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October 23, 2017

*Via Online Submission*

Directorate-General for Financial Stability, Financial Services and Capital Markets Union  
European Commission  
1049 Brussels  
Belgium

Re: *European Commission Proposal on Authorisation of CCPs and Recognition of Third-Country CCPs*

Dear Sir or Madam:

ICI Global<sup>1</sup> fully supports the European Commission's decision to evaluate the process for authorising and supervising central counterparties (CCPs), but we have serious concerns regarding the potential negative consequences to the derivatives markets and its participants of a forced relocation of a third-country CCP to the European Union.<sup>2</sup> The Proposal tacitly recognizes that imposing a CCP location requirement could fragment liquidity and make derivatives markets less stable than they are today, but it does not assess appropriately these risks. This letter explains how regulated funds and other investors could be harmed by the Proposal's CCP location requirement. We recommend that the Commission accomplish its supervisory objectives without fragmenting liquidity, for example, by applying the European Market Infrastructure Regulation (EMIR) directly to systemically significant third-country CCPs and ensuring enforceability of EMIR.

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<sup>1</sup> ICI Global carries out the international work of the Investment Company Institute, the leading association representing regulated funds globally. ICI's membership includes regulated funds publicly offered to investors in jurisdictions worldwide, with total assets of US\$27.2 trillion. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of regulated investment funds, their managers, and investors. ICI Global has offices in London, Hong Kong, and Washington, DC.

<sup>2</sup> See Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 1095/2010 establishing a European Supervisory Authority (European Securities and Markets Authority) and amending Regulation (EU) No 648/2012 as regards the procedures and authorities involved for the authorisation of CCPs and requirements for the recognition of third-country CCPs, dated 13 June 2017, *available at* [http://ec.europa.eu/info/law/better-regulation/initiative/30988/attachment/090166e5b2ff17c9\\_en](http://ec.europa.eu/info/law/better-regulation/initiative/30988/attachment/090166e5b2ff17c9_en) (Proposal).

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Derivatives play an important role in regulated funds' efforts to build long-term value for their investors, and ICI Global generally supports reforms that improve liquidity, fairness, efficiency, and transparency in the capital markets.<sup>3</sup> Derivatives markets are global with many transactions occurring between counterparties established in different jurisdictions. This cross-border character improves liquidity and resiliency by enabling market participants to transact with a wide range of counterparties that have varied trading objectives and diverse risk sensitivities.<sup>4</sup> The potential geographic fragmentation that could accompany any determination that a CCP must relocate to the European Union to provide clearing services for EU counterparties runs counter to the benefits provided by the cross-border nature of the derivatives markets. We believe a location requirement could reduce market liquidity, raise costs, and reduce efficiencies for individual market participants and, potentially, increase rather than decrease financial stability concerns.

Specifically, a decision by EU regulators to require a third-country CCP to move into the European Union to provide clearing services to EU firms could fragment liquidity into two markets, one for European firms and one for third-country entities.<sup>5</sup> Each market that results from such a reform likely would be more geographically concentrated and shallower than the global derivatives market we have today. Investors of all kinds—including regulated funds and the millions of individuals that entrust these funds with their savings—would suffer. We concur with the Impact Assessment's recognition that forcing a CCP to relocate to the EU could make the derivatives markets "more expensive" for EU counterparties by imposing a plethora of new costs, including transaction costs, legal costs, costs associated with reduced margin efficiencies, operational costs, and liquidity costs. EU-regulated funds and their investors would bear a portion of these costs, and it is not clear what benefit, if any, they would receive in return. Although not addressed in the Impact Assessment, the fragmentation that could accompany a location determination also could impose similar costs on non-EU regulated funds and other investors if EU counterparties withdraw from the global derivatives market.

A potentially dire consequence of forcing relocation of CCPs is that the clearing system could become less resilient. As more instruments are being cleared globally in keeping with the G-20 commitments and CCPs are becoming more critical to the global infrastructure, regulators have worked to strengthen CCP resiliency. Requiring a CCP to locate in the European Union to serve EU counterparties appears to be antithetical to that goal because forced relocation could regionalize the clearing system and make CCPs more susceptible to local economic or geopolitical risks as CCPs and their clearing members—and clients—would become more geographically concentrated.

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<sup>3</sup> Derivatives are a particularly useful portfolio management tool in that they offer regulated funds considerable flexibility in structuring their investment portfolios. A regulated fund can use derivatives to hedge positions, equitize cash that it cannot immediately invest in direct equity holdings, manage cash positions, and adjust portfolio duration, all in accordance with the investment objectives stated in the fund's prospectus.

<sup>4</sup> The Impact Assessment to the Proposal contains a variety of statistics demonstrating the cross-border nature of derivatives markets. *See* Impact Assessment Accompanying the Document Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 1095/2010 establishing a European Supervisory Authority (European Securities and Markets Authority) and amending Regulation (EU) No 648/2012 as regards the procedures and authorities involved for the authorisation of CCPs and requirements for the recognition of third-country CCPs, dated 13 June 2017, at 62 available at [http://ec.europa.eu/info/law/better-regulation/initiative/30988/attachment/090166e5b2ff291d\\_en](http://ec.europa.eu/info/law/better-regulation/initiative/30988/attachment/090166e5b2ff291d_en).

<sup>5</sup> *See id.* at 62.

Regional CCPs also may have fewer resources available to recover from economic stress if they have a smaller base of clearing members to bid in a default auction, fund the default waterfall, accept client positions ported from defaulted clearing members, or otherwise contribute to CCP recovery.

One feature of a less resilient clearing system—reduced porting—would affect disproportionately EU regulated funds and other investors. The ability for clients of a defaulting clearing member to port their positions to a healthy clearing member is an important tool to improve market confidence, limit contagion, and ensure financial stability. The clearing members in a regional clearing system likely would have less capacity to take on additional positions—especially during times of economic stress when clearing member balance sheets might be stretched too thinly—than the diverse group of clearing members that currently supports the global clearing system.

We do not believe requiring a third-country CCP to relocate to the European Union is necessary or helpful to achieve the Commission’s objectives of enhancing CCP supervision and ensuring financial stability. One potential alternative approach is for EU authorities to apply EMIR to systemically important third-country CCPs and ensure that EMIR can be enforced rather than granting these CCPs recognition. If the CCPs can satisfy the EMIR standard, we do not see any additional regulatory benefit of physically locating its facilities in the European Union. Most importantly, this type of supervisory regime should enable EU authorities to regulate their markets fairly and efficiently without disrupting liquidity and harming regulated funds and other investors.

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We appreciate the opportunity to provide input on the Proposal. If you have any questions on our letter, please feel free to contact the undersigned, Jennifer Choi, Associate General Counsel, at (202) 326-5876, or George Gilbert, Assistant General Counsel, at (202) 326-5810.

Sincerely,

/s/ Dan Waters

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