WORLD FEDERATION OF EXCHANGES

Response: Bank of England proposals on 'tiering' of overseas CCPs – February 25th, 2022

Background

The World Federation of Exchanges (WFE) is the global trade association for regulated exchanges and clearing houses. We represent over 250 market-infrastructures, spread across the Asia-Pacific region (~37%), EMEA (~43%) and the Americas (~20%). with everything from local entities in emerging markets to groups based in major financial centres. Collectively, member exchanges are home to nearly 53,000 listed companies, and the market capitalisation of these entities is over $95 trillion, while the 50 distinct CCP clearing services (both vertically integrated and stand-alone) collectively ensure that traders put up $1 trillion of resources to back their risk positions.

With extensive experience of developing and enforcing high standards of conduct, WFE members support an orderly, secure, fair and transparent environment for investors; for companies that raise capital; and for all who deal with financial risk. We seek outcomes that maximise financial stability, consumer confidence and economic growth. And we engage with policy makers and regulators in an open, collaborative way, reflecting the central, public role that exchanges and CCPs play in an internationally integrated financial system.

If you have any further questions, or wish to follow-up on our contribution, the WFE remains at your disposal. Please contact:

Ryan Ingram, Senior Adviser, Regulatory Affairs: ringram@world-exchanges.org

Richard Metcalfe, Head of Regulatory Affairs: rmetcalfe@world-exchanges.org

Nandini Sukumar, Chief Executive Officer: nsukumar@world-exchanges.org

As operators of critical market infrastructure, we share regulatory authorities' goals of ensuring the safety and soundness of the global financial system, which is critical to enhancing the confidence of investors and citizens and promoting economic growth. This includes ensuring a sound and robust regulatory regime for CCPs.

The WFE welcomes well-designed frameworks that enhance the resilience of the financial system and supports proportionate initiatives contributing to that objective. We believe that society derives significant benefits from integrated financial markets. It is therefore important to have strong principles and co-ordinating mechanisms to promote financial integration and market integrity.

To this end, the WFE welcomes the Bank's intention to promote principles of regulatory deference in its proposed approach to 'tiering' incoming CCPs and agrees that, for cleared markets to operate to the optimal extent, there must be regulatory co-operation. We are also supportive of Bank's decision to not pursue location regulations or 'Tier 3' as part of this framework. However, we have concerns about the determination of the thresholds, particularly the methodology applied and the risk-insensitive nature of the numerical thresholds that results, when assessing the systemic risk of an incoming CCP.

Specifically, the WFE supports approaches that assess the systemic risk relevance of an incoming CCP based on quantitative, risk-based methods, subject to and informed by the informed reliance assessments described in the proposal.

The WFE has the following primary concerns regarding the initial triage criteria used for the assessment of an incoming CCP:

1) **The criteria for evaluation appear inappropriately low**
   Using such low criteria, where the stated amount is not risk-based, will not accurately assess if an incoming CCP is in fact systemically important to the UK. In support of the stated intention to create a level playing field, a more risk-aligned approach is required. Risk-based criteria should be the only and the primary, front-line test of systemic significance.

   To put this into context, the Bank's proposed criteria for margin and default fund are approximately 80% lower than the corresponding threshold implemented in the EU under EMIR 2.2.

2) **The criteria use collateral held, as opposed to collateral required**
   Using collateral on deposit, as opposed to collateral required, may create unintended consequences, and fails to recognize different models and requirements that are imposed across jurisdictions with respect to, for example, customer margining (i.e., gross versus net). Such an approach will not allow for consistent evaluation of incoming CCPs and inappropriately penalizes those CCPs that employ customer gross margining practices. In addition, using collateral on deposit creates a perverse incentive for incoming CCPs to discourage UK clearing members from maintaining excess collateral.

3) **The criteria use peak collateral amounts, as opposed to average**
   Using peak collateral amounts over a 5-year period may not be representative of an incoming CCPs current or anticipated systemic risk relevance to the UK (particularly where an incoming CCP may currently be well below such thresholds) nor reasonably consider that peak collateral may be in result of short-term and/or temporary market events. It may also It would be more adequate to consider the average over a time series, more recent representations and/or the trend of such amounts over the time series.

4) **The criteria should not consider non-UK based subsidiaries of UK headquartered firms**

We believe that the overall approach stands to create unnecessary ambiguity for incoming non-systemic CCPs, when looked at in conjunction with the subjective nature of the systemic risk assessment, since it could lead to an outcome where an incoming CCP that is not systemically important to the UK is designated as such. Further, the proposed systemic risk assessment (outlined in Annex 1) that an incoming CCP would be subject to where it breaches one of the initial triage criteria inappropriately focuses on areas for review that do not have a clear nexus to the UK. For example, the Bank proposes to review an incoming CCP's clearing of non-Sterling products, total collateral held (i.e., this includes collateral posted by non-UK clearing members), and broadly the CCP's membership requirements, among other things. The subjectiveness of this assessment, combined with focusing on items that have no nexus to the UK, creates uncertainty for all market stakeholders and could unfortunately result in an incoming CCP that would otherwise be viewed as not having systemic impact on the UK being deemed Tier 2. Thus, we advise the Bank to increase the initial triage criteria and adjust their calculation, as set out above, and address the shortcomings of the systemic risk assessment.

With respect to the informed reliance assessments, we appreciate the intended focus on deference and co-operation, but we think that the Bank's assessment should recognize and state that there are multiple means by which the necessary degree of co-operation from relevant home authorities can be achieved.

As for the systemic risk assessment, it would be helpful to add and specify which points are of specific importance to the Bank, to enhance a common understanding and clarify the Bank's expectations of incoming CCPs.

The proposal should provide more information on implementation (for those who may fall into certain categories), including any transitionary measures and timelines.