

**BREXIT AND OTHER INTERNATIONAL  
DEVELOPMENTS AFFECTING U.S.  
DERIVATIVES MARKETS**

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**HEARING**  
BEFORE THE  
SUBCOMMITTEE ON COMMODITY EXCHANGES,  
ENERGY, AND CREDIT  
OF THE  
COMMITTEE ON AGRICULTURE  
HOUSE OF REPRESENTATIVES  
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WEDNESDAY, JUNE 26, 2019

HOUSE OF REPRESENTATIVES,  
SUBCOMMITTEE ON COMMODITY EXCHANGES, ENERGY, AND  
CREDIT,  
COMMITTEE ON AGRICULTURE,  
*Washington, D.C.*

The Subcommittee met, pursuant to call, at 10:00 a.m., in Room 1300 of the Longworth House Office Building, Hon. David Scott of Georgia [Chairman of the Subcommittee] presiding.

Members present: Representatives David Scott of Georgia, Van Drew, Spanberger, Delgado, Craig, Maloney, Axne, Austin Scott of Georgia, Crawford, Bost, Marshall, Dunn, Johnson, Baird, and Conaway (*ex officio*).

Staff present: Carlton Bridgeforth, Emily German, Matt MacKenzie, Ashley Smith, Paul Balzano, Patricia Straughn, Dana Sandman, and Jennifer Yezak.

**OPENING STATEMENT OF HON. DAVID SCOTT, A  
REPRESENTATIVE IN CONGRESS FROM GEORGIA**

The CHAIRMAN. [audio malfunction in hearing room] Exchanges, Energy, and Credit entitled, *Brexit and Other International Developments Affecting the U.S. Derivatives Market*, will now come to order.

I want to thank everyone for joining us this morning. This is a very, very important hearing. The very future of our international cross-border financing is very critical because of what is happening concerning Brexit.

Today, we really want to examine, and examine it very thoroughly, so we come to a very succinct understanding with supreme knowledge as to how this situation involving the European Union's divorce with Great Britain affects our United States financial industry.

It is most important that when we leave this hearing today, we will have one resolve, and that is to make sure what is happening with Brexit and the European Union does not, will not, and cannot put our United States financial industry in a weakened position. It is important that the United States financial industry remain in its position as the most significant, most important, most influential financial system in the world, because the world is depending on that and us making sure of it.

There are some threats out there with this move in Brexit, and that is why we in this Committee realize our responsibility as Members of Congress to hear from you, to hear from our market participants, for you are the ones that engage in this. And we have to remember that this is an \$843 trillion, not million, not billion, but trillion dollar, piece of the world's economy. And let me assure you that the United States financial system must remain number one in this strengthening position.

Now, there are some very important facts I want to go over so you can see where we are.

First of all, as we look at Brexit and other international developments, we know without a doubt that there are 27 members of the EU that are bracing for Great Britain's exit from the Union, and the UK approaches a leadership crisis with its Prime Minister's departure, and she is still at the helm, but there are so many things that are bubbling up underneath.

Now, it is important for me to share with you that in 2016, the CFTC completed, that is the Commodity Futures Trading Commission, completed a 3 year negotiation for an equivalence agreement. It is very important to note that prior to this point, it was the European Union that was our equivalency partner. And this agreement on the regulatory treatment of derivatives clearinghouses with the European Union, and this agreement ensured that both the EU and U.S. clearinghouses operate at the same high standards, and at a comparable level of cost to their participants. Last year, as the EU prepared for the potential impact of Brexit, the EU Parliament passed the European Market Infrastructure Regulation, EMIR 2.2.

I want to pause there, EMIR 2.2, and we have to examine EMIR 2.2 thoroughly this morning, because we on this Committee are convinced that EMIR 2.2 presents a very clear and present danger to our United States financial industry.

When they passed EMIR 2.2, it unilaterally and automatically scrapped the 2016 equivalence agreement. EMIR 2.2 increases oversight of the EU and third-country clearinghouses, and it has significant implications, as I said, for the industry in the United States.

Some of the most extreme parts of this suggested policy is, number one, administrative fees charged to clearinghouses in other countries in exchange for oversight, and we will get back to that, by the EU. Comparable compliance discounts instead of grandfathering, which means that even when granted, you will get a discount of 15, 20, or 35 percent of fees. Also, a very complex tiering regime where the difference between Tier 1 and Tier 2 is fees that are as much as seven times higher. Tier 1 is €50,000. Tier 2 is €350,000, seven times higher.

However, the largest concern is a possible relocation provision requiring that all clearing move to the EU, either by the letter of the law or by making it so expensive that companies outside the EU will be priced out of competition. And everyone in this room knows that financial instruments do not operate in a vacuum. What happens in the EU and the UK will ripple through financial markets, just as our decisions here in our country have ramifications for them.

It is my hope today that with our discussions and conversations that we will have today, that we can begin to explore and better understand what Brexit and the associated geopolitical developments in Europe and elsewhere will mean for the derivatives market in the United States.

[The prepared statement of Mr. David Scott of Georgia follows:]

PREPARED STATEMENT OF HON. DAVID SCOTT, A REPRESENTATIVE IN CONGRESS FROM  
GEORGIA

Thank you for joining us today as we look at Brexit and other international developments. This hearing is an important one, and a timely one, as the 27 members of the EU brace for the UK's exit from the Union, or "Brexit" and the UK approaches a leadership change.

In 2016, the CFTC completed a 3 year negotiation for an equivalence agreement on the regulatory treatment of derivative clearinghouses with the European Union. This agreement ensured that both the EU and U.S. clearinghouses operate at the same high standards and at a comparable level of cost to their participants.

Last year, as the EU prepared for the potential impact of Brexit, the EU Parliament passed the European Market Infrastructure Regulation (EMIR 2.2), which unilaterally scrapped the 2016 equivalence agreement.

EMIR 2.2 increases oversight of EU and third-country clearinghouses, and it has significant implications for the industry in the U.S.

Some of the most extreme parts of their suggested policies are:

- Administrative fees charged to clearinghouses in other countries in exchange for oversight by the EU.
- Comparable compliance discounts instead of grandfathering which means that even when deemed comparable the only difference is a 15, 20 or 35 percent discount on your fees.
- A very complex tiering regime where the difference between Tier 1 and Tier 2 is fees that are as much as seven times higher.

The largest concern is a possible relocation provision requiring that all clearing move to the EU either by the letter of the law or by making it so expensive that companies outside the EU will be priced out of competition.

Everyone in this room knows that financial instruments do not operate in a vacuum. What happens in the EU and the UK will ripple through financial markets just as our decisions here in this country have ramifications for them. It's my hope that with our conversations today we can begin to explore and better understand what Brexit and the associated geopolitical developments in Europe and elsewhere will mean for the derivatives market in the United States.

With that I would recognize my Ranking Member, the other distinguished Mr. Scott of Georgia, for 5 minutes.

The CHAIRMAN. And with that, I would like to now recognize my Ranking Member, the other distinguished Mr. Scott from Georgia, for 5 minutes.

**OPENING STATEMENT OF HON. AUSTIN SCOTT, A  
REPRESENTATIVE IN CONGRESS FROM GEORGIA**

Mr. AUSTIN SCOTT of Georgia. Thank you, Mr. Chairman, for convening this hearing. You and I share a deep concern over what I would refer to as the potential absence of international harmonization work between the CFTC and their global counterparts.

The main focus of today's hearing is the impact of Brexit on U.S. derivatives markets. We can't talk about that without discussing the European Commission's potential divergence from what was a hard fought 2016 equivalency agreement. For years, this Committee has been focused on the importance of harmonizing our international response to the financial crisis. And we, when Chairman Gensler sought to impose the U.S. swap dealer rules around the world, we pushed back because we rightly believed that over-

lapping rules would make it more difficult or impossible for global risk markets to function as end-users and other market participants need them to.

Today, we are in a similar place, except instead of making common cause with our European colleagues, we are having to have another discussion about what I thought were principles that we had agreed on, principles that were agreed on with people who share both our interests and our values.

Implementing EMIR 2.2 in a way that would disrupt our existing equivalency agreement would trample on our previously shared principles. Just like in 2011 and 2012, regulators are playing a dangerous game, trying to expand their reach into places that are already well-regulated. Such an effort, just as it was going to then, will result in inevitable conflicts, legal uncertainty, and other challenges for market participants. When there is uncertainty, there will be less liquidity, and when there is less liquidity, there is more risk for those who are driving our economy. We need our regulators to work together to preserve our open global markets while building the compatible standards that protect market participants and encourage financial stability.

Open markets and financial stability should be our goals. Regulators should seek to implement rules that promote both. Our U.S. Prudential Regulators could also remember this lesson from time to time. The capital standard and margin rules that they have been working on are both out of step with global norms and do not promote access to clearing or sound hedging practices. The capital rules treatment of initial margined and unmargined commodity derivatives both penalize end-users who will see reductions in access to cleared market intermediaries and increase the cost for utilizing the right to opt out of the margin requirements.

Our Prudential Regulators insistence on requiring margin for internal swaps that transfer risk within the same bank holding company presents similar problems for end-users. Ultimately, the cost of moving risks within a bank to the place that is most economical is the cost of providing a service to a client. If we make the services more expensive, it won't be the bank that pays, it will be the bank's client, the end-users who rely on the services, that pay. They will either pay in money or they will pay in loss of access. These requirements in both rules run contrary to the spirit and intent of our Committee's commitment to end-users when we enacted the law.

I am happy to note the Commission is examining changes that will improve coordination and harmonization. I hope their efforts bear fruit, and I hope our European colleagues will join them.

Mr. Chairman, I will end with this. The first meeting I was in this morning, a gentleman said, "Do you want to beat people or win people?" What we want in the harmonization with the regulators is a win-win situation for all of us who have shared interests and shared values. And if we don't have that, my fear is that it will be other countries who control the trading who don't share either our interests or our values.

Thank you, Mr. Chairman for having this hearing.

The CHAIRMAN. Well, I certainly agree with you, Ranking Member.



