CME Group

23 February 2015

Ms. Rohini Tendulkar
International Organization of Securities Commissions (IOSCO)
Calle Oquendo 12
28006 Madrid
Spain

RE: IOSCO Task Force on Cross-Border Regulation Consultation Report CR09/2014

Dear Ms. Tendulkar,

CME Group Inc. ("CME Group") appreciates the opportunity to respond to the consultation published by the IOSCO Task Force on Cross-Border Regulation ("Task Force"). CME Group operates global futures and options markets with execution, clearing and reporting infrastructure based in North America and Europe.[1] Our products and services are used by customers in over 150 countries and we maintain cross-border licences, recognitions or exemptions in most major jurisdictions in order to serve the needs of our diverse customer base.

We commend the Task Force for its timely undertaking to examine the current system of cross-border regulation and establish principles and reforms that will improve the coherence of this regulatory framework for the global marketplace. We support IOSCO's objectives to play a stronger role within the framework of international standard setters and national policy makers, working with counterparts at the FSB, CPMI, and other bodies to bring greater coordination and coherence to regulation of the financial markets. We were pleased to have the opportunity to contribute to the Task Force stakeholder roundtables in 2014, hosted in Hong Kong, London and Washington, D.C. These discussions brought together regulators and industry representatives from many of the major jurisdictions and produced constructive analyses and recommendations that are reflected in this consultation.

Although we agree with many of the industry concerns related to the cross-border challenges around the new OTC regulatory regime, our comments below focus on issues in the regulated futures markets. We commend and encourage policy makers and regulators on the continued progress that is being achieved. However, delays in harmonizing or resolving jurisdictional differences in futures regulation have created uncertainty and regulatory arbitrage. Although futures markets did not contribute to the financial crisis, the well-established framework of futures regulation, including cross-border access to those markets, have been significantly impacted by the broader set of reforms.

In Section I below, we offer a few specific examples where differences in jurisdictional rules and approaches to cross-border access have created regulatory distortions in the futures markets. In Section II, we draw from these current challenges and existing suggestions in the consultation to

[1] CME Group operates four US-based futures and options exchanges – CME, CBOT, NYMEX, and COMEX – and a UK-based futures exchange, CME Europe ("exchanges"). CME Group exchanges operate in many jurisdictions under various recognition arrangements – for instance, CME, CBOT, and NYMEX are Recognized Overseas Investment Exchanges by the UK FCA. Our clearing division operates a US based DCO, CME Inc., and UK-based CCP, CME Clearing Europe ("CCPs") that provide central counterparty clearing services for futures, options and OTC derivatives. CME Inc. is a Recognized Overseas Clearing House by the Bank of England. We also operate reporting facilities based in the US, UK and Canada ("reporting facilities") that provide reporting services for futures, options, and OTC derivatives.

provide recommendations for enhancing the system of cross-border regulation for futures markets. Overall, we believe it is critical that guidance be adopted by IOSCO, in coordination with other global standard setters, on the methodology which national authorities should follow in applying global standards as the appropriate baseline for assessing cross-border equivalence. We believe such guidance will increase the transparency and consistency in the processes for rationalizing regulatory differences across jurisdictions. Working towards these goals will continue to build trust between jurisdictions and ultimately benefit futures markets and market participants.

I. Current Challenges in Cross-border Recognition of Futures Markets

A. Activity permitted by recognition

In most major jurisdictions, recognitions or exemptions are needed by a foreign futures market to offer products and services to market participants in that jurisdiction. However, there are jurisdictional differences in regulatory approaches to this activity for both the foreign futures market and the CCP clearing for that market.

In the U.S., foreign futures exchanges need to register with the CFTC as a Foreign Board of Trade ("FBOT") in order to be directly accessed by U.S. market participants. In addition, certain exemptions exist within the CFTC regulations that allow U.S. customers to access foreign markets indirectly through omnibus accounts with registered U.S. clearing members, or Futures Commission Merchants (FCMs), and in certain cases directly through foreign brokers. The CFTC allows U.S. customer activity in FBOT markets to clear through a non-U.S. CCP. Although the CFTC *permits* foreign CCPs to register under the domestic DCO regime, the CFTC does not *require* a foreign CCP clearing for an FBOT to register under the domestic DCO regime. Although the new FBOT regime came into force with the wave of Dodd-Frank reforms, it created clear transitional provisions that provided certainty for foreign markets and continuity for customers.

In the EU, foreign futures exchanges access EU-based customers via a layered regime of national licenses, recognitions or exemptions in each of the 28 Member States and separate EU-level recognition regimes tied to other areas of EU regulation. In particular:

1. Foreign futures markets must obtain licenses or exemptions at the national level to permit direct market access for customers in that jurisdiction.

