# Caught in a cross-fire? The US CFTC and the European Commission's proposals on third country CCPs

Pierre Schammo*

A few months ago, I reported on the European Commission's proposals to amend the European Market Infrastructure Regulation (EMIR),[1] especially the second part of these proposals which deal (among other things) with third country Central Counterparties (CCPs) that provide services in the EU.[2] Third country CCPs can benefit from EMIR's equivalence arrangements. Under these arrangements, third country CCPs can essentially provide services in the EU if they are compliant with relevant regulatory and supervisory requirements in their home jurisdiction and provided that these requirements benefit from a determination of equivalence by the Commission. The Commission has proposed to revise this system and in the process to introduce a new tiered system for third country CCPs. This system is meant to give proper recognition to the fact that CCPs located in third countries can be a threat to financial stability in the Union. Specifically, the proposals suggest differentiating between 'Tier 1' and 'Tier 2' CCPs. The former are not considered systemically important. Thus, under the proposals, Tier 1 CCPs would essentially continue being the main beneficiaries of EMIR's (revised) equivalence framework. Most of the changes concern Tier 2 CCPs which are deemed to be, or likely to become, systemically important. For these Tier 2 CCPs, a determination of equivalence of domestic requirements would not suffice. To provide services in the EU, Tier 2 CCPs would have to comply with additional obligations under a new revamped EMIR. These additional obligations concern both the regulation and the supervision of Tier 2 CCPs. Thus, Tier 2 CCPs would *inter alia* be required to comply with prudential obligations under EMIR; requirements which an EU central bank of issue (e.g. the ECB) might impose; extensive requirements regarding access to information by ESMA, including the possibility to carry out on-site inspections. ESMA would be tasked with overseeing Tier 2 CCPs' ongoing compliance with the relevant EU requirements. EU central banks of issue would also be involved.

Clearly, the Tier 2 CCP regime is a significantly buttressed and a far more intrusive version of the current third country regime. To lessen some of the new additional EU regulatory burden (and to further complicate things), the Commission also proposes to introduce a system of 'comparable compliance' for Tier 2 CCPs under which ESMA would be allowed to take into account the CCPs' compliance with comparable third country regulatory requirements. Last but not least, the proposals also envisage that there may be cases where financial stability concerns are so significant that compliance with the Tier 2 regime is not sufficient. In this case, a CCP could be deemed to be 'substantially systemically important' and would have to establish itself in the EU if it wished to provide clearing services in the Union.

I have noted previously that the UK, when considering its prospects as a third country jurisdiction outside the EU, is unlikely to be too dissatisfied with the Commission's proposals. Rules on relocation were always seen as the greatest threat to the City of London. Under the Commission's proposals, refusing recognition to a third country CCP that is deemed to be substantially systemically important is more likely to be a last line of defense than a first line of response.

That said, the UK will not be the only jurisdiction that will take a close look at the revisions of EMIR's equivalence framework. CCPs from various third country jurisdictions are

* Reader in Law, Durham University, School of Law.

[1] Regulation (EU) No 648/2012 [2012] OJ L201/1.

[2] COM(2017) 331 final/2.

currently providing clearing services in the EU under EMIR's existing equivalence arrangements. Among them are several US CCPs that are registered with the CFTC in the US.[3] These US CCPs have so far benefited from a Commission decision on the equivalence of US requirements.[4] This decision was adopted in 2016,[5] three years after the Commission and the CFTC reached agreement on how to treat US/EU CCPs.[6] Thus, several CFTC registered CCPs currently offer services in the EU whilst complying with relevant US requirements and whilst being subject to the sole oversight of the CFTC.[7] Indeed, under the current EMIR equivalence framework, ESMA does not have direct supervision or enforcement powers over third country CCPs that are active in the EU. ESMA and the CTFC have cooperation arrangements – they signed a Memorandum of Understanding (MOU) in 2016[8] – but this does not change the fact that currently ESMA defers to the CFTC's competence to supervise US CCPs that provide services in the Union. Supervisory deference also means that ESMA has no right to conduct on-site inspections of these US CCPs. Under Article 5(2) of the MOU, on-site inspections by ESMA representatives are only supposed to be considered in 'exceptional circumstances and subject to prior agreement of the CFTC'.[9]

Hence, the current EMIR approach to third country CCPs puts significant trust and reliance on third country rules and supervision. This approach appears to be something of an anomaly. While many jurisdictions have deference rules, *full* deference appears to be the exception.[10] I have argued in the past that arrangements that defer excessively to other jurisdictions' oversight competence are likely to be unstable.[11] The power asymmetries that they create can undermine trust and even create distrust. Hence, the fact that ESMA is meant to be given an enhanced oversight role over third country CCPs that offer services in the EU is not objectionable in my opinion. Where reasonable people can disagree is on the extent of oversight that a host state supervisor should be able to exercise over a third country actor that is already subject to proper supervision in its home jurisdiction. How the EMIR proposals score in this respect cannot be assessed here. At the time of writing, the proposals are still going through the legislative process. The equivalence framework, including the role of ESMA and EU central banks of issue, is still developing. That said, what is already very clear at this time is that the CFTC does not share the Commission's enthusiasm for revising EMIR's equivalence framework. Indeed, the CFTC has been very vocal in criticizing the Commission for attempting to revamp EMIR's equivalence regime. It has described the revisions as unacceptable and as an attempt by the Commission to 'renege' on the 2016 agreement between the CFTC and the Commission.[12] As CFTC Commissioner Quintenz put it recently:

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[3] These are CME Inc., ICE Clear Credit LLC, ICE Clear US Inc., Minneapolis Grain Exchange Inc., and Nodal Clear LLC. See.

[4] Commission Implementing Decision (EU) 2016/377 of 16 March 2016 [2016] OJ L70/32.

[5] CFTC, 'The U.S. Commodity Futures Trading Commission and the European Commission: Common Approach for Transatlantic CCPs' (10 February 2016).

[6] The U.S. Commodity Futures Trading Commission and the European Commission: Common Approach for Transatlantic CCPs (10 February 2016), available at https://www.cftc.gov/PressRoom/PressReleases/cftc_euapproach021016.

[7] The CFTC extended facilities to EU CCPs complying with the requirements of EMIR under their substituted compliance framework.

[8] The memorandum is available at https://www.esma.europa.eu/sites/default/files/library/mou_for_usa.pdf.

[9] Ibid.

[10] See e.g. FSB, 'Jurisdictions' ability to defer to each other's OTC derivatives market regulatory regimes' (18 September 2014) 4, available at http://www.fsb.org/wp-content/uploads/r_140918.pdf.

[11] P Schammo 'Home country control with consent: a new paradigm for ensuring trust and cooperation in the internal market?' (2013) 15 Cambridge Yearbook of European Legal Studies 467.

[12] Keynote Address of Commissioner Brian Quintenz before FIA Annual Meeting (Boca Raton, Florida, 14 March 2018), available at https://www.cftc.gov/PressRoom/SpeechesTestimony/opaquintenz9.

> 'The EC's proposal is unacceptable to the CFTC. It is unacceptable to the United States Treasury Department. It is unacceptable to senior United States Senators. And it is unacceptable to the White House, itself. The entire United States Government is steadfast in its opposition to the EC's proposal'.[13]

It is also noteworthy that CFTC officials have consistently described the US as effectively being caught in a cross-fire between Brexit Britain and the EU27. Clearly, the issue of CCP supervision has long created ill feelings between the UK and the EU. The revisions of EMIR can indeed be seen in this light. But as I noted, the UK's main concern is about avoiding relocations post-Brexit. UK based CCPs fully comply with EMIR and one would expect that this will not radically change in the near future. Moreover, market supervisors in the UK and the EU27 have for many years worked closely together. One can imagine that this will benefit their post-Brexit relations although it yet unclear what these relations are going to be. However, they are presumably used to sharing information and working together on the ground. As noted, the situation is entirely different in the case of the US. The Commission's proposals will involve a much more radical change for the US. Would it really be far-fetched to suggest that the CFTC is not caught in a cross-fire, but in fact precisely in the Commission's line of sight?

[13] Ibid.