And now, I would like to recognize our distinguished former Chairman and our Ranking Member, Mr. Mike Conaway.

**OPENING STATEMENT OF HON. K. MICHAEL CONAWAY, A  
REPRESENTATIVE IN CONGRESS FROM TEXAS**

Mr. CONAWAY. Thank you, Mr. Chairman, and I agree wholeheartedly with what you and the Ranking Member both said during your opening statements. I certainly appreciate that.

I know that you both remember the hearing that we conducted in 2012 on international regulatory harmonization. It was a good and informative hearing, and I expect that today's hearing will build on that work.

I was looking through the transcript of that hearing in preparation for today, and I would like to share some words of wisdom submitted by Chairman Steven Maijoor, who was then and still remains the Chairman of the European Securities and Market Authority, or ESMA. In written testimony, he summed up the issues we are talking about today quite well. At the time, he wrote "A number of conflicting duplicative and inconsistent requirements have been identified when analyzing the simultaneous application of different national regulations. These requirements, if applied on a cross-border basis to the same entities and transactions would, in certain cases, impede a transaction from taking place or might impede an entity from operating with the United States counterparts. This would have serious consequences for global market liquidity, and might even have financial stability consequences. ESMA considers it to be of fundamental importance to avoid the application of two or more sets of rules to the same entities or transactions, if those entities and transactions are subject to appropriate requirements in their home jurisdiction. Therefore, we urge U.S. regulators to rely on the maximum extent and equivalent requirements enshrined in EU law instead of imposing U.S. requirements when those non-U.S. entities are dealing with U.S. persons. When a duplicative application of rules cannot be avoided, we believe it is essential to identify and mitigate any possible conflict that might arise from that situation."

As Ranking Member and Mr. Scott mentioned, at that time, you and I and this whole Committee argued strenuously against our own U.S. regulators when they sought to push the boundaries of our regulations too far. We were worried about exactly what Chairman Maijoor identified, duplicative and inconsistent requirements harming global liquidity formation and raising financial stability concerns. Yet today, it is U.S. regulators who are recalibrating their approach and working to offer solutions to these thorny cross-border issues, and our European colleagues who are failing to heed their own advice. If European regulators persist down this path, we will likely learn that they were correct in their analysis and find that their actions have left our global markets in disarray.

Mr. Chairman, before I close, I want to mention my deep disappointment in comments made by a senior Commission official at a conference several weeks ago in London. It is particularly personal to me because you and I so warmly received his testimony on this topic during that December 2012 hearing. In their worst light, his comments suggest that the United States does not have

a partner, but a competitor in financial market regulation, a competitor who is willing to use its regulations to its strategic advantage. Viewing financial regulations as a competition would be a grave mistake. But, even in their best light, his comments betray a smugness that is inappropriate among friends. Such casual arrogance breeds mistrust, frustration, and needless friction at a time when we cannot afford intramural sniping.

I have been struggling to make sense of the complete reverse on principle from our European friends expressed at their 2012 hearing. It is comments like these that lend credence to the argument that our ongoing CCP equivalence disagreements have nothing to do with systemic risks or safety and soundness of European institutions, and everything to do with retribution and competitive regulatory arbitrage. I certainly hope that is not the case. If it isn't, European leadership plainly made that clear through their words and their actions.

With that, I yield back.

The CHAIRMAN. Well, Ranking Member Conaway, thank you so much for that. As you know, I agree with you 100 percent. I really appreciate you really exposing that to the Committee this morning.

Mr. CONAWAY. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much.

And now, the chair would request that other Members submit their opening statements for the record so the witnesses may begin their testimony, and to ensure that there is ample time for questions.

Let me begin now by welcoming all of our distinguished panel members and thanking you all for coming, and we are looking forward to your testimony on this important issue.

First of all, Mr. Terrence Duffy, thank you for coming. Mr. Duffy is Chairman and CEO of the CME Group, Chicago Mercantile Exchange in Chicago, Illinois. Thank you for coming, sir.

We also have next Mr. Christopher Edmonds. Mr. Edmonds is Senior Vice President of Financial Markets for the Intercontinental Exchange, Chicago, Illinois. Wonderful. Please give my regards to Mr. Jeff Sprecter, a good friend, and ICE, as you may know, is headquartered in our wonderful State of Georgia in Atlanta. Thank you.

And next, we have Mr. Daniel Maguire who is CEO of the LCH Group, London, United Kingdom. Thank you for coming. We really appreciate you coming over the pond to deal with this very important issue that London and Great Britain are grappling with at this moment. Thank you for bringing this insight to our Subcommittee hearing.

And next, we have Mr. Walt Lukken, who is the President and CEO of Futures Industry Association, Washington, D.C. We are very much looking forward to your comments as well.

And finally, we have Mr. Stephen Berger, Managing Director and Global Head of Government and Regulatory Policy, Citadel, LLC, on behalf of Managed Funds Association out of New York, New York. Good to have you. Thank you. We look forward to your input as well.

What a distinguished panel. Thank you all very much for coming.

And now, we will now proceed to hearing from our witnesses. Each of you will have 5 minutes, and 1 minute is left when the light turns yellow, signaling time is closely expiring. However, this is indeed a very critical and important hearing, and if there is something else that is pressing that you need to say, the chair will be lenient to make sure your full thoughts are here, because you are the ones who are out there day in and day out within this as leaders of our financial system in this international marketplace. We want to make sure that we hear from you and your recommendations as to what recommendations we need to take as a Committee to make sure your positions at the world market are strengthened, and you are not weakened on the world financial stage.

All right. We will hear from you first, Mr. Duffy.

**STATEMENT OF HON. TERENCE A. DUFFY, CHAIRMAN AND  
CHIEF EXECUTIVE OFFICER, CME GROUP INC., CHICAGO, IL**

Mr. DUFFY. Well thank you, Chairman Scott, Ranking Member Scott, and Members of the Committee. I am Terry Duffy, as the Chairman said. I am the Chairman and Chief Executive Officer of CME Group.

Before I go into some of my prepared remarks that I wanted to give to you today, I am absolutely struck by what I heard here by this Congress, and I want to thank you, Mr. Chairman, for your leadership, Ranking Member Scott for your leadership on the comments that I heard. And Mr. Conaway, what you had said is just so profound to dig back up what people said in 2012. It is just truly amazing that we are sitting here today in the duplicativeness of what people have said throughout the time.

I don't think a lot of people understand the importance of this Committee, what it is doing here today. And so, Mr. Chairman, I really applaud you, your foresight to bring this forward because you look at what is going on in the world today alone, just with the farm community, and not only are they dealing with very difficult issues as far as trade goes; they are also dealing with extremely difficult issues with weather. These are a couple issues that they have no control over.

But to your point, Mr. Conaway, the liquidity—or Chairman—Ranking Member Scott on the liquidity, this is critical. This Congress has an opportunity not to impose another problem for the American farmer, and that is giving them a place where they don't have any risk management tools during these very uncertain times. And if you think that there is nothing else to it but agricultural products, you can talk about home mortgages. You can talk about fuel for your car. You can talk about your 401(k). All these different services that we use in our daily lives need risk management products, and if you drive the cost up, I think Mr. Conaway said, it will fall on the consumers. That is where it ultimately goes. Your foresight to have this Committee hearing is critically important. It is a lot more than just regulatory arbitrage. This has a lot to do with the American consumer and the global consumers. I really applaud your efforts, all of you on this Committee, for going forward with this.

That being said, I testified before this Subcommittee almost 3 years ago to the day in June of 2016. After that hearing, I stated the negotiations between the United States and the European Union on equivalence were successfully resolved in February when the European Commission officially granted the CFTC equivalent status. I encouraged global regulators to avoid potential market disruption in the future by implementing long-term solutions. And I warned if this was not the case, regulation will artificially influence liquidity, price discovery, and risk management, and competitively disadvantage individual markets in an increasingly competitive global marketplace.

Unfortunately, here we are 3 years later again discussing our regulatory overreach by the European Union that is in direct challenge to the authority of the United States Congress and the Commodity Futures Trading Commission to set rules and to regulate the U.S. futures market. One year after the U.S. and the European Union reached the equivalence agreement in 2016, in the wake of Brexit, the European Union proposed legislation creating a sweeping new set of regulations to apply to clearinghouses operated outside the European Union.

This new law, as the Chairman referred to it as EMIR 2.2, unilaterally amends the agreement layering significant new requirements on top of those previously agreed to without justification. The 2016 agreement was the result of painstaking comparison of U.S. and European Union clearinghouse regulations. Its ratification reflected consensus that the U.S. regulations were comparable and equivalent to those in the European Union. Yet, just last month, as the Chairman said, ESMA and the European Union regulatory authority asked—they were tasked with overseeing the non-European Union clearinghouses, released its consultations detailing how they recommend implementing the new EMIR 2.2 requirements.

The consultations proposed to needlessly require a line-by-line comparison of U.S. and European Union laws, ignoring the principles of deference and substituted compliance that the two jurisdictions agreed to just a few years ago.

ESMA proposed to classify U.S. clearinghouses according to their systemic relevance to the European Union through a set of subjective criteria that in many cases have no nexus to the European Union, and are inappropriate tests of whether a U.S. clearinghouse has systemic importance to the Union.

ESMA further proposes to override U.S. law and the 2016 agreement by rejecting substituted compliance for U.S. clearinghouses that they deemed systemically important to the European Union. ESMA's proposal would demand strict compliance with the majority of the European Union rulebook, effectively making ESMA, instead of the United States Congress and the CFTC, the standard setter for U.S. clearinghouses.

ESMA would also give European Union regulators authority over clearinghouses' corporate governance. This is in direct conflict with U.S. law, and imposes fees on U.S. clearinghouses to fund the European Union's expansion of its regulatory apparatus.

This wholesale regulatory takeover by the European Union is inconsistent with the needs of global financial markets. Without deference and cooperation, global markets will face regulatory frag-

mentation resulting in, as we said earlier, decreased liquidity, increased volatility, and higher prices for all market participants, and ultimately, consumers. It will place a higher cost on farmers, end-users, and producers that use U.S. markets to hedge risk. If this European Union legislation were to be enacted, it will weaken the stability of the U.S. financial system, in addition to the global financial marketplace.

