ISDA Safe, Efficient Markets

Commissioner Mairead McGuinness

Directorate-General for Financial Stability, Financial Services and Capital Markets

European Commission

1049 Bruxelles / Brussels

Belgium

27 September 2021

Dear Commissioner McGuinness,

**Equivalence under Article 13 EMIR**

ISDA would like to raise with the European Commission its concerns regarding the equivalence regime under Article 13 of Regulation (EU) No 648/2012 (EMIR)[1] and the equivalence decisions made under that regime to date.

ISDA and its members are appreciative of the work carried out by the European Commission so far to adopt equivalence decisions for key non-EU jurisdictions. However, there are aspects of these equivalence regimes (and their interpretation) which adversely impact their usefulness in practice. We consider that Article 13 equivalence should both ensure that derivatives business involving EU market participants is covered by appropriate regulatory requirements (such as clearing and collateralisation requirements) and enable EU market participants to compete with their counterparts from and in other jurisdictions without having to comply with duplicative or conflicting regulatory requirements.

ISDA and its members have identified that, in the case of a number of jurisdictions covered by Article 13 equivalence decisions, only the first of these aims is achieved.

In particular we would like to draw your attention to the following concerns:

- The potential effect of the word "established" in Article 13 EMIR and any equivalence decisions made under Article 13;
- The requirement for "at least one counterparty" to be both established in the US and considered a Covered Swap Entity in the Article 13 equivalence decision for the US Prudential Regulators (and similar requirements in other equivalence decisions);

[1] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32020D1308&from=EN

- Application of intragroup exemptions under EMIR and CRR that are dependent on Article 13 equivalence.

**About ISDA**

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has more than 960 member institutions from 77 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org. Follow us on Twitter @ISDA.

## 1. Executive summary

- The uncertainty regarding the effect of the word "established" in Article 13 EMIR (and in equivalence decisions made under Article 13) may give rise to an unlevel playing field for EU firms that are subject to equivalent obligations in a third country (regardless of the jurisdiction of establishment of their counterparties) without being "established" in that jurisdiction. We would ask the Commission to **consider amending Article 13 EMIR to clarify that an EU firm may rely on an equivalence decision where at least one counterparty is either established or subject to equivalent requirements in a third country**.
- We would also ask the Commission to **consider amending the equivalence decision for the US Prudential Regulators so that EU firms may benefit where at least one counterparty is considered a Covered Swap Entity** even if neither party is "established" in the US, to avoid a situation where EU firms that are Covered Swap Entities (but that are not "established" in the US) are unable to benefit from equivalence while US Covered Swaps Entities dealing with EU clients can benefit.
- We note that these areas of uncertainty do not only affect the availability of exemptions under Article 13, but also the availability of other exemptions that cross-refer to Article 13 EMIR, including the intragroup exemptions from margin and clearing under EMIR and the intragroup exemption from CVA under CRR.

## 2. The effect of the word "established" in Article 13 EMIR

Article 13 EMIR provides that an implementing act on equivalence in relation to a third country shall imply that counterparties entering into a transaction subject to EMIR shall be deemed to have fulfilled the obligations contained in Articles 4, 9, 10 and 11 "where at least one of the counterparties is established in that third country".

If this term is interpreted to mean "incorporated" then there will be situations where a transaction is subject to duplicative and conflicting rules because a counterparty is subject to the rules of a non-EU jurisdiction, but the equivalence decision for that jurisdiction does not provide relief because neither party is incorporated in the relevant jurisdiction. Two examples where this situation may arise in practice are:

- Where the relevant non-EU jurisdiction applies equivalent obligations to those under EMIR to foreign entities with a branch in the relevant jurisdiction. For example, this is the case in Hong Kong. So an EU entity with a Hong Kong branch would be subject to obligations both under EMIR and under Hong Kong law, regardless of the jurisdiction of its counterparty. The EU entity would not be able to rely on the equivalence decision for Hong Kong when dealing with counterparties in other jurisdictions as neither party is incorporated in Hong Kong.
- Where the relevant non-EU jurisdiction applies equivalent obligations to those under EMIR to foreign entities that are connected with the relevant jurisdiction. For example, the US regulators apply equivalent obligations to foreign entities with no local presence if they have a US affiliate or if they carry on business with local entities that requires them to be registered or authorised under local law. In this case, an EU entity may be subject to obligations both under EMIR and under US law, again regardless of the jurisdiction of its counterparty. The EU entity would not be able to rely on any of the equivalence decisions for the US regulators when dealing with counterparties in other jurisdictions, as neither party is incorporated in the US (nor does either party have a branch or any place of business in the US).

**In both cases the Article 13 equivalence decision may give rise to an unlevel playing field between EU firms that are also subject to obligations under Hong Kong or US law (who would not be able to rely on the equivalence decision), and firms incorporated in Hong Kong or the US who deal with EU counterparties (who would be able to rely on the equivalence decision).**

In order to give effect to the intent of Article 13 (which was to remove the problems associated with duplicative or conflicting obligations, while also preventing a regulatory 'gap' where relationships involving an EU counterparty would not be covered by appropriate regulatory requirements) we would welcome:

(i) amendment of Article 13(3) EMIR so that it reads "…where at least one of the counterparties is established in *or subject to the equivalent requirements of* that third country"; and

(ii) pending such change being made[2], confirmation that Article 13 EMIR and any equivalence decisions made under Article 13 may be interpreted as meaning that a counterparty will benefit from equivalence where they have sufficient connection

[2] We are aware that, unfortunately, the next review of the Level 1 text of EMIR is not scheduled until 2024

to the relevant jurisdiction that they are subject to the OTC derivatives regulation of that jurisdiction.

We would ask the Commission to ensure that it is clear that the guidance is provided solely for the purposes of interpreting Article 13 EMIR and any equivalence decisions made under Article 13, to avoid unintended consequences for other references to "established" in EMIR.

### 3. Additional conditions that apply to certain equivalence decisions

We would also welcome clarification from the Commission on application of the equivalence decision recently granted in relation to the US Prudential Regulators[3]. The equivalence decision currently provides that an EU counterparty may rely on the equivalence decision where:

- At least one of the counterparties is established in the USA and considered a Covered Swap Entity by the Prudential Regulators; and
- That counterparty is subject to the Swap Margin Rule.

This gives rise to a similar concern to that raised above, with regard to the potential for an asymmetrical impact on EU and non-EU firms, undermining the competitive position of EU firms.

The key issue here is the requirement that at least one counterparty should be both established in the US and considered a Covered Swap Entity (as well as being subject to the Swap Margin Rule). The result of this is that an EU Covered Swap Entity will not be able to benefit from the Article 13 equivalence decision unless it deals with a US counterparty that is also a Covered Swap Entity (i.e., dealers).

**This means that in practice this requirement is likely to benefit US firms that deal with EU clients within Phases 5 and 6 IM (who will only have to apply the US margin rules), while EU firms will have to apply both sets of rules when dealing with US clients within Phases 5 and 6 IM (who are generally not dealers).** We have provided an example by way of context:

- An EU Covered Swap Entity (e.g., an EU 'foreign bank' under US Prudential Regulator rules) that deals with a US counterparty that is not a Covered Swap Entity (e.g., a US-established hedge fund) will not be able to benefit from the equivalence decision[4], as neither counterparty in this relationship meets both requirements: the EU entity is a Covered Swap Entity but not established in the US, and the US entity is established in the US but not a Covered Swap Entity.

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[3] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32021D1108

[4] It should be understood that the US-established hedge fund in this example would be subject to the US Prudential Regulators' non-cleared margin rules, because it would be dealing with a Covered Swap Entity (i.e., the EU 'foreign bank'). Although it would be subject to the US Prudential Regulators' non-cleared margin rules for the purposes of its dealings with the EU 'foreign bank' Covered Swap Entity, we understand that it would not itself be considered a Covered Swap Entity under the US Prudential Regulators' rules.

- In contrast, for a US Covered Swap Entity, any trade with an EU counterparty (other than a corporate end user) would benefit from the equivalence decision, as the US counterparty would be both a Covered Swap Entity and established in the US. This would mean that US Covered Swap Entities would be able to negotiate onboarding of Initial Margin Phase 5 (effective date 1 September 2021) and Phase 6 (effective date 1 September 2022) with EU clients subject to just one set of rules, while EU firms, when dealing with US hedge funds or other buyside firms subject to Phase 5 or Phase 6 IM requirements, would have to be in compliance with both rulesets.

**The rational choice for these US clients would be to avoid EU firms.**

We do not consider that there is a legal or prudential justification for the requirement that one counterparty be both established in the US and considered a Covered Swap Entity. As mentioned above, we understand that the purpose of the Article 13 EMIR exemption was to ensure that EU counterparties should benefit from relief where they are subject to duplicative and conflicting obligations under the laws of multiple jurisdictions (so long as those obligations are deemed to be equivalent to those under EMIR). In order to achieve this result, it should be sufficient for at least one counterparty to be subject to the relevant US requirements, either because they are established in the US or because they are a Covered Swap Entity[5].

We would ask the Commission to consider amending the recent equivalence decision for the US Prudential Regulators so that the requirement is only that at least one counterparty should be considered a Covered Swap Entity:

> …where at least one of the counterparties to those transactions is ~~established in the USA and~~ considered a Covered Swap Entity by [the prudential regulators] and that the *Covered Swap Entity* counterparty is subject to the Swap Margin Rule laid down in Title 12 of the Code of Federal Regulations…

We note that in any event because the requirement for at least one counterparty to be "established" in the relevant third country is set out in Article 13 EMIR, it should not be necessary to repeat this in the equivalence decision. This amendment would make a significant difference in making the equivalence decision of practical benefit to EU firms seeking to trade with US counterparties within scope of Phases 5 and 6 IM.

In the event that it is not possible to amend the equivalence decision at this stage, we would ask the Commission to publish guidance **as soon as possible** on interpretation of the equivalence decision (and on other equivalence decisions that include similar requirements), confirming that EU firms may rely on this equivalence decision where at least one counterparty is subject to the relevant rules.

We also note that similar issues arise in relation to other equivalence decisions already granted by the Commission (for example, in relation to Hong Kong). As a result we would ask the Commission to review the existing equivalence decisions and consider amending these in a

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[5] While we remain concerned about the use of the word "established", this approach would also be of significant assistance in ensuring that the Article 13 EMIR provides for relief from duplicative and conflicting obligations.

similar way, and would also ask the Commission to consider this point in future equivalence decisions to avoid similar issues arising in connection with other jurisdictions.

## 4. Other key requirements that depend on Article 13 equivalence

We would also note that Article 13 equivalence decisions are cross-referenced not just elsewhere in EMIR but also in CRR, and so are relevant to both the intragroup exemption from margin and clearing under EMIR and to the intragroup exemption from CVA under CRR.

As a result, any uncertainty regarding application of Article 13 and the equivalence decisions taken under Article 13 will also result in uncertainty regarding application of these intragroup exemptions. If the points raised above are addressed, this would help resolve the majority of issues. However, it would also be helpful if the Commission could take these interactions into account when considering future equivalence decisions (and in particular if the Commission could consider the impact of any conditionality in equivalence decisions or any partial equivalence decisions on the application of these intragroup exemptions).

We thank you for taking the time to consider our views on this issue. If you have questions on any of the issues addressed in this letter we are happy to discuss them with you at your convenience.

Yours sincerely,

Scott O'Malia,
CEO
International Swaps and Derivatives Association