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# European Commission Public Consultation: The Operations of the European Supervisory Authorities



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# Background

The World Federation of Exchanges (WFE) is the global industry association for exchanges and clearing houses, representing more than 200 Market Infrastructure Providers, of which more than 100 are Central Counterparties (CCPs) and Central Securities Depositories (CSDs). Our members include exchange groups and standalone CCPs.<sup>1</sup>

Our members are both local and global, operating the full continuum of Financial Market Infrastructure in both developed and emerging markets. Of our members, 41 percent are in the Asia-Pacific region, 40 percent in EMEA and 19 percent in the Americas. WFE exchanges are home to nearly 45,000 listed companies, and the market capitalisation of these entities is over \$67.9 trillion; furthermore, around \$84.18 trillion in trading annually passes through the infrastructures our members safeguard.<sup>2</sup>

The WFE works with standard setters, policy makers, regulators and government organizations around the world to support and promote the development of fair, transparent, stable and efficient markets. We share regulatory authorities' goals of ensuring the safety and soundness of the global financial system. Further, we agree there are significant benefits to the wider population through integrated financial markets, and on the importance of strong common principles, approaches and supervisory coordination in order to promote financial integration and market integrity, whilst safeguarding supervisory coordination. This is fundamental to well-functioning and safe markets in which investors can have confidence.

## Introduction

Much has been achieved in strengthening the EU system in the context of global markets and reform post-crisis. The Capital Markets Union (CMU) will be an important cornerstone of that continued work. As such, to deliver this, supervisory convergence remains an important principle.

Nevertheless, the challenges of financial integration continue, particularly given the shifting dynamic and current/future likely direction of travel.

It is right therefore that the operation of the EU supervisory authorities (ESAs) are continually reviewed to ensure the EU system functions optimally as part of the wider global financial system. This includes reviews - such as those foreseen in the De Larosiere report<sup>3</sup> - including whether changes to powers and governance may be required to increase the effectiveness of supervision. In that context, the WFE appreciates the opportunity to respond to this public consultation relating to the operations of the ESAs.<sup>4</sup>

The WFE acknowledges that the consultation is focused on ensuring the ESAs can continue to play their key role in ensuring that the financial markets across the EU are well regulated, strong and stable. Given several WFE member exchange groups are also members of other, more regionally relevant, industry associations, we will not seek to duplicate the EU-focused commentary that will be provided by them.

Nevertheless, the WFE, on behalf of operators of regulated exchanges and CCPs that operate in other, non-EU jurisdictions, welcomes the opportunity to provide its perspectives on the consultation document insofar as:

- the EU's approach toward items of a global nature that may impact the attainment of broader international financial stability objectives;
- the ability of the ESAs to require additional information from market participants; and
- aspects of the EU financial market regulatory scope and structure that may have unintended consequences for other non-EU markets and participants.

<sup>1</sup> The WFE membership list [can be found here](#)

<sup>2</sup> As at end 2016

<sup>3</sup> [Report of the High-Level Group on Financial Supervision in the EU](#) – February 2009

<sup>4</sup> [European Commission Public Consultation: The Operations of the European Supervisory Authorities](#)

# Executive Summary

On behalf of WFE members – and particularly those operators of regulated exchanges and CCPs that operate in other, non-EU jurisdictions – the WFE provides the following broad comments:

## **International Aspects of the ESA's Work**

- In executing the post-crisis reform agenda, we acknowledge a major challenge for national or regional regulators has been how best to regulate financial markets that are international in nature within a more local regulatory remit. This has resulted in legislation with varying degrees of extra-territorial impact, and the concept in the EU of third-country equivalence, with some evidence of market fragmentation – particularly in global derivative markets - occurring as a result.
- Whilst it is important for the ESAs to remain comfortable that third countries continue to satisfy standards of equivalence post-determination, our view is that this should be in the context of deference or mutual recognition principles underpinned by strong communication and information sharing arrangements.
- It is not clear to us that formally extending the ESA's powers in the way described would be compatible with the general principle of mutual recognition/deference as this would encourage the use of those powers in a way that may be extra-territorial in nature. This in turn would add complexity and ambiguity for market stakeholders (both firms and authorities), undermine the principles of deference and trust between regulators, and risk fragmenting markets (reducing liquidity and efficiency).
- Nevertheless, to address the unnecessarily burdensome and administratively duplicative third country application processes, before considering strengthening ESAs' powers in this respect, we suggest consideration should be given to standardising and centralising the application and recognition approach through the ESAs (following an equivalence decision by the European Commission).