Our U.S. regulators have longstanding experience overseeing complex markets, ensuring robust risk management, and assessing systemic risk. Rather than attempting to override this capable and vigilant regulatory regime, the European Union regulators should work with the U.S. to build a coordinated global regulatory framework.

Mr. Chairman, Members of the Committee, I thank you for giving me the extra time to give my comments today. I look forward to answering any questions you may have.

[The prepared statement of Mr. Duffy follows:]

PREPARED STATEMENT OF HON. TERRENCE A. DUFFY, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, CME GROUP INC., CHICAGO, IL

#### **Hearing To Review U.S. CCP Equivalence in the EU**

Chairman Scott, Ranking Member Scott, and Members of the Subcommittee, I am Terry Duffy, Chairman and CEO of CME Group Inc. (“CME Group”).<sup>1</sup> Thank you for the opportunity to testify today regarding U.S. central counterparty (“CCP”) equivalence in the European Union (“EU”) and the potential implications for the U.S. futures markets. We appreciate your interest in addressing the EU’s recent legislation on non-EU CCPs, which could have a drastic impact on Congress’s and the Commodity Futures Trading Commission’s (“CFTC”) authority over U.S. domiciled derivatives clearing organizations (“DCO”). Congress now has the opportunity to positively influence the EU to move towards an approach of regulatory deference before the full package of revised legal and regulatory requirements for non-EU CCPs is finalized by the EU. We expand on our views on how Congress can reduce the likelihood of EU overreach in our concluding remarks and believe that active Congressional engagement is a prerequisite to a positive result.

#### *Background on EU CCP Equivalence*

In March of 2016, the CFTC and the EU entered into an equivalence agreement following years of negotiations.<sup>2</sup> This agreement was soon followed by the recognition of individual DCOs in the U.S., like Chicago Mercantile Exchange Inc. (“CME”), which allowed EU persons to efficiently access U.S. futures markets for their hedging needs.

On June 23, 2016, the United Kingdom (“UK”) voted to depart from the EU. To ensure ongoing oversight of the Euro currency and financial markets denominated in Euros, the European Commission proposed new legislation in June of 2017 (here-

<sup>1</sup> CME Group Inc. (“CME Group”) is the parent of the Chicago Mercantile Exchange Inc. (“CME”). CME is registered with the Commodity Futures Trading Commission (“CFTC”) as a derivatives clearing organization (“DCO”) and is one of the largest central counterparty (“CCP”) clearing services in the world. CME’s clearing house division offers clearing and settlement services for exchange-traded futures and options on futures contracts, as well as over-the-counter (“OTC”) derivatives transactions, including interest rate swaps (“IRS”) products. On July 18, 2012, the Financial Stability Oversight Council designated CME as a systemically important financial market utility under Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”) based on its U.S. exposures, among other things. See, *Minutes of the Financial Stability Oversight Council*, pg. 5 (July 18, 2012), available at <https://www.treasury.gov/initiatives/fsoc/Documents/July%2018%20FSOC%20Meeting%20Minutes.pdf>.

<sup>2</sup> *Commission Implementing Decision* (EU) 2016/377 of 15 March 2016 on the equivalence of the regulatory framework of the United States of America for central counterparties that are authorised and supervised by the Commodity Futures Trading Commission to the requirements of Regulation (EU) No 648/2012 of the European Parliament and of the Council, available at <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016D0377&from=EN>.

after, “EMIR 2.2”).<sup>3</sup> But rather than focus on Euro denominated products and EU risks,<sup>4</sup> this legislation instead proposed a broad test to determine whether non-EU CCPs are of systemic importance to the EU. As drafted, the legislation may have captured non-EU CCPs with an extremely limited nexus to the Euro and/or limited exposures to EU financial institutions. As expanded upon below, this approach potentially captures U.S. DCOs such as CME, which have limited exposures to the Euro and EU clearing members. Consequently, under these very broad standards, U.S. DCOs that are found to be of systemic importance to the EU would be subject to direct EU regulation and supervision, contrary to the original equivalence agreement reached in March of 2016.

Despite efforts by the CFTC to encourage EU policy makers to incorporate cross-border deference into EMIR 2.2, political agreement was reached among the European Commission, European Parliament and European Council in March of 2019 on a version of EMIR 2.2 that provides for a test for systemic importance that does not require that a non-EU CCP have a nexus to the EU.<sup>5</sup> Thus, U.S. DCOs such as CME could be designated systemically important in the EU, despite CME’s limited exposures in EU denominated products and to EU clearing members. A DCO that is so designated would be directly regulated and supervised by the European Securities and Markets Authority (“ESMA”). Last month, ESMA issued technical advice consultations on EMIR 2.2 (hereafter, “ESMA Consultations”).<sup>6</sup> The ESMA Consultations propose text for regulations that are required to be adopted by the European Commission to implement EMIR 2.2.

Although EMIR 2.2 provides a mechanism based on comparable regulation that could potentially avoid the application of EU laws and regulations directly to U.S. DCOs, fulsome comparable compliance is not permitted by the proposed ESMA Consultations. Instead, the ESMA Consultations require that U.S. DCOs designated as systemically important in the EU must comply with the majority of laws and regulations adopted for EU CCPs. As a result, ESMA would exercise primary supervisory powers over such U.S. DCOs such as CME. This approach fails to recognize the comprehensive legal and regulatory framework adopted by Congress and implemented by the CFTC for U.S. DCOs generally and those designated as systemically important in the U.S. particularly.<sup>7</sup> Congress adopted this framework as the exclusive form of regulation for such U.S. DCOs.

In effect, EMIR 2.2 and the ESMA Consultations propose, in many cases, to supersede not only U.S. laws but also CFTC regulations that were subject to a robust notice and comment process. Instead of those Congressional and CFTC mandates,

<sup>3</sup>European Commission, *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* (June 2017), available at [https://eur-lex.europa.eu/resource.html?uri=cellar:80b1cafa-50fe-11e7-a5ca-01aa75ed71a1.0001.02/DOC\\_1&format=PDF](https://eur-lex.europa.eu/resource.html?uri=cellar:80b1cafa-50fe-11e7-a5ca-01aa75ed71a1.0001.02/DOC_1&format=PDF).

<sup>4</sup>*Id.* at pg. 6 (noting, “[m]oreover, a substantial volume of euro-denominated derivatives transactions (and other transactions subject to the EU clearing obligation) is currently cleared in CCPs located in the United Kingdom. When the United Kingdom exits the EU, there will therefore be a distinct shift in the proportion of such transactions being cleared in CCPs outside the EU’s jurisdiction, exacerbating the concerns outlined above. This implies significant challenges for safeguarding financial stability in the EU that need to be addressed. In light of these considerations, the Commission adopted a Communication on 4 May 2017 on responding to challenges for critical financial market infrastructures and further developing the Capital Markets Union 22. The Communication indicated that ‘further changes [to EMIR] will be necessary to improve the current framework that ensures financial stability and supports the further development and deepening of the Capital Markets Union (CMU).’”).

<sup>5</sup>Council of the European Union, *Regulation of the European Parliament and of the Council amending Regulation (EU) No 648/2012 as regards the procedures and authorities involved for authorisation of CCPs and requirements for recognition of third-country CCPs—Confirmation of the final compromise text with a view to agreement* (March 2019), available at <https://data.consilium.europa.eu/doc/document/ST-7621-2019-ADD-1/en/pdf>.

<sup>6</sup>European Securities and Markets Authority, Consultation Paper, *Draft technical advice on criteria for tiering under Article 25(2a) of EMIR 2.2* (May 2019), available at [https://www.esma.europa.eu/sites/default/files/library/esma70-151-2138\\_cp\\_ta\\_on\\_tiering\\_criteria.pdf](https://www.esma.europa.eu/sites/default/files/library/esma70-151-2138_cp_ta_on_tiering_criteria.pdf); European Securities and Markets Authority, Consultation Report, *Technical Advice on Comparable Compliance under article 25a of EMIR* (May 2019), available at [https://www.esma.europa.eu/sites/default/files/library/esma70-151-2179\\_cp\\_ta\\_on\\_comparable\\_compliance.pdf](https://www.esma.europa.eu/sites/default/files/library/esma70-151-2179_cp_ta_on_comparable_compliance.pdf); European Securities and Markets Authority, Consultation Paper, *ESMA fees for Third-Country CCPs under EMIR 2.2* (May 2019), available at [https://www.esma.europa.eu/sites/default/files/library/esma70-151-1663\\_cp\\_on\\_emir\\_2\\_2\\_ccp\\_fees.pdf](https://www.esma.europa.eu/sites/default/files/library/esma70-151-1663_cp_on_emir_2_2_ccp_fees.pdf).

<sup>7</sup>U.S. DCOs that have been designated as systemically important in the U.S. are subject to heightened regulatory standards along with direct oversight and annual examinations by the CFTC and the Board of Governors of the Federal Reserve System.

U.S. DCOs would be subjected to recently developed EU laws and regulations on risk management and governance which were drafted with EU financial markets in mind. It is notable that ESMA does not, and will not under EMIR 2.2 or the ESMA Consultations, supervise any EU CCPs. In fact, the EU policy-makers specifically considered giving ESMA supervisory powers over EU CCPs as part of the legislative process and decided to continue to defer to the local regulators in the EU member states.

The U.S. approach to supervision and oversight of foreign futures markets stands in stark contrast to EMIR 2.2 and the ESMA Consultations. CCPs outside of the U.S. can clear foreign futures for U.S. persons without being subject to any supervision or oversight from the CFTC due to exemptive relief offered by the CFTC under Part 30 of its regulations, which has been in place for decades.

*CME Does Not Pose A Systemic Risk to the EU*

CME does not pose a systemic risk to the EU and is subject to the robust regulatory oversight of the CFTC under a framework designed for U.S. financial markets by this Committee and Congress. Notwithstanding CME's lack of systemic importance to the EU based on its financial exposures and products cleared, the ESMA Consultations are designed to capture CME as systemically important. If so captured, CME would be subject to EU supervision and regulation, which would have negative implications for the U.S. economy and regulatory sovereignty, as further discussed in the next section.

