22 June 2015

Jonathan Hill
Commissioner
Financial stability, Financial Services and Capital Markets Union
European Commission

By email: Jonathan.hill@ec.europa.eu

Dear Commissioner Hill,

RE: EMIR Article 13 and MiFIR Article 33 – Equivalence in the context of Clearing, Margin, Reporting and Trading requirements for OTC derivatives transactions. Potential negative impact on access to non-EU markets by EU institutions.

We, the undersigned associations, are writing to you in the context of the ongoing implementation of the European Market Infrastructure Regulation (EMIR), the Markets in Financial Instruments Regulation (MiFIR) and their implications for active participants in the derivatives markets operating in non-EU jurisdictions and/or with non-EU counterparties.

We acknowledge and applaud the efforts by the European Commission (EC) to deliver positive equivalence determinations for jurisdictions where non-European central counterparties (CCPs), which provide services to EU firms, are established. We urge the EC and the European Securities and Markets Authority (ESMA) to work closely in order to grant recognition to these non-EU CCPs at the earliest possible time. We welcome the recent recognition of 10 third-country CCPs established in Australia, Hong Kong, Japan and Singapore.

As stated in a previous letter to Commissioner Barnier in the context of the implementation of Article 25 of EMIR, as our members engage in cross-border transactions in the derivatives markets, we, the undersigned organisations strongly believe in the need to achieve a regulatory level playing field across jurisdictions. In the context of EMIR and MiFIR, we would like to emphasise our concerns regarding the need for positive equivalence determinations under EMIR Article 13 and MiFIR Article 33 for the purposes of avoiding duplicative or conflicting requirements for clearing (EMIR Article 4), reporting (EMIR Article 9), the treatment of non-financial counterparties (NFCs) (EMIR Article 10), risk mitigation techniques for non-cleared trades, including, in due course, margin requirements (EMIR Article 11), and trading on regulated markets, multilateral trading facilities and organised trading facilities (MiFIR Article 28).

The absence of equivalence decisions, particularly for the purposes of clearing and margin requirements, could put the international operations of many of our respective member firms at a competitive disadvantage by requiring, for example, that margin be posted and collected multiple times. Such an outcome would harm not only European banks but their clients too, many of which are major European corporates that make significant contributions to outbound and inbound trade and investment flows from Europe to non-EU markets.

Practical application of equivalence

Therefore, we request that the EC confirm that it agrees with our interpretation of the application of equivalence determinations under EMIR Article 13 and MiFIR Article 33 as discussed below, and

further clarify the practical application mechanics of equivalence. We also encourage the EC to work closely with regulators in third countries as it develops plans for equivalence decisions. In particular, with regards to rules governing the margining of non-cleared derivatives, we believe it would be helpful to raise these issues as part of the cross border sub-group for the IOSCO/BCBS Working Group on Margin Requirements ("WGMR").

We understand that an EC equivalence decision under EMIR Article 13 or MiFIR Article 33 would effectively mean that counterparties entering into a transaction subject to EMIR or MiFIR will be deemed to have fulfilled the obligations contained in EMIR Articles 4, 9, 10 and 11 or MiFIR Article 28 where at least one of the counterparties is established in a third country declared equivalent. However, it is not fully clear how this principle would apply in practice to trades with counterparties established in, and/or subject to the rules of, an equivalent jurisdiction (particularly an equivalent jurisdiction in which neither counterparty is established).

First, the undersigned associations would appreciate confirmation from the EC that when EU counterparties trade with counterparties established in, or subject to the rules of, an EMIR Article 13(2) or MiFIR Article 33(2) equivalent jurisdiction, the parties are permitted to mutually agree which set of equivalent rules would apply to a particular trade between them, based on considerations such as the jurisdictional nexus of the trade and any other rulesets to which the counterparties are subject. This flexible, pragmatic approach would allow for situations where EU firms entered into transactions with counterparties that are obliged to comply with another ruleset – for example, where an EU-counterparty trades with a non-US entity that is majority-owned by US investors (including an investment fund), which is treated by the CFTC as a US Person regardless of where it is established, the parties would need the ability to defer to US rules.

Second, the undersigned associations also believe that EMIR Article 13(3) should each allow for separate equivalence acts to be adopted regarding the obligations contained in EMIR Articles 4, 9, 10 and 11, instead of a single all-encompassing equivalence act. The undersigned associations would appreciate confirmation of this approach.

Third, we would believe that any assessment of equivalence for the purpose of EMIR Article 13 should follow an outcomes-based approach.

Lastly, unlike with EMIR Article 25, where the equivalence process was triggered by the submission of an application by a CCP, EMIR Article 13 and MiFIR Article 33 do not provide any guidance with regards to the process or timeline for the delivery of equivalence decisions. As a result, we believe that while the EC should seek to engage with third country regulators, it should not be a requirement for third countries to have to apply for an EC equivalence determination. We would appreciate further guidance on the expected timeline for EC equivalence, and while we understand that the EC has been considering EMIR Article 25 to be the priority, we consider EMIR Article 13 and MiFIR Article 33 equivalence decisions to be of equal importance.

Given EU firms and some of their EU or non-EU counterparties are active in most major markets across Africa, the Asia-Pacific region, the Middle East, Latin America, Switzerland and the US, we are particularly concerned that the absence of such equivalence decisions could have significant negative impacts on the provision of financial services in, and effective functioning of, those markets to local players, EU firms, their EU and non-EU counterparties, and also to European clients looking to access overseas markets. This is of particular concern for third country entities which do not benefit from exemptions granted to EU entities of the same nature, e.g. pension funds, which would have to look therefore to a local exemption plus an equivalence determination.

The absence of equivalence will harm the financial market

The lack of substantive convergence between the rules of different jurisdictions and the absence of equivalence determinations will act as an incentive to market participants to focus their trading activity in their local markets (so that they are not subject to conflicting and/or duplicative rules). This will likely result in increased trading costs as a result of liquidity fragmentation, loss of market efficiencies and ultimately damage to the real economy. We do not believe this is an intended policy outcome.

Intragroup exemption

Furthermore, ISDA and FIA Europe are supportive of the EC's (and ESMA's) continued efforts to identify an approach for allowing financial counterparties to benefit from the EMIR intra-group exemption from the clearing obligation in respect of transactions with third-country entities in the absence of an equivalence decision. We also believe that a similar approach should be used to allow counterparties to benefit from the intra-group exemption from margin requirements in respect of non-cleared transactions with third-country entities in the absence of an equivalence decision.

We reiterate our full support to the ongoing efforts of regulators globally to implement the G20 commitments on derivatives reform. We strongly believe the WGMR has proven to be a fruitful forum, as demonstrated by the existence of internationally agreed margin principles. However, while we appreciate the difficulties associated with determining equivalence when not all rule sets are in place, we respectfully urge the EC to adopt a pragmatic approach to the equivalence process and to be mindful of ongoing efforts by non-EU regulators to implement G20 reforms and continue open regulatory dialogue and coordination to achieve a level playing field.

We would be happy to discuss this further with your team at your earliest convenience or to answer any questions you may have on this topic.

With kind regards,

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