## **Access to Data**

- We acknowledge the principle of strong and effective supervision being based on the timely receipt of information. Nevertheless, there already exist practices set out in international guidance and/or specific cooperation arrangements between jurisdictions to facilitate the exchange of relevant information. Authorities should consider carefully whether duplication of such requirements would be proportionate to the costs to the market of doing so.

## **Direct Supervisory Powers in Certain Segments of Capital Markets: Post-Trading Infrastructure**

- The WFE and its members support a system that is based upon global standards and principles, and which is implemented and overseen by national authorities. National authorities are best placed to understand and take swift action on issues that are particular to the local market, environment and market structure. Failure to do so could be to the potential detriment of the wider overriding goals of financial stability and fair, efficient and orderly markets.
- We see no benefit – and indeed only risk – in moving from an established and well-functioning global approach for third country CCPs in which many stakeholders now have experience.
- As such, we do not support an extension of ESMA's powers to non-EU post-trading infrastructure. We continue to support mutual recognition arrangements between jurisdictions. These should be based on common standards, use an outcomes-based approach to recognising the framework in foreign jurisdictions, and rely on regulatory deference thereafter. This should ensure continuous access to trading and clearing infrastructure without uncertainty or disruption and – importantly - maintain a level playing field without distortions to cross-border access or competition.

Our more detailed comments on these aspects of the Consultation Paper follow.

# Specific Comments

## Section A: Optimising Existing Tasks and Powers

### Subsection 5: International Aspects of the ESAs' Work

*Q.9. Should the ESA's role in monitoring and implementation work following an equivalence decision by the Commission be strengthened and if so, how? For example, should the ESAs be empowered to monitor regulatory, supervisory and market developments in third countries and/or to monitor supervisory co-operation involving EU NCAs and third country counterparts? Please elaborate and provide examples.*

We acknowledge that a major challenge for national or regional regulators in executing the post-crisis reform agenda has been how best to regulate financial markets that are international in nature within a more local regulatory remit. This has resulted in legislation with varying degrees of extra-territorial impact and the concept in the EU of third-country equivalence, with some evidence of market fragmentation – particularly in global derivative markets - occurring as a result<sup>5</sup>.

ESMA already plays a role regarding CCPs following EU Commission determinations on the equivalence of a third country regime – specifically running the recognition process for third country CCPs which, in some cases, already results in the application of EU standards to foreign CCPs and the ongoing monitoring of those third country CCPs' compliance with the conditions of the equivalence determination.

Notwithstanding these powers to ensure a more effective control of the application of equivalence decisions in practice, it has been suggested the ESAs could have a greater involvement in the monitoring and implementation of equivalence decisions<sup>6</sup>.

**In general terms, we understand and acknowledge the principle of the ESAs having appropriate tools to enable them to remain comfortable that third countries continue to satisfy standards of equivalence post-determination. This includes access to information relating to the relevant third country environment. However, we respectfully note this should be in the context of deference or mutual recognition principles underpinned by strong communication and information sharing arrangements, and should not be used as a tool to dilute equivalence assessments already made.**

In global markets, participants need cross-border access to well-regulated markets on reasonable and certain terms. The current system of recognitions and exemptions has helped to connect market participants - increasing liquidity and efficiency – and also to establish trust and cooperation between regulators based on MOUs and other arrangements.

**We support mutual recognition between jurisdictions based on common standards and using an outcomes-based approach to recognising the framework in foreign jurisdictions** – ensuring continuous access to trading and clearing infrastructure without uncertainty or disruption and – importantly - maintaining a level playing field without distortions to cross-border access or competition.

Empowering ESAs in the way described (ex-post equivalence determination) in our view verges on providing extra-territorial supervisory (and presumably, as a result, requiring enforcement) competence. This brings in additional complexity as to who the competent authority is for the third country entity (and indeed the supervisory authorities themselves).

<sup>5</sup> For example, fragmentation and lack of market certainty has been seen through both the delays of the EU/US cross-border CCP equivalence discussion, as well as regarding equivalence of US Swap Execution Facilities and EU MTFs.

<sup>6</sup> This may include following regulatory, supervisory and market developments in third-countries as well as the supervisory record of third-country authorities, monitoring and co-ordinating supervisory co-operation among financial supervisors in the EU and their foreign counterparts

In particular:

- We have already seen negative impacts of an extra-territorial approach to business in a foreign jurisdiction as a result of divergent application and recognition processes<sup>7</sup>;
- Complexity around cross-border recognition/equivalence on an ongoing basis creates uncertainty for markets and all market participants including those that rely on exchanges to efficiently raise capital and manage risk; and
- For many exchanges and CCPs – including in mature and emerging economies – it is difficult (verging on prohibitive) to comply with multiple sets of standards in order to access foreign markets or retain existing clients.

**It is therefore not clear to us that formally extending the ESA’s powers in the way described would be compatible with the general principle of mutual recognition/deference as this would encourage the use of those powers in a way that may be extra-territorial in nature.** This in turn would add complexity and ambiguity for market stakeholders (both firms and authorities) and in addition undermine the principles of deference and trust between regulators. This would also risk fragmenting markets, reducing liquidity and efficiency, and would appear at odds to the wider G-20 undertaking to

*“take action at the national and international level to raise standards together so that our national authorities implement global standards consistently in a way that ensure a level playing field and avoids fragmentation, protectionism, and regulatory arbitrage”.*

More pragmatic would be ensuring existing tools and co-operation arrangements – including between the ESAs and the Competent Authorities of the larger CCPs - are clear and embed strong two-way information sharing protocols that encourage and require effective engagement between home state authorities and the ESAs whilst at the same time respecting the principles of home-state primacy.

Further, before considering strengthening ESAs’ powers in this respect, following an equivalence decision by the European Commission, we suggest consideration should be given to standardising and centralising the application and recognition approach through the ESAs. This would not only address some of the risks of complexity and confusion, but also reduce the duplicative and unnecessarily burdensome application processes.

#### **Subsection 6: Access to Data**

*Q.11. Are there areas where the ESAs should be granted additional powers to require information from market participants? Please elaborate on what areas could usefully benefit from such new powers and explain what would be the advantages and disadvantages.*

We acknowledge the principle of strong and effective supervision being based on the timely receipt of information. Nevertheless, we respectfully note that there already exist practices set out in international guidance and/or specific cooperation arrangements between jurisdictions (e.g. memoranda of understandings) to facilitate the exchange of relevant information<sup>8</sup>. As recently noted by Executive Board member of the ECB Benoit Couere<sup>9</sup>

*“Responsibility E of the PFMI provides for cooperation between relevant authorities that is commensurate with a Financial Market Infrastructure’s systemic importance across jurisdictions for both normal times and crisis situations”.*

Given such practices and expectations to increase data analysis/understanding are already in existence - and are well used and understood by market participants and market authorities – we urge authorities to consider carefully whether the duplication of such requirements would be disproportionate to the costs to the market of doing so.

<sup>7</sup> For example, clearing requirements/implementation of PFMI, segregation requirements, SEF requirements/QMTF, Benchmarks

<sup>8</sup> For example, [Responsibility E of the CPMI-IOSCO Principles for Financial Market Infrastructure](#) (PFMI), the [PFMI disclosure framework](#), and [Article 25\(2\)\(c\) of EMIR](#)

<sup>9</sup> see page 10 (of 14) - [https://www.ecb.europa.eu/press/key/date/2017/html/ecb.sp170420\\_tBdF-FSR21.en.pdf](https://www.ecb.europa.eu/press/key/date/2017/html/ecb.sp170420_tBdF-FSR21.en.pdf)



## **Section C: Direct Supervisory Powers in Certain Segments of Capital Markets**

### **Subsection 3. Post-Trading Market Infrastructure**

*Q.19. In what areas of financial services should an extension of ESMA's direct supervisory powers be considered in order to reap the full benefits of CMU?*

We note the suggestion that ESMA's supervisory powers could be extended to post-trade infrastructures<sup>10</sup> on the basis there is a strong need for more integrated, efficient and well-functioning markets.

While in most major jurisdictions licensing – or exemptions – are needed in order for a CCP to offer clearing services to market participants in that jurisdiction, the EU has already gone further and is globally unique in taking a line-by-line comparison approach to evaluating the equivalence of foreign jurisdictions before individual clearing houses are granted a licence.

Each jurisdiction develops regulations that are appropriate to their local market whilst accounting for global standards. If the EU were to adopt the proposed approach of direct application and enforcement of EU standards to foreign CCPs, this would further perpetuate the current situation whereby foreign clearing houses are subjected to regulations which may be inappropriate for their markets and market structures.