CME has long provided a wide variety of U.S. Dollar denominated futures products to its market participants. While these products are used to hedge business risk on a global basis due to the role of the U.S. Dollar as the world's reserve currency, the vast majority of the risks that CME manages stem from U.S. domiciled clearing members. In fact, EU domiciled entities clear less than 2% of the risks that CME manages. The de minimis nature of CME's exposures to EU domiciled clearing members is consistent with the limited products that CME clears denominated in EU currencies. These products represent significantly less than 5% of CME's volume and exposure and an even smaller portion of the overall Euro denominated futures markets.

*Potential Impacts of EU Superseding U.S. Law*

The powers proposed under EMIR 2.2 and the ESMA Consultations are far reaching. They present negative implications for U.S. sovereignty over its financial markets. Ultimately, the EU's imposition of its laws and regulations risk weakening the stability of the U.S. and global financial systems and fragmenting U.S. futures markets, while potentially undermining the central role the U.S. has played in the global commodities markets.<sup>8</sup> As just one example of the wide ranging regulations imposed, the combination of EMIR 2.2 and the ESMA Consultations would allow ESMA to remove members of the board of directors of a U.S. DCO designated systemically important in the EU. That power directly conflicts with well-established corporate law principles in the U.S. and exceeds the authority afforded to the CFTC under U.S. law. The ability to dictate board representation has consequences beyond corporate governance since the board is the ultimate decision-making power on all manner of major strategic issues, including U.S. DCO's risk management.

EMIR 2.2 and the ESMA Consultations would supplant U.S. regulatory standards for U.S. DCOs' risk management, even though the EU standards were drafted by policy-makers unfamiliar with the nuances of the U.S. futures markets. The application of foreign regulation to U.S. futures markets has the potential to create systemic risk through increased regulatory complexity and conflict. Risk management best practices originated in the U.S. futures markets and have served as a template for global financial reform due to the robust performance of U.S. DCOs during the financial crisis. Congress and the CFTC have expanded upon these best practices by applying their well-earned expertise to develop a robust set of principles-based regulations that are designed to ensure financial stability while taking into account

<sup>8</sup>European Commission, Communication from the Commission to the European Parliament, the European Council (Euro Summit), the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions—Towards a stronger international role of the euro (Dec. 2018) (noting, recently, the European Commission laid out a vision for a future state where the Euro replaces the U.S. Dollar as the currency of choice when transacting in commodities markets. That vision, if realized, will have broader deleterious effects on the U.S. economy and mainstream consumers. Historically, most commodities have been priced in U.S. Dollars due to the central role of the U.S. Dollar in the global economy and the pre-eminence of the U.S. financial markets.), available at <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52018DC0796&from=en>.

the unique characteristics of the deeply liquid U.S. cleared futures markets used by farmers, end-users and producers for price discovery and hedging purposes.

*Next Steps for Congress and the CFTC*

The ESMA Consultations are currently open for comment with the period closing on July 29, 2019. It is expected that the ESMA Consultations would then be finalized by the end of 2019 with the new EU powers going into effect in early 2020. We respectfully urge Congress and the CFTC to act now to ensure that the implementation of EMIR 2.2 respects U.S. sovereignty and expertise over its financial markets.

This Committee and Congress have since 1974 provided the exclusive regulatory framework for U.S. futures markets to be administered by the CFTC. Ensuring the continuation of that framework is critical. In the event that regulatory deference is not offered by its foreign regulatory peers, the CFTC has powers under the Commodity Exchange Act and Part 30 of its regulations to take actions to support U.S. financial markets' stability and the broader role played by U.S. financial markets in the global financial system. We encourage Congress and the CFTC to use their powers as necessary while also considering whether any additional statutory or regulatory tools are necessary to address regulatory overreach by policy-makers outside of the U.S., including the EU.

Thank you. I look forward to answering your questions.

The CHAIRMAN. Thank you very much, Mr. Duffy. That was very informative.

And now, I recognize Mr. Edmonds.

**STATEMENT OF CHRISTOPHER S. EDMONDS, SENIOR VICE PRESIDENT, FINANCIAL MARKETS, INTERCONTINENTAL EXCHANGE, INC., CHICAGO, IL**

Mr. EDMONDS. Chairman Scott, Ranking Member Scott, and Members of the Subcommittee, I am Chris Edmonds, Senior Vice President for Financial Markets, Intercontinental Exchange, or ICE. I appreciate this opportunity to appear before you today as this Committee looks at Brexit and EMIR 2.2, and related cross-border issues.

Central counterparties play a critical role in the financial markets serving the needs of market participants around the globe. Policy makers across the world, including this Committee, have an interest in safe and efficient markets.

Since launching an electronic marketplace for energy in 2000 in Atlanta, Georgia, ICE has expanded in both the U.S. and internationally. We have acquired or founded derivatives exchanges and clearinghouses in the U.S., Europe, Singapore, and Canada. Today, ICE owns and operates six geographically diverse clearinghouses that serve global markets and customers across North America, Europe, and Asia. Each of these clearinghouses is subject to direct oversight by local national regulators, and subject to regulations reflective of the G20 reforms and IOSCO principles. Our assets are regulated by the CFTC, the SEC, the Federal Reserve System, the Bank of England, the UK Financial Conduct Authority, The European Securities Market Authority, the Monetary Authority of Singapore, among others.

Over the last decade, we have become familiar and work closely with global regulators to understand their unique perspectives.

Clearing has consistently proven to be a fundamentally safe and sound process for managing systemic risk. Observers frequently point to non-cleared derivative contracts as a significant factor in the broad reach and complexity of the 2008 financial crisis, while noting the relative stability of cleared markets. Regulators and



market participants also understand these are global markets, and to realize the goals of the G20 reforms, it is essential regulators share information and continue to cooperate with each other, consistent with agreed upon international frameworks.

As an example, ICE supports the ongoing dialogue between the European and U.S. policy makers where there have been notable success. The 2016 agreement between the European Commission and CFTC established a common approach to supervision of cross-border CCPs. This agreement promotes regulatory deference as well as prioritizes provisions supporting robust global derivatives markets. Continued regulatory cooperation is imperative, as issues such as Brexit, which should have no bearing on these efforts, are determined by other political bodies and agendas.

Differences and unsubstantiated changes in financial sector reforms can lead to overlapping and conflicting requirements. This is in no one's best interest, and it has been clearly articulated here today in previous comments. This spirit of cooperation should guide our ongoing discussion on critical cross-border issues, including EMIR 2.2 implementation and potential Brexit responses.

The proposed EMIR 2.2 text contemplates that with respect to non-European Union domiciled CCPs determined to be systemically important, ESMA could rely on comparable compliance with the CCP local regulatory regime. However, the text also contemplates that ESMA be able to recommend and the Commission be able to adopt after agreement with the ECB, an act requiring a clearinghouse to relocate in the EU if the central counterparty or some of its clearing services are of such systemic importance.

A better outcome would be to continue the development and reliance on the model of supervisory cooperation, enabling EU supervisors to exercise appropriate and proportionate oversight of central counterparties.

The European Commission policy goals to ensure appropriate supervision of non-EU domiciled CCPs that are deemed systemically important, are completely understandable. ICE believes these goals can be achieved by ESMA employing mechanisms based on international standards such as CPMI-IOSCO. Each national regulator should consider the interest of other relevant authorities and interested parties when managing a crisis. However, there should be no ambiguity in the ultimate decision-making authority for the avoidance of doubt. The industry cannot afford any regulatory confusion in a time of stress.

ICE believes the cross-border oversight and regulatory deference to home country regulators are essential to well-functioning markets. They are the foundation of healthy global markets. The CFTC's recent publication and Chairman Giancarlo's description of his vision for future CFTC rule proposals are, in ICE's view, positive steps towards implementing relevant laws, standards, and policies that further the goal for financial stability and resilience while minimizing supervisory duplication and conflict.

ICE has always been, and remains a strong proponent of open and competitive markets with appropriate regulatory oversight. To that end, we have, and we will continue to work closely with this Committee and all regulatory authorities to ensure access to all relevant information available.

Mr. Chairman, thank you for the opportunity to share our views with you. I would be happy to answer any questions you or Members of the Subcommittee have today.

[The prepared statement of Mr. Edmonds follows:]

PREPARED STATEMENT OF CHRISTOPHER S. EDMONDS, SENIOR VICE PRESIDENT,  
FINANCIAL MARKETS, INTERCONTINENTAL EXCHANGE, INC., CHICAGO, IL

### **Introduction**

Chairman Scott, Ranking Member Scott, I am Chris Edmonds, Senior Vice President, Financial Markets for Intercontinental Exchange, or ICE. I appreciate the opportunity to appear before you today, as this Committee looks at Brexit, the European Commission's recent reforms to its legislation governing the regulation and supervision of CCPs, called the European Market Infrastructure Regulation (or EMIR 2.2), and related cross-border issues.

Central counterparties (or CCPs) play a critical role in the financial markets that serve the needs of market participants around the globe. Policy makers across the world, including this Committee, have an interest in safe and efficient markets. To further the common interest of well-functioning markets and well-regulated CCPs, we appreciate the opportunity to participate in this hearing as it examines the cross-border supervision of CCPs.

### **Background**

Since launching an electronic over-the-counter (OTC) energy marketplace in 2000 in Atlanta, Georgia, ICE has expanded both in the U.S. and internationally. Over the past seventeen years, we have acquired or founded derivatives exchanges and clearing houses in the U.S., Europe, Singapore and Canada. In 2013, ICE acquired the New York Stock Exchange, which added equity and equity options exchanges to our business. Through our global operations, ICE's exchanges and clearing houses are directly regulated by the U.S. Commodity Futures Trading Commission (CFTC), the Securities and Exchange Commission (SEC), the Bank of England, the UK Financial Conduct Authority (FCA), the European Securities and Markets Authority (ESMA) and the Monetary Authority of Singapore, among others.

ICE has a successful and innovative history of clearing exchange traded and OTC derivatives across a spectrum of asset classes, including energy, agriculture and financial products. Today, ICE owns and operates six geographically diverse clearing houses that serve global markets and customers across North America, Europe and Asia. Each of these clearing houses is subject to direct oversight by local national regulators, often in close coordination and communication with other regulatory authorities with important interests, and subject to regulations reflective of the G20 reforms and IOSCO principles.

ICE acquired its first clearing house, ICE Clear U.S., as a part of the 2007 purchase of the New York Board of Trade. ICE Clear U.S. is primarily regulated by the CFTC and is recognized by ESMA and clears a variety of agricultural and financial derivatives. In 2008, ICE launched ICE Clear Europe, the first new clearing house in the UK in over a century. ICE Clear Europe clears derivatives in several asset classes, including energy, interest rates, equity and credit derivatives, and is primarily supervised by the Bank of England, in close cooperation with the CFTC, the SEC and ESMA. ICE Clear Credit was established as a trust company in 2009 under the supervision of the Federal Reserve Board and the New York State Banking Department and converted to a derivatives clearing organization (DCO) following implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). ICE Clear Credit is primarily regulated by the CFTC and SEC and also recognized by ESMA and clears a global set of credit default swaps on indices, single names and sovereigns. ICE also operates ICE Clear Netherlands under the regulatory supervision of De Nederlandsche Bank, Autoriteit Financiële Markten and ESMA and ICE Clear Singapore which is overseen by the Monetary Authority of Singapore.

### *CCPs Vital Role in the Derivatives Market*

The risk reducing benefits of central clearing have long been recognized by users of exchange-traded derivatives (futures) and the pre-existing regulatory framework and efficacy of the clearing model throughout even the most challenging financial situations made it the natural foundation of the financial reforms put forward over the past decade. Clearing has consistently proven to be a fundamentally safe and sound process for managing systemic risk. Observers frequently point to non-cleared

derivative contracts as a significant factor in the broad reach and complexity of the 2008 financial crisis, while noting the relative stability of cleared markets.

The disciplined and transparent risk management practices of regulated clearing houses serve to reduce systemic risk. A clearing house, by acting as a central counterparty, to clearing members' transactions, eliminates the bilateral counterparty credit risk and imposes on clearing members a transparent set of rules and prudent risk management practices, such as margin requirements, to minimize risks managed by the clearing house. Over the past 100 years, clearing house risk management practices have been repeatedly tested and proven in resolving clearing member defaults including large bankruptcy proceedings, such as Lehman Brothers and MF Global. The recent introduction of mandated clearing obligations for certain swaps has sensibly extended the significant benefits of clearing to a broader array of financial instruments.

#### *Regulatory Cooperation*

Following the 2008 financial crisis, global regulators were tasked with implementing the G20 reforms to achieve the goals of increased financial stability, resilience and transparency in the global OTC derivatives market. Over the last decade, ICE has worked with global regulators as they implement reforms designed to foster financial stability, facilitate robust, liquid and transparent markets, and protect the geographically diverse users of those global markets.

It is well understood by regulators and market participants that the derivatives markets are global markets, as participants in those markets trade across venues and jurisdictions to meet their unique business needs. To realize the goals of the G20 reforms, it is essential that regulators share information and continue to cooperate with each other, consistent with agreed upon global frameworks. It is important that regulators carefully implement regulatory requirements to minimize the fragmentation of markets and liquidity, which can reduce the efficacy of commercial firms' risk management efforts and undermine the goals of financial stability and resilience. To this end, constructive relationships among regulators are critical to building the confidence and trust essential for effective cross-border regulatory frameworks and that are consistent with globally agreed to principles. This effort to work together is in all of our best interests, just as the prevention of market fragmentation should be. Such deference and cooperation can enhance liquid, well-functioning markets and minimize confusion and inefficient, duplicative oversight.

ICE supports the ongoing dialogue between European and U.S. policy makers where there have been notable successes. The 2016 agreement between the European Commission (EC) and the CFTC established a common approach to the regulation and supervision of cross-border CCPs (CCP Agreement).<sup>1</sup> The CCP Agreement promotes regulatory deference as well as prioritizes provisions supporting robust global derivatives markets. In addition, the CFTC, Bank of England and the Financial Conduct Authority recently issued a joint statement providing assurances to market participants on the continuity of derivatives trading and clearing activities between the UK and U.S. regardless of the outcome of the UK's withdrawal process from the EU. Similarly, the EU announced its intention to continue to recognize UK-based clearing firms after the UK's withdrawal process from the EU. Together, these authorities took cooperative measures to avoid regulatory uncertainty about the continuation of the global derivatives market regardless of their location; such an important step achieved through communication, coordination and local regulatory frameworks established based upon global principles. These measures give confidence to market participants about their continued ability to trade and manage their global risks on a cross-border basis.

Continued regulatory cooperation is imperative, as issues such as Brexit, which should have no bearing on these efforts, are determined by other political bodies. ICE has a long history of working with U.S. and global regulators on mutually beneficial supervisory outcomes. Differences and unsubstantiated changes in financial sector reforms can lead to overlapping or conflicting requirements. By working together across the globe, regulators can avoid this harmful and counterproductive outcome and promote a more resilient financial system. This spirit of cooperation should guide our ongoing discussions on critical cross-border issues, including EMIR 2.2 implementation and potential Brexit responses.

<sup>1</sup>Joint Statement from CFTC Chairman Timothy Massad and European Commissioner Jonathan Hill, *CFTC and the European Commission: Common approach for transatlantic CCPs* (February 10, 2016), <https://www.cftc.gov/PressRoom/PressReleases/pr7342-16>.

## EMIR 2.2

Recently, the European Parliament and EU-Member States reached an agreement on reforms to EMIR 2.2, legislation governing the regulation and supervision of CCPs. Prior to this announcement, the EU's approach to supervising non-EU CCPs was based on equivalence and deference to the 2016 CCP Agreement. EMIR 2.2 expands the regulatory and supervisory authority of ESMA over third-country CCPs, *i.e.*, non-EU domiciled CCPs, if those CCPs are determined to be systemically important for the financial stability of the EU. EMIR 2.2 contemplates that, with respect to non-EU domiciled CCPs determined to be systemically important, ESMA could rely on comparable compliance with the CCP's local regulatory regime. EMIR 2.2 also contemplates that ESMA be able to recommend, and the Commission be able to adopt, after agreement from the ECB, an act that requires a clearing house to relocate to the EU if the CCP or some of its clearing services are deemed to be of such systemic importance. We agree with the final agreement of the European Parliament and Council that such an act should be a measure of last resort, as such a requirement would increase costs considerably for banks and their customers, because the current portfolio efficiencies would be unavailable if the euro-denominated portion were disaggregated. A better outcome would be to continue the development and reliance on a model of supervisory cooperation that enables EU supervisors to exercise appropriate and proportionate oversight of CCPs that provide clearing services in the EU.

ESMA recently published two consultations on the implementation of the new EMIR 2.2 regime for non-EU domiciled CCPs. Specifically, ESMA is currently seeking public consultation on the criteria for assessing the systemic importance of non-EU domiciled CCPs. ESMA is also consulting on the detailed rules regarding ESMA's approach to comparable compliance. ICE is evaluating ESMA's recently published consultations and will be commenting. ICE supports the EMIR 2.2 goal to establish appropriate supervision of non-EU domiciled CCPs that are determined to be systemically important for the financial stability of the EU and looks forward to contributing to the dialogue on implementation of EMIR 2.2.

The European Commission's policy goals to ensure appropriate supervision of non-EU domiciled CCPs that are deemed systemically important to the EU are understandable. ICE believes that these goals can be achieved by ESMA employing mechanisms based on international standards such as CPMI-IOSCO, together with continued cooperation and information-sharing agreements among CCP supervisory authorities. These mechanisms can provide ESMA with the information and oversight they require, while leaving the final decision-making in the hands of national regulators to prevent overlapping or conflicting requirements, which is particularly critical in a time of crisis. ESMA, in any effort to enhance oversight of non-EU CCPs, should consider strong and effective supervisory cooperation between the relevant authorities. This approach will enable EU supervisors to exercise appropriate and proportionate oversight of non-EU CCPs.

A global approach to supervision brings significant benefits. Especially in a crisis situation, the market needs clarity that the national regulator can take the lead in managing a default and have the ultimate decision making authority. The national regulator should consider the interests of other relevant authorities and interested parties when managing a crisis, however there should be no ambiguity in the ultimate decision making authority.

## CFTC Cross-Border Regulation

In 2018, the CFTC indicated its desire to reassess the current cross-border application of its swaps regime with a rule-based framework based on regulatory deference to third-country regulatory jurisdictions that have adopted the G20 swaps reforms.<sup>2</sup> The CFTC has stated that, as global regulators continue to implement swaps reforms in their markets, it is critical to ensure CFTC rules do not conflict and fragment the global marketplace. The CFTC has proposed to move to a flexible, outcomes-based approach for cross-border equivalence and substituted compliance and to employ deference to overseas regulators. To this end, Chairman Giancarlo has recently described a new approach to supervising certain foreign derivatives clearing organizations (DCOs). This approach would introduce an alternative compliance regulatory framework for those foreign DCOs that do not pose a substantial risk to the U.S. financial system and would rely on the DCOs' home country rules to a large extent. ICE supports this type of approach and hopes the CFTC will publish the proposal for comment shortly.

<sup>2</sup>"Chairman Giancarlo Releases Cross-Border White Paper", October 1, 2018 at: <https://www.cftc.gov/PressRoom/PressReleases/7817-18>.

ICE believes that the cross-border oversight and regulatory deference to home country regulators is essential to well-functioning markets. The [CFTC's] recent publications and Chairman Giancarlo's description of his vision for future CFTC rule proposals are, in ICE's view, positive steps towards implementing relevant laws, standards, and policies that further the goal of financial stability and resilience, while minimizing supervisory duplication and conflict.

**Conclusion**

ICE has always been, and remains, a strong proponent of open and competitive markets with appropriate regulatory oversight. As an operator of global futures and derivatives markets, ICE understands the importance of ensuring the utmost confidence in its markets and we take seriously our obligations to mitigate systemic risk. To that end, we have worked closely with regulatory authorities in the U.S. and abroad in order to ensure they have access to all relevant information available to ICE regarding trade execution and clearing activity on our markets. We look forward to continuing to work closely with governments and regulators at home and abroad to address the evolving regulatory challenges presented by derivatives markets and to expand the use of demonstrably beneficial clearing services that underpin the best and safest marketplaces possible.

Mr. Chairman, thank you for the opportunity to share our views with you. I would be happy to answer any questions you and Members of the Subcommittee may have.

The CHAIRMAN. Yes, thank you very much, Mr. Edmonds. I appreciate that.

And now, Mr. Daniel Maguire.

**STATEMENT OF DANIEL J. MAGUIRE, CHIEF EXECUTIVE OFFICER, LCH GROUP LIMITED; MEMBER, EXECUTIVE COMMITTEE, LONDON STOCK EXCHANGE GROUP PLC, LONDON, UK**

Mr. MAGUIRE. Chairman Scott, Ranking Member Scott, Members of the Committee, thank you for your warm welcome and the opportunity to appear before the Committee today to discuss the evolving global dialogue on cross-border regulation of clearinghouses, as well as Brexit and its potential ramifications and impact on the wider markets.

Some context: I am Daniel Maguire. I serve as Chief Executive Officer of LCH Group, and I am a member of the Executive Committee of the London Stock Exchange Group, a global financial market infrastructure business which comprises of 4,500 employees globally, of which over 700 are here based in the United States. I have been with the firm for 20 years, including several years based in New York during the formative years of Dodd-Frank implementation, during which time I spent a substantive amount of time here in Washington working with the regulators on the swaps rules that were developed and implemented.

LCH operates the world's largest clearinghouse for swaps. It is domiciled in the UK, and it is a global business serving global clients. It covers 60+ jurisdictions in terms of clients, 26 currencies, and has regulatory oversight and direct licenses in ten jurisdictions. Our home country regulator is the Bank of England; however, LCH has also been registered as a derivatives clearing organization, a DCO, with the CFTC since 2001, for over 18 years now, long before the crisis in 2008 and the Dodd-Frank Act.

LCH's interest rate swap clearing service, SwapClear, clears 90 percent of the global cleared interest rate market.

Really, just to give some context, just as farmers and ranchers may use commodity derivatives to manage their risk of exposure to commodity price fluctuations, it is fair to say U.S. corporations,

asset managers, and other end-users in the U.S. utilize interest rate swaps to manage their risk exposure to interest rate fluctuations.

The interest rate swap market is one of the largest global financial markets, and I am pleased to provide our perspective on this important piece of the Committee's jurisdiction. My remarks today will focus on three topics.

First, with respect to Brexit, I am pleased to say that temporary measures have been put in place to avoid disruption for the interest rate swap markets, regardless of political outcome. Three years ago, the UK voted to leave the EU. To date, no agreement has been reached for their orderly exit from the EU, and if no agreement is reached by the end of October 2019, no extension of the current deadline provided, the UK will leave the EU without the transitional arrangements in place, commonly known as a hard Brexit.

To mitigate the significant market disruption and financial stability risks, in the event of a hard Brexit, the European Commission and the UK Government collaborated to install temporary contingency measures that would allow EU participants to continue to have access to UK clearinghouses and their global liquidity in the event of a hard Brexit.

However, regardless of if there is a hard Brexit scenario or not, LCH will therefore be able to continue offering all of these clearing services. We welcome these proposals and actions by the European Commission and ESMA, as has been referred to by others, which provided great clarity and certainty to market participants in the EU and outside of the EU, too.

As a systemically important global institution, our main priority continues to ensure the orderly functioning of the markets, continuity of service to our customers, and most importantly, supporting financial stability, regardless of the Brexit outcomes.

My second point really comes to the evolving framework regarding large global international clearinghouses. The future architecture of global derivatives markets must, at all costs, avoid unnecessary fragmentation, and therefore, must support a form of regulatory supervisory cooperation and deference mentioned by my other colleagues today.

Following the financial crisis in 2008, the G20 agreement in 2009, the U.S. passed derivative reforms in 2010, and Europe the same in 2012. In 2016, the Brexit vote was shortly followed thereafter by the EU proposed amendments to EMIR that would redefine how clearinghouses outside of the EU would be regulated. It is commonly known as EMIR 2.2. Under EMIR 2.2, in the event of the UK departure from the EU, the UK will be treated similar, if not the same, to the U.S. and other non-EU jurisdictions, known as third countries in the EU regulatory context.

Regulating global markets requires different jurisdictions to agree on the mechanisms to allow national regulatory frameworks to interact on an international level to avoid fragmentation into smaller localized markets, which increases risk and increases costs for the U.S. and their users.

My third and final point, systemically important DCOs should be able to deposit their U.S. dollar cash margin in a U.S. central bank account, regardless of their domicile. Although LCH does have ac-

cess to central bank accounts in many of the G20 jurisdictions, it does not currently have that facility here in the U.S. with the Federal Reserve.

As the discussion over the cross-border clearinghouse regulation progresses, we believe that is absolutely imperative for central banks to require clearinghouses that manage substantial risks in their jurisdiction to maintain a deposit account for their currency. To be clear, this is deposit accounts for safekeeping of customer margin. This is not and should not be confused with the Fed providing emergency lending in the event of a crisis, often known as a discount window access.

Central bank deposit accounts are widely agreed by the industry and regulation community as the safest option for clearinghouses. To put this in context, LCH's daily U.S. dollar cash balances for U.S. customers is in the region of \$30 to \$40 billion.

It is important to note that we operate an extensive global collateral management function to ensure safety of margin that it receives. Having access to a central bank account would only enhance that.

So, in line with the recommendations from the U.S. Treasury Department and others, we would urge this Committee and the relevant U.S. financial regulators to further evaluate the important financial stability role that central bank deposit accounts could make and could play for systemically important DCOs, such as LCH and others that are here today.

Chairman Scott, Ranking Member Scott, and Members of the Committee, I would like to thank you again for this opportunity. I apologize for running over. I appreciate the opportunity to finish, and I look forward to answering any questions you may have.

[The prepared statement of Mr. Maguire follows:]

PREPARED STATEMENT OF DANIEL J. MAGUIRE, CHIEF EXECUTIVE OFFICER, LCH GROUP LIMITED; MEMBER, EXECUTIVE COMMITTEE, LONDON STOCK EXCHANGE GROUP PLC, LONDON, UK

### Introduction

Chairman Scott, Ranking Member Scott, and Members of the Committee, I appreciate the opportunity to appear before you today to discuss Brexit, its impact on the markets and the evolving international dialogue on cross-border regulation of clearing houses.

I am Daniel Maguire and I serve as Chief Executive Officer of LCH Group Limited ("LCH") and as a Member of the Executive Committee of London Stock Exchange Group ("LSEG"), a global financial market infrastructure business.<sup>1</sup> LSEG has approximately 4,500 employees around the world, over 700 of which are employed in the U.S. across offices in five states. LCH and FTSE Russell, one of the world's largest index providers, which is also part of LSEG, are important components of the U.S. financial markets.

LCH operates the world's largest swaps clearing house, LCH Ltd., which is domiciled in the UK.<sup>2</sup> LCH Ltd is directly licensed in ten jurisdictions, has customers in 60 jurisdictions and offers clearing services in 26 different currencies. LCH Ltd's home country regulator is the Bank of England ("BoE") and LCH Ltd has been registered with the U.S. Commodity Futures Trading Commission ("CFTC") as a Derivatives Clearing Organization ("DCO") since 2001. LCH also clears futures traded

<sup>1</sup>LSEG holds an 82.6% stake in LCH Group, the remaining share is held by a consortium of banks.

<sup>2</sup>LCH also operates LCH SA, domiciled in Paris, which is regulated in four jurisdictions. LCH SA has been registered at the CFTC since 2013 and the U.S. Securities and Exchange Commission ("SEC") since 2016. LCH SA's primary regulator is the Autorité de contrôle prudentiel et de résolution ("ACPR").

on the London Stock Exchange Derivatives Market (“LSEDM”), which is registered as a Foreign Board of Trade (“FBOT”) by the CFTC.

LCH’s interest rate swap (“IRS”) clearing service, SwapClear, clears over 90 percent of the cleared IRS market globally. The health and liquidity of the IRS market allows banks and other financial institutions to manage fluctuations in interest rates, which translates into direct benefits for end-users, U.S. consumers and the broader U.S. economy. Our U.S. end-user clients includes pension funds, regional banks, Federal Home Loan Banks and government sponsored enterprises, among many others.

### Summary

My remarks today will focus on three related topics.

First, I will discuss LCH’s response to Brexit and what this means for our market participants, including U.S. banks and end-users. Through the focused efforts of the derivatives industry and key central banks and market regulators, contingency measures have been established that will permit LCH and other clearing houses in the UK and EU to continue to offer services to our clients in the event the UK exits the EU without an agreement, referred to as “no-deal” or “Hard” Brexit.

Second, I will discuss the evolving international dialogue on cross-border regulation of global clearing houses. Brexit has sharpened the ongoing focus on this topic between the UK and EU as well as many other jurisdictions around the world, including here in the U.S. We have been encouraged by the progress and regulatory cooperation among major jurisdictions, yet significant work lies ahead. LCH will continue to work with our regulators, market partners and customers towards outcomes that enhance financial stability and support global markets.

Finally, I will discuss the topic of clearing house resilience and our views on how the global regulatory framework for clearing houses can best support the common objective of strengthening these increasingly important components of the financial markets. I will specifically discuss the role central bank deposit accounts play in enhancing the resilience of clearing houses as the safest place to deposit cash margin, an issue that is widely agreed on by the industry and regulatory community.

### UK Withdrawal from the EU and “Hard Brexit” Contingency Measures

Three years ago, on June 23, 2016, the UK voted to leave the EU. In March 2017, the legal instrument to commence this withdrawal, known as Article 50, was triggered. The UK Government and EU began withdrawal negotiations in June 2017. In November 2018, the UK Government and the EU agreed on a Brexit deal, known as the Withdrawal Agreement, subject to approval by the EU Council and UK Parliament. In a series of three votes between January and March of this year, the UK Parliament voted against the Withdrawal Agreement. It was subsequently agreed to extend the deadline for Brexit until October 31, 2019.

Currently, if no agreement is reached by October 31 and no extension of the current deadline is provided, the UK will leave the EU without transitional arrangements in place. To avoid the significant market disruption and financial stability risks in the event of a Hard Brexit, on December 19, 2018, the European Commission (“EC”) implemented its no-deal contingency action plan that includes a conditional and temporary equivalence decision to allow UK clearing houses to continue to provide services in the EU.<sup>3</sup>

On February 18, 2019, the European Securities and Markets Authority (“ESMA”) recognized three UK clearing houses following the EC’s equivalence decision.<sup>4</sup> ESMA’s recognition of LCH Ltd. as a “third-country CCP” applies until March 30, 2020 and is only triggered in the event of a Hard Brexit, allowing LCH Ltd. the ability to continue to offer all clearing services for all products to all members and clients. We welcomed these actions by the European Commission and ESMA, which provided clarity for our market participants.<sup>5</sup>

As a systemically important institution, our main priority is ensuring the orderly functioning of markets, continuity of service to our customers and supporting financial stability. As the negotiations progress, we will continue to engage with the relevant regulatory authorities to secure the long-term recognition of LCH Ltd. in the

<sup>3</sup>*Brexit: European Commission implements “no-deal” Contingency Action Plan in specific sectors*, available at [http://europa.eu/rapid/press-release\\_IP-18-6851\\_en.htm](http://europa.eu/rapid/press-release_IP-18-6851_en.htm). Similar temporary equivalence was granted by the BoE for EU27 domiciled clearing houses, including LCH SA and LSEG’s Italian clearing house, Cassa di Compensazione e Garanzia (“CC&G”).

<sup>4</sup>*ESMA to Recognise Three UK CCPs in the Event of a No-Deal Brexit*, available at <https://www.esma.europa.eu/press-news/esma-news/esma-recognise-three-UK-ccps-in-event-no-deal-brexit>.

<sup>5</sup>*LCH Member Update, April 5, 2019*, available at <https://www.lch.com/membership/ltl-membership/ltl-member-updates/brexit-update-lch-limited-article-25-recognition-0>.



EU. It remains LCH's objective to ensure a smooth transition for our customers whatever the outcome of the negotiations around the UK's withdrawal from the EU.

### **Cross-Border Regulation of Global Clearing Houses**

The IRS market, along with many other derivatives asset classes, are global in nature. This requires different jurisdictions to agree on regulatory mechanisms that allow national rules to interact on an international level. This supports global market health and liquidity and avoids fragmentation into smaller, localized markets.<sup>6</sup> Creating a harmonized, level playing field of regulation and cross-border market access enhances competition among global markets and increases financial stability. This results in lower costs and increased protection for market participants, including end-users.

Large, global clearing houses manage different levels of risk in the various jurisdictions where they operate. A key debate among national regulators is how to measure a foreign clearing house's importance in their jurisdiction and the resulting regulatory oversight needed to oversee those clearing houses. We believe that regulation of clearing houses outside of their home jurisdiction should be proportionate to the risk that clearing house is managing in the host jurisdiction. Host country regulators should afford deference to comparable home country oversight where appropriate.

The regulatory frameworks governing the cleared swaps markets were significantly enhanced and redefined with the Dodd-Frank Act in 2010 and the European Market Infrastructure Regulation ("EMIR") in 2012. Similar derivatives reforms were implemented in many other markets around the world pursuant to the G20 financial regulatory reforms, which were established following the 2008 financial crisis.<sup>7</sup>

In 2016, an equivalence decision concerning the cross-border regulation of clearing houses was made between the CFTC and EC.<sup>8</sup> In 2017, the EC proposed amendments to EMIR, known as "EMIR 2.2," which were agreed this past March.<sup>9</sup> Provisions in EMIR 2.2 will redefine how non-EU domiciled clearing houses that provide clearing services to EU participants will be regulated by EU authorities.

In the event of the UK departure from the EU, the UK will be treated similar to the U.S. and other non-EU jurisdictions, referred to as "third countries" in the EU regulatory context. We will continue to work with our regulators in the UK, EU and U.S. to define how these regulatory standards under EMIR 2.2 are developed, which will result in enhanced regulatory cooperation among these three major jurisdictions and beyond.

Given LCH's significant risk management role in the U.S. financial markets, we have supported the direct registration of LCH Ltd with the CFTC since our registration 18 years ago and the legal certainty this has provided for our customers under the CFTC's customer protection rules, which serve as an important cornerstone of the CFTC's mission. We also believe the cooperative relationship between the BoE and the CFTC is a model to follow for oversight of swaps clearing houses that play a substantial risk management role in multiple jurisdictions.

### **Strengthening the Resiliency of Clearing Houses**

A central component of the risk management function of clearing houses is the collection of margin from counterparties to collateralize their derivatives trades, serving as a buffer in the event a counterparty or clearing member defaults on their financial obligations. Clearing houses are prohibited from holding this margin within their own legal entity and regulation carefully prescribes the management and

<sup>6</sup>IOSCO notes fragmenting global markets into smaller, localized markets increases counterparty risk, restricts liquidity, increases costs and reduces financial stability, *IOSCO Report on Market Fragmentation & Cross-border Regulation*, June 2019, available at <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD629.pdf>.

<sup>7</sup>*Implementation and Effects of the G20 Financial Regulatory Reforms: Fourth Annual Report*, November 28, 2018, available at <https://www.fsb.org/2018/11/implementation-and-effects-of-the-g20-financial-regulatory-reforms-fourth-annual-report/>.

<sup>8</sup>*CFTC Approves Substituted Compliance Framework in Follow-up to the Recent Equivalence Agreement between the U.S. and the EU*, available at <https://www.cftc.gov/PressRoom/PressReleases/pr7342-16>; European Commission adopts equivalence decision for CCPs in USA, available at [http://europa.eu/rapid/press-release\\_IP-16-807\\_en.htm](http://europa.eu/rapid/press-release_IP-16-807_en.htm).

<sup>9</sup>*EMIR 2.2 Final Compromise Text*, available at <https://data.consilium.europa.eu/doc/document/ST-7621-2019-ADD-1/en/pdf>.

placement of collateral. Clearing house placement or investment options for collateral is appropriately limited to a small number of very conservative options.<sup>10</sup>

Central bank deposit accounts are widely agreed as the safest option for clearing houses to place collateral in any given currency, especially during periods of financial market stress.<sup>11</sup> LCH Ltd. holds more margin than any other global clearing-house.<sup>12</sup> LCH Ltd operates an extensive global collateral management function to ensure the safety and liquidity of margin it receives, in line with applicable regulation and conservative risk management practices that often exceed minimum standards. LCH Ltd.'s SwapClear service daily U.S. dollar cash margin holdings fluctuate between \$35–\$40 billion. Daily margin flows range from \$10–\$20 billion in U.S. dollar cash. Currently, LCH does not have access to a Federal Reserve Bank deposit account.

In the U.S., Title VIII of Dodd-Frank provided a legal framework by which clearing houses can deposit margin in central bank deposit accounts.<sup>13</sup> We believe the Financial Stability Oversight Council (“FSOC”) has the statutory authority to take measures that would allow non-U.S. domiciled DCOs that are systemically relevant to the U.S. market to apply to the Federal Reserve for deposit account access.

As the discussion over cross-border clearing house regulation progresses, we believe it is critical for central banks to require clearing houses that manage substantial risks in their jurisdiction to maintain a deposit account for their respective currency. This would further strengthen the financial resilience of clearing houses, and overall, the financial markets. Central bank deposit accounts also provide end-users with the ultimate reassurance that their U.S. dollar cash margin is protected during times of market stress. In line with the 2017 recommendation from the U.S. Department of the Treasury, we call on Congress to further evaluate the important financial stability role that central bank deposit accounts can play for non-U.S. domiciled

<sup>10</sup>Including overnight reverse repurchase agreements, government bonds, commercial banks, money market funds (allowed in the U.S. but not the EU), and, where available, central bank deposit accounts.

<sup>11</sup> “[Fed] accounts permit DFMUs to hold funds at the Federal Reserve, but not to borrow from it. Allowing DFMUs to deposit balances at the Federal Reserve helps them avoid some of the risk involved in holding balances with their clearing members. Doing so also provides CCPs with a flexible way to hold balances on days when margin payments unexpectedly spike and it is difficult to find banks that are willing to accept an unexpected influx in deposits. In such a case, it may also be too late in the day to rely on the repo market. The availability of Fed accounts could help avoid potential market disruptions in those types of circumstances,” Federal Reserve Governor Jerome Powell, *Central Clearing and Liquidity*, June 2017, available at <https://www.federalreserve.gov/newsevents/speech/powell20170623a.htm>; “Where CCPs are permitted to have deposit accounts at central banks, they can deposit initial margin cash there instead of investing it, eliminating investment risk. As many of the banks providing custodial services to CCPs are also major clearing members, central bank deposit accounts would also help CCPs avoid wrong-way exposure to clearing members.” Federal Reserve Bank of Chicago, *Non-default loss allocation at CCPs*, April 2017, available at <https://www.chicagofed.org/-/media/publications/policy-discussion-papers/2017/pdp-2017-02-pdf.pdf>; “CCP access to central bank money in the currencies in which they do business makes clearing more efficient and reduces risk to end-users and the broader financial system. Access should include the ability to use central bank money for payments, central bank accounts for safe-keeping of participants’ cash, and access to central bank liquidity, at least in emergency situations.” ISDA, *The Case for CCP Cooperation*, April 2019, available at <https://www.isda.org/2018/04/18/the-case-for-ccp-supervisory-cooperation/>; “Allowing CCPs to hold cash initial margin with central banks will reduce CCP exposure to commercial bank risk generally. . . . Permitting CCPs to maintain central bank deposits will also reduce the need for CCPs to utilize reverse repos and/or directly purchase securities to reduce settlement or concentration bank risk, which pose enormous investment challenges and risks, like forced diversification.” FIA Global, “CCP Risk Position Paper,” April 2015, available at [https://fia.org/sites/default/files/content\\_attachments/FIAGLOBAL\\_CCP\\_RISK\\_POSITION\\_PAPER.pdf](https://fia.org/sites/default/files/content_attachments/FIAGLOBAL_CCP_RISK_POSITION_PAPER.pdf);

“As a result of the initiative of our staff and the assistance of the Federal Reserve, the pre-funded resources held by systemically important clearinghouses can now be deposited and held at Federal Reserve Banks. This is good for customer protection and for financial stability,” CFTC Chairman Timothy Massad, *Keynote Remarks at SEFCON VII*, January 18, 2017, available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/opamassad-55>.

<sup>12</sup> Per LCH Ltd’s Q4 2018 CPMI–IOSCO quantitative disclosures, LCH Ltd holds \$195 billion U.S. dollar equivalent in margin. A list of all clearing houses’ CPMI–IOSCO quantitative disclosures is available at <https://ccp12.org/ccp12-public-quantitative-disclosures/>.

<sup>13</sup> Specifically, financial market utilities (“FMUs”) can be designated by the Financial Stability Oversight Council (“FSOC”) as systemically important or designated financial market utilities (“DFMUs”). DFMUs may apply to a Federal Reserve Bank for a deposit account. In 2012, FSOC designated eight DFMUs.

DCOs such as LCH who manage a substantial portion of cleared derivatives risk in the U.S. markets.<sup>14</sup>

**Conclusion**

Despite the many challenges Brexit has presented, our industry and regulatory community have worked collaboratively to mitigate the risk of market disruption and preserve financial stability in the event of a Hard Brexit scenario.

Brexit has also reshaped the ongoing debate around the future cross-border framework for global clearing houses. We believe this framework should support global markets and avoid fragmentation. LCH believes the CFTC's direct registration model remains appropriate for LCH Ltd in the U.S. and other jurisdictions where we manage a substantial risk in the market. We recognize that other models may be more proportionate for clearing houses that do not manage the same level of risk in a foreign jurisdiction.

Strengthening the resiliency of clearing houses and ensuring that client margin can be managed in the safest and most efficient manner, including the role of central bank deposit accounts, should continue to remain a key focus as the cross-border framework for global clearing houses evolves.

The CHAIRMAN. Well, thank you, Mr. Maguire, and you have certainly opened our eyes to much of what we really need to be aware of, being on site there in London.

Mr. Lukken?

**STATEMENT OF HON. WALTER L. LUKKEN, J.D., PRESIDENT AND CHIEF EXECUTIVE OFFICER, FUTURES INDUSTRY ASSOCIATION, WASHINGTON, D.C.**

Mr. LUKKEN. Chairman Scott, Ranking Member Scott, Ranking Member Conaway, and other Members of the Committee, thank you for this opportunity to testify. I agree with the rest of the panel, your leadership on this topic is extraordinarily important.

FIA is the leading global trade organization for the futures options and cleared derivatives markets. Our mission is to support open, transparent, and competitive markets. I highlight the word *open* in our mission, because open markets allow people access to hedging vehicles around the world, as you can see by the panel here today. Most importantly, open to farmers, producers, and manufacturers who are looking to hedge that risk. Open markets are extremely important. And certainly, in fact, this Committee earlier this month in a separate Subcommittee held a hearing entitled, *The State of U.S. Agricultural Products in Foreign Markets*. Members of both sides of the aisle agreed that U.S. producers benefit from fair access to open markets.

The same holds true when it comes to financial markets as well. The American farm economy benefits from open and fair access to global derivatives markets. Without this access, costs to farmers, ranchers, and producers to hedge their risk would increase.

To illustrate the global nature of the derivatives markets, FIA has polled several of its member exchanges, many of them sitting at this table, regarding the percentage of their volume that comes from foreign counterparties. The full results are included in my written testimony, but the survey highlights that, for example, CME Group reports that 42 percent of its metals contract volume originates in jurisdictions outside the United States. ICE reports that 35 percent of its volume in agricultural business comes from

<sup>14</sup>U.S. Department of the Treasury, *A Financial System That Creates Economic Opportunities: Capital Markets*, page 217, October 2018, available at <https://www.treasury.gov/press-center/press-releases/documents/a-financial-system-capital-markets-final-final.pdf>.

outside of the borders of the United States as well. European Exchange, Eurex, has 79 percent of its volume for interstate products coming from outside of Germany.

These global markets would not have developed without a common-sense regulatory approach based on international cooperation. FIA strongly supports the regulatory recognition and deference model that has been the foundation of the futures industry for years. This Committee well knows, but the CFTC was one of the first regulators to put in place a cross-border recognition and deference approach, starting with foreign brokers back in the 1980s, and foreign exchanges in the 1990s. The approach focuses on whether comparable foreign rules are indeed comparable, and achieve a desired outcome, instead of a line-by-line regulatory comparison.

As a former Commissioner and Chairman of the CFTC, I saw the benefits of this flexible regulatory approach to our domestic markets. However, with post-crisis reforms in the Brexit decision, there are concerns that regulators are moving away from the pragmatic approach by imposing direct authority on third-country exchanges, clearinghouses, and transactions. And this divergence could lead to conflicting rules and harmful market fragmentation.

Europe, of course, as we have been discussing, is beginning to design a regulatory framework without Britain, treating them as any third-country nation outside the EU. This will have an impact on all third-country nations, including the United States. FIA is closely monitoring recent revisions to the EMIR 2.2 legislation on clearinghouse supervision. This law may require U.S. clearinghouses that are deemed systemic to be in compliance with significant elements of EU law, and to be overseen by EU regulators. If implemented without proper deference to U.S. supervision, this law could lead to contradictory requirements, duplicative supervision, and counter reactions by global regulatory authorities. Indeed, the G20 has market fragmentation as an agenda item for discussion later on this week in Japan. This is of real concern at all levels.

The CFTC Chairman has announced his intent to strengthen the CFTC's ability to recognize and to defer to home country supervision for certain foreign CCPs. FIA stands ready to comment on both EMIR 2.2 and the CFTC's proposals when they are released to ensure that the proven regulatory deference and recognition approach remains the standard for cross-border regulation. It is imperative that we get cross-border issues right, especially with Brexit looming. The stakes are incredibly high. Without common ground, we may find ourselves with increasingly fragmented markets. That doesn't benefit anyone, especially customers and producers.

I want to thank this Committee for focusing on this important topic, and I welcome any questions this Committee may have.

[The prepared statement of Mr. Lukken follows:]

PREPARED STATEMENT OF HON. WALTER L. LUKKEN, J.D., PRESIDENT AND CHIEF EXECUTIVE OFFICER, FUTURES INDUSTRY ASSOCIATION, WASHINGTON, D.C.

Chairman Scott, Ranking Member Scott, and Members of the Subcommittee, thank you for the opportunity to testify about Brexit and various cross-border matters that impact derivatives markets and market participants.

I am the President and Chief Executive Officer of FIA. FIA is the leading global trade organization for the futures, options and centrally cleared derivatives markets, with offices in London, Brussels, Singapore and Washington, D.C. FIA's membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from more than 48 countries as well as technology vendors, law firms and other professionals serving the industry.

FIA's mission is to support open, transparent and competitive markets, protect and enhance the integrity of the financial system, and to promote high standards of professional conduct. As the principal members of derivatives clearinghouses worldwide, FIA's clearing firm members help reduce systemic risk in global financial markets. Equally important, our clearing firm members provide access to the commodity futures markets, which allows a wide range of companies in the commodity supply chain to manage their price risks.

Prior to serving as the President and CEO of FIA, I had the honor of serving as a Commissioner of the Commodity Futures Trading Commission from August 2002 to June 2009. During that time, I served as the Acting Chairman from June 2007 to January 2009.

Earlier this month, a separate House Agriculture Subcommittee held a hearing titled "The State of U.S. Agricultural Products in Foreign Markets." There was agreement from Members on both sides of the aisle that American farmers, growers, and ranchers, and the farm economy more broadly, benefit from fair access to foreign markets.

The same holds true when it comes to our financial markets. The American farm economy benefits from open and fair access to global derivatives markets. Without this access, the costs to hedge risk become greater. Ultimately, this would be felt by American consumers when they visit their local grocery stores or order food at a restaurant.

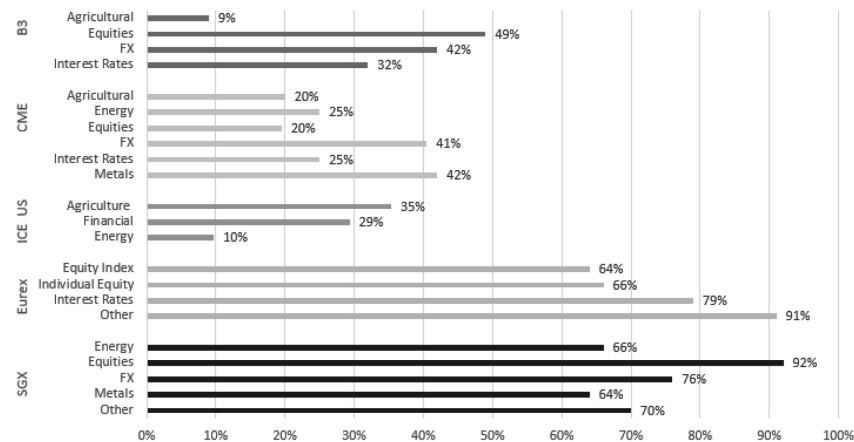
Dating back to my time as a CFTC Commissioner, and even prior, the derivatives markets have been global in nature. Transactions, clearing and settlement often take place in different countries and across different time zones and continents.

Ultimately, market participants benