economic growth. This includes ensuring a sound and robust regulatory regime for CCPs.

The WFE welcomes well-designed international efforts to enhance the resilience of the financial system and supports proportionate initiatives contributing to that objective. Markets are increasingly global and regulatory architecture and practices should reflect this fact in a manner that supports the objectives of economic policy and financial supervision.

We believe society derives significant benefits from integrated financial markets. It is therefore important to have strong common principles and co-ordinating mechanisms to promote financial integration and market integrity. This is fundamental to well-functioning and safe markets at local and global levels.

We believe that the G20-endorsed approach of regulatory deference should be a guiding principle in the area of cross-border supervision of CCPs. Approaches of regulatory deference have a long history of allowing market participants across the globe to effectively and efficiently hedge their business risk. G20 leaders have strongly endorsed this approach, embodied in the September 2013 declaration "*that jurisdictions and regulators should be able to defer to each other when it is justified by the quality of their respective regulatory and enforcement regimes, based on similar outcomes.*"¹ Speaking about the regulatory framework for clearing activities (including location policies for CCPs), CPMI-IOSCO has warned "*in some cases the manner in which reforms have been implemented may have led to some fragmentation.*"² In addition, the Financial Stability Board (FSB) has noted that market fragmentation as one of its top priorities and has recently published a report describing its upcoming efforts.³ As with any jurisdiction, we also acknowledge the legitimate interests of the CFTC in ensuring the systemic stability of the financial system of the U.S.

International comity is a fundamental building block of safe and efficient global financial markets. We welcome the establishment of Crisis Management Groups to facilitate information-sharing amongst interested supervisors

¹ [G20 Leaders' Declaration](#), September 2013.

² CPMI-IOSCO, [Market Fragmentation & Cross-border Regulation](#), June 2019.

³ FSB, [Report on Market Fragmentation](#), June 2019.

in the event of market stress. We have furthermore supported the significant efforts that went into establishing the regime for EU-U.S. co-operation in respect of CCPs with cross-border activities.

We welcome the CFTC's impetus to consult upon and codify practices that further embrace an approach of regulatory deference which have until now been undertaken more informally for U.S. customers accessing cleared swaps markets overseas. We appreciate that the CFTC regulatory framework for U.S. customers accessing foreign (i.e., non-U.S.) futures and options on futures that has been in place for decades embraces an approach of regulatory deference by providing U.S. customers access to these markets on the basis of comparability determinations. We believe that a similar approach for cleared swaps can help to avoid unnecessary market fragmentation and agree with the sentiments expressed in *Cross-border Swaps Regulation 2.0*:⁴

Fragmented markets are shallower, more brittle, and less resilient to market shocks, thereby increasing systemic risk rather than diminishing it. Such fragmentation of global swaps markets is neither prescribed by the G20 swaps reforms nor justified as an unavoidable by-product of global reform implementation. In fact, market fragmentation is not only incompatible with global swaps reform efforts, but also detrimental to them.

We furthermore believe that enhanced transparency in regulation strengthens the business planning of CCPs and their stakeholders, including their ability to comply with regulations and do so in an efficient manner. While we have some suggestions to improve the risk-sensitivity of these proposals, we support their general thrust, including to the extent that clear thresholds are helpful in promoting transparency.

We note that there are many international agreements that pertain between regulatory authorities in respect of financial institutions and CCPs. These include, for example: memoranda of understanding (or similar information sharing agreements); specific agreements related to financial markets (e.g., the EU-U.S. cooperation agreement in respect of CCPs); and resolution and resolvability planning and assessments (as provided for in relevant regulation). Such agreements may go some way address financial stability concerns. In this context, WFE strongly welcomes the significant efforts have gone into ensuring better U.S.-EU cooperation in the area of financial market regulation such as the establishment of the U.S.-EU Joint Financial Regulatory Forum. We wholeheartedly agree with the joint statement following the most recent Forum, published by the U.S. Treasury Department, which states:⁵

"Given the global nature of financial markets... [a] cooperative approach to the supervision and regulation of financial services should foster financial stability, investor protection, market integrity, and a level playing field."

We hope these ambitions are realised and that any brinkmanship and consequent negative impact on financial markets and their end-users is avoided in relation to the implementation of these reforms.

Executive Summary

We recognise that the proposed rules seek to balance the principle of regulatory deference with authorities' objectives related to financial stability. We believe that for most non-U.S. CCPs, there will not be a case for their posing substantial risk to the U.S. financial system. Meanwhile, those that may be considered as posing a substantial risk to the U.S. financial system should enjoy a regime that is fair, transparent, predictable and non-distortive with respect to market dynamics nor the competitive environments in which the market infrastructures operate.

We respectfully ask that you consider the following suggestions as these rules are further developed:

- Recalibrate the operation of threshold tests to enhance risk-sensitivity;

⁴ J. Christopher Giancarlo, [Cross-border Swaps Regulation 2.0](#), CFTC, October 2018.

⁵ [Joint Statement on the U.S.-EU Financial Regulatory Forum](#), July 2019.

- Add a nuance to the consideration of the potential impact of stress at a clearing member to their U.S.-parented entity and the U.S. financial system;
- Introduce procedures for communication with a CCP and its home state supervisor to promote fairness and due process;

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Risk-sensitivity

Departing from the international principle of regulatory deference should only be required if there is a clear and truly substantial risk to the financial stability of the host-authority jurisdiction. In line with this, it is of crucial importance that determinations of substantial systemic importance to the U.S. financial system are risk-based. We recommend modifying the proposed threshold test and introducing nuance to the consideration of the potential impact on the U.S. financial system of a branch or subsidiary of a U.S.-parented entity.

Thresholds

We believe the threshold set at “20% or more of the required initial margin of U.S. clearing members for swaps across all registered and exempt derivatives clearing organizations” to be a logical risk-based indicator. Though we understand the CFTC’s concerns regarding potential contagion to U.S. FCMs, the extent to which the threshold set at “20% or more of the initial margin requirements for swaps at that derivatives clearing organization is attributable to U.S. clearing members” captures this is less clear. Indeed, a small CCP in a market with substantial foreign participation, as is the case for many emerging markets, could meet this threshold without posing a substantial risk to the US financial system.

If the CFTC proposal were to determine substantial risk based strictly on exceeding *both* thresholds, the second threshold would be less problematic. However, because the proposal allows for discretion where even just one of the thresholds is close to 20%, an overly wide cohort of non-U.S. CCPs are in potential scope. To improve the threshold tests, we recommend prioritising the first threshold, related to initial margin from U.S. clearing members as a percentage of overall initial margin for swaps across CCPs, such that the second threshold is only tested when the first threshold is breached.

Furthermore, we feel that discretion should be introduced in the case that the thresholds are reached, but the CFTC is able to determine based on other qualitative and quantitative factors that substantial risk is not posed to the U.S. financial system, or that such a risk has been mitigated by other means. Such discretion would help avoid the cliff-edge effect associated with an automatic trigger.

Introducing such discretion would mean that meeting the threshold tests would trigger a more comprehensive assessment and determination, which could involve appropriate discussions and/or potential remedies being agreed between jurisdictions to avoid full DCO registration for a given non-U.S. CCP or providing for full DCO registration relying on a framework of substituted compliance, as is the case for EU CCPs that are dually registered with the CFTC.⁶ We believe that this suggestion, taken together with proposals we made to European authorities concerning the implementation of EMIR 2.2, could offer a means of converging the approaches of U.S. and EU authorities in a satisfactory manner.⁷

Meaning of U.S. clearing member

We welcome that the threshold tests include clearing members that are U.S. domiciled or registered futures commission merchants, but have some concerns with the undifferentiated inclusion of clearing members with U.S.-parent entities in the definition of U.S. clearing member. We feel that in making an ultimate determination

⁶ [Comparability Determination for the European Union: Dually-Registered Derivatives Clearing Organizations and Central Counterparties](#), 81 Fed. Reg. 15260, CFTC, March 2016.

⁷ Specifically, we suggested that the large cohort of CCPs not systemically relevant to the EU designated Tier 1 under EMIR 2.2 on a prima facie basis (e.g. based on information contained in the PFMI disclosure framework), and the decision to open a tiering assessment should be triggered a dialogue with the CCP’s home state supervisor. Given the differences in scope between the EU and U.S. proposals with respect to products covered, consideration may be due to realizing convergence the non-U.S. DCO regime in respect of futures and options.

concerning substantial risk, greater nuance could be introduced to make the indicator appropriately risk-sensitive. In particular, we feel there are additional considerations that bear on the potential risk to the U.S. financial system, related to the legal organization and recovery and resolution planning of U.S.-parented clearing members. These have an important relationship to the potential impact of stress in a branch or subsidiary to the parent organization.

Much progress has been achieved in the post-crisis regulatory reform efforts to reduce contagion within systemically important banking groups, enhance recovery procedures and to ensure their orderly resolution if appropriate. This has included costly measures to introduce intermediate holding companies and to subsidiarise branches with separate capitalisation. Systemically important banks must prepare recovery plans and publish their living wills (resolution plans), using either a single-point-of-entry or multiple-point-of-entry strategy. The adequacy of these plans and how they are proposed to be discharged has a clear impact on the extent to which a clearing member with a U.S. parent would pose risk to the U.S. financial system. Therefore, we propose that in making a determination of substantial risk to the U.S. financial system, the CFTC duly consider clearing members' legal organization (including with respect to separate capitalisation) and parent organization recovery and resolution plans.

Fairness and due process

As described, jurisdictions around the world have rightly made considerable efforts to identify systemically important financial institutions and to put in place regimes to address associated risks. The regimes managing such risks may involve regulatory add-ons, increased oversight and other material conditions, resulting in a significant compliance differential between designated and non-designated financial institutions. Because of the implications these regimes can have in terms of cost, competitive dynamics, shareholders' property rights and management responsibilities, it is essential that the process for determination of systemic importance is characterised by predictability, fairness and due process.

We believe that fairness and due process could be enhanced by introducing a series of formal milestones for communication and decision-making related to determinations of a non-U.S. CCP's substantial risk to the U.S. financial system for its clearing of swaps:

Prior to determination: When a CCP is determined to have neared or breached a relevant threshold, there ought to be an early discussion with the CCP and its home supervisor.

During determination: Requests for further information or clarification of stipulated information should generally be made in a reasoned manner and with appropriate timescales; CCPs should have the possibility to raise process concerns with U.S. authorities.

Following designation: The determination of a CCP as posing substantial risk to the U.S. financial system should be accompanied by a communication outlining the relevant factors taken into consideration in said determination. Should a CCP believe that the process leading to designation be flawed, there ought to be a right of appeal on the basis of an error of law or fact.

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Conclusion

We broadly welcome these proposals and recognise the challenge in striking a balance that adheres to G20 commitment to regulatory deference while giving U.S. authorities the appropriate tools to support the financial stability of the country. However, we believe improvements can be made to the risk-sensitivity of the U.S. approach and to procedures related to fairness and due course. The WFE and its members stand ready to work with U.S. authorities to achieve the goals of the G20 commitments. The Federation would welcome the opportunity to arrange a discussion about our members' thinking and priorities, and remains at your disposal should that be helpful.

Thank you for your consideration of the contents of this letter.

Yours sincerely,

A handwritten signature in blue ink that reads "Nandini Sukumar". The signature is written in a cursive style with a small circle at the end of the last word.

Nandini Sukumar

Chief Executive Officer