**Whilst acknowledging the well-meaning intentions of providing the ESAs an enhanced role and tools, the broader benefits and principles of third country recognition arrangements should not be forgotten. The risks of extending powers are potentially significant.** In particular, the application of one jurisdiction's rules to institutions operating in another jurisdiction could make it costlier to transact in markets subject to such rules. This in turn could undermine the ability of firms to manage risk, make for higher financing costs for the real economy, and impact investment and employment. Further, the market fragmentation occurring as a result of the extra-territorial application of rules would likely in turn lead to a more fragmented view of activity in financial markets, making it more difficult for regulators to monitor - and prevent a build-up of - systemic risk.

**As such, the WFE and its members do not support such an extension of ESMA's powers to non-EU post-trading market infrastructures. We contend this would introduce risk, undermine the wider direction of travel of global regulatory initiatives, and remove the benefits of close local supervision.** In particular, we note:

- CCPs may operate in many jurisdictions and clear products which are globally traded and so it is important international frameworks are consistently applied across jurisdictions. This has enabled CCPs - including those in non-EU countries - to employ prudent risk management practices which are able to sufficiently flex to fit the national legal and regulatory requirements in which they operate, alongside suiting the nuances of the products and markets they clear for;
- Further, in increasingly global markets, it is critical that participants have cross-border access to well-regulated markets on reasonable and certain terms. The current system of recognitions and exemptions for third country CCPs has helped not only to connect market participants - increasing liquidity and efficiency – but also in establishing trust and cooperation between regulators, usually based on MOUs and information sharing arrangements; and
- In addition, we note that CCPs have performed well through a range of significant market stress events<sup>11</sup> under the current arrangements. Nevertheless, despite their impressive track record through stressed market conditions, they are incentivised, and continue, to refine and improve their resilience and ability to manage future market crises as the core function of their offering. This happens in tandem to the evolution of the global regulatory structure in a direction that is familiar to all.

As such, we see no benefit – and indeed only risk – in moving from an established and well-functioning global approach for third country CCPs in which many stakeholders now have experience.

<sup>10</sup> in the interests of more effective and consistent supervision of financial entities and activities to eliminate unjustified supervisory barriers to cross-border investment  
<sup>11</sup> including the 2008 global financial crisis and - more recently - in the global market volatility seen in August 2015 and through the various events of 2016

In summary, **we continue to support mutual recognition arrangements between jurisdictions based on common standards and using an outcomes-based approach to recognising the framework in foreign jurisdictions and relying on regulatory deference thereafter** – ensuring continuous access to trading and clearing infrastructure without uncertainty or disruption and – importantly - maintaining a level playing field without distortions to cross-border access or competition.

*Q.20. For each of the areas referred to in response to the previous question, what are the possible advantages and disadvantages?*

As a general matter, we support a system that is based upon global standards and principles, and which is implemented and overseen by national authorities. This is because national authorities are best placed to understand and take swift action on issues that are particular to the local market, environment and market structure. Failure to do so could be to the potential detriment of the wider overriding goals of financial stability and fair, efficient and orderly markets.

Extending powers in the way described in our view verges on providing extra-territorial supervisory (and presumably, as a result, requiring enforcement) competence. This brings in additional complexity as to who the competent authority is for the third country entity (and indeed the supervisory authorities themselves). In particular:

- We have already seen negative impacts of an extra-territorial approach to business in a foreign jurisdiction as a result of divergent application and recognition processes<sup>12</sup>;
- Introducing increased costs for market participants, liquidity constraints, risks of fragmentation and/or regulatory arbitrage;
- Complexity around cross-border recognition/equivalence on an ongoing basis creates uncertainty for markets and all market participants - including those that rely on exchanges to efficiently raise capital and manage risk; and
- For many exchanges and CCPs – including in mature and emerging economies – it is difficult (verging on prohibitive) to comply with multiple sets of standards in order to access foreign markets or retain existing clients.

As such, **we support mutual recognition arrangements between jurisdictions based on common standards and using an outcomes-based approach to recognising the framework in foreign jurisdictions and relying on regulatory deference thereafter** – ensuring continuous access to trading and clearing infrastructure without uncertainty or disruption and – importantly - maintaining a level playing field without distortions to cross-border access or competition.

*Q.21. For each of the areas referred to in response to question 19, to what extent would you suggest an extension to all entities or instruments in a sector or only to certain types or categories?*

N/A. We do not support an extension of direct supervisory powers for post-trade infrastructures for the reasons set out above.



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<sup>12</sup> For example, clearing requirements/implementation of PFMI, segregation requirements, SEF requirements/QMTF, Benchmarks