2. Under MiFID I (2004) the EC is authorized to publish a list of recognized foreign markets, which was intended to be completed by 2007. This list has still not been published and Member State national licenses have not been permitted to provide transitional relief for foreign futures markets related to new regulatory requirements tied to this list.[2]

3. Under MiFID II (2014), the EC is authorized to conduct two separate equivalence and recognition processes for foreign markets. Both of these are tied to separate regulatory requirements that will come into effect when the MIFID II and MiFIR rules are applicable in 2017.[3]

[2] Article 19(6) of the Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC [MiFID I], OJ L 145, 30.04.2004.

[3] Article 28(4) of the Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012 [MiFIR], OJ L 173, 12.06.2014 and Article 25(4) of the Directive 2014/65/EU of

In the EU, there is also a separate recognition regime for foreign CCPs which effectively requires that a foreign CCP clearing for a foreign futures market to register under the EU regime.[4] Furthermore, there are not clear transitional provisions to provide certainty for foreign markets or continuity for customers. Although non-EU CCPs applied for recognition in 2013 shortly after EMIR was passed, this process has involved many complex substantive challenges and uncertainty around transitional relief. The EU does not permit foreign CCPs to register under the domestic CCP authorization regime.

B. Other regulatory requirements tied to recognition

With respect to the EU process, there have been significant differences in other regulatory requirements tied to recognition that have amplified the negative consequences of delays or uncertainty around recognitions. Although transitional relief has been extended to certain regulations to avoid unintended consequences, these have been applied inconsistently and not extended to other aspects of regulation.

i) Regulatory status of futures products

The regulatory status of products (i.e. "futures" versus "swaps" in the U.S. or "exchange traded derivatives" verses "OTC derivatives" in the EU) has become increasingly important in the new derivatives regulatory environment. This is driven by the fact that, in both the U.S. and EU, an entity's regulatory status is significantly impacted by its activity in products deemed "swaps" or "OTC derivatives" under the relevant regulations. Although many FBOT markets operating in the U.S. have been subject to transitional review periods, this transition did not change the regulatory status of FBOT products, i.e. they remained "futures" under CFTC rules.

In contrast, ESMA has explicitly stated in their Q&A that the lack of recognition under MiFID I requires commercial market participants trading on non-EU futures markets to count those futures as "OTC derivatives" when calculating their OTC activity. This inappropriately forces commercial end-users towards the relevant OTC thresholds. Breaching these thresholds requires these firms to register under a heightened regulatory status (NFC+), and comply with increased regulatory requirements under EMIR. This imbalance has created market uncertainty for many European commercial entities and global commercial end-users subject to EMIR. It has also driven regulatory arbitrage, particularly in the commodity futures markets.

ii) Regulatory status of CCPs under Basel III capital rules

For the cleared derivatives industry, one of the most critical elements of the Basel III capital framework is the need for CCPs be treated as a "QCCP" in each individual jurisdiction where their clearing member has a parent. Whereas nearly all major jurisdictions around the world have assessed QCCP status based on compliance with the Principles for Financial Market Infrastructures

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the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU [MiFID II], OJ L 173, 12.06.2014

[4] EU recognition regime for third country CCPs is governed by Article 25 of the Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories [EMIR], OJ L 201, 27.07.2012. Recognition of third country CCPs under EMIR is closely tied up with their ability to uphold Qualifying CCP (QCCP) status under EU legislation implementing Basel III, which has significant capital requirements implications for market participants (see Article 497(3) of the Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 [CRR], OJ L 176, 27.06.2013).

("PFMI's"),[5] the EU is the only jurisdiction that has tied QCCP status directly to the EU recognition process for foreign CCPs. This has created a capital cliff whereby non-EU CCPs from around the world are at risk of becoming far too costly from a capital standpoint, in a manner consistent with CCPs that have not adopted the heighted PFMI risk management standards, for clearing members with a European parent subject to CRDIV. While we support the requirement for additional capital to be held against non-QCCP exposures, we believe it inappropriate, and inconsistent with BCBS guidance, to apply such increased capital requirements to exposures to CCPs that have adopted the global PFMI standards. Delays in EMIR recognition have created delays in obtaining QCCP status, thus creating market uncertainty about capital costs of facing non-EU CCPs. Since many of CME Group's major futures clearing members have an EU-based parent subject to CRDIV, this capital cliff has created a high-degree of market uncertainty and threatened regulatory arbitrage and international market disruption.

C. Identifying and resolving substantive differences in national implementation

i) Development of international standards

For CCPs, the CPMI-IOSCO PFMIs established an international standard for legislators and regulators to follow in implementing their regional or national rules. The PFMIs have helped align many of the CCP reforms globally. However, some jurisdictions have implemented higher regulatory standards for certain line-items in their national regulations, while other jurisdictions have higher standards for other related regulations. Thus, an outcome-based approach to assessing equivalence is necessary and must take into account all relevant regulations in both jurisdictions

ii) Process for assessing foreign regulatory regimes

Although there is not a standardized process for identifying or resolving substantive differences between jurisdictions, substantial progress has been made in this area through bilateral and multilateral working groups. However, these processes are often closed to the public with very limited formal calls for input.

In 2013, ESMA published its analysis of the differences between EMIR and related rules in other major jurisdictions to assist in the EC's equivalence determinations. However, by design, this analysis was limited to areas where the EMIR standards were higher than other jurisdictions, not visa-versa. Upon a more detailed analysis of the U.S. rules, it was apparent that there were also several material areas of U.S. CCP regulation that were more conservative than EMIR. There have been challenges in resolving these gaps, including identification of the materiality threshold a gap must meet to create a prudential or competition concern. Ensuring a level playing field is also paramount which requires evaluating gaps holistically on a bilateral or multilateral basis.

Looking ahead, there are several areas of futures regulation that could present further cross-border challenges. Regarding the clearing ecosystem, seeking to resolve conflicts in underlying bankruptcy law and the impact on clearing member regulation are critical. For markets, the structure and requirements for new position limits and pre-trade transparency are also areas that should be evaluated early in the process. The cross-border application of benchmark rules will also be critical to address, particularly since there is currently a potential for divergence between major jurisdictions.

[5] This is consistent with guidance provided by the BCBS on how to determine whether a CCP should be treated as a QCCP.

II. Recommendations for strengthening the recognition process for futures markets

IOSCO, in conjunction with its partners at CPMI, BCBS, FSB, and other international standard setters, should issue guidance that will achieve the following objectives:

1. **Provide assistance to national authorities in the application of global standards when making equivalence determinations** – a framework is needed to define an appropriate approach for national authorities to apply global standards to foreign jurisdictions and market infrastructures in assessing their equivalence with local regulatory requirements. While this was originally the intent of the PFMI's and other global standards, they have not always been utilized appropriately in assessing equivalence. Further guidance on the proper assessment methodology for equivalence determinations would be a valuable tool for national authorities and may reduce the likelihood that unique or heightened line-items will be inappropriately applied on a cross-border basis. We believe this is critical going forward considering the ongoing challenges on CCP equivalence between the EU and the U.S. along with the expectation that significant further bilateral assessments will be needed in several other areas of regulation.

2. **Increase overall transparency in the process for identifying and resolving substantive differences** – IOSCO and its international peers should develop principles that increase the transparency and standardization for assessing foreign regulatory regimes. These processes should emphasize the need for greater public consultation and engagement.

3. **Define transparent measures for regulatory outcomes that create a level playing field** – as the consultation suggests, it is important define what "outcomes-based" assessment and recognition means on a case-by-case basis. In particular, where international principles have been implemented differently at national levels, there should be bilateral or multilateral agreement upfront regarding what constitutes a "material" difference. A thorough quantitative analysis of perceived gaps is a necessary component of this process. International principles should also emphasize the need to maintain a level playing field among jurisdictions when resolving gaps to avoid creating a competitive imbalance.

4. **Provide clear, effective, and consistent transitional relief** – as new rules and regulations come into force in different jurisdictions, gaps must be identified and resolved which can lead to delays in new or pending recognitions. Temporary or transitional relief has been used as an effective tool in many jurisdictions to allow new market access or permit existing market access to continue. However, this relief should apply consistently within and across jurisdictions. For example, the national rules and transitional relief that allow continued access to the EU market by foreign futures exchanges should not in turn place those foreign exchanges at a disadvantage relative to domestic EU markets.

5. **Avoid inconsistent and unnecessary coupling of recognitions to Basel III and other rules** - IOSCO should encourage policymakers to rationalize the legal ties across bodies of regulation in order to minimize cross-border conflicts and threats of market disruptions. Delays in resolving line item differences in CCP regulation should not threaten international market disruption due to unnecessary linkages between CCP regulation and bank capital standards. International principles should establish that jurisdictions should seek to minimize the negative transitional impact of a recognition process by ensuring that recognition is not unnecessarily tied to requirements or obligations embedded in other bodies of regulation or law.

Again, we commend the Task Force on this important undertaking and for further developing the concepts in the consultation paper. As jurisdictions move further down the path of implementing regulatory reforms, IOSCO and its international peers will play an increasingly critical role in rationalizing jurisdictional differences and increasing coordination and consistency. We look forward to continuing our engagement in this process.

Sincerely,

Sunil Cutinho
Senior Managing Director & President, CME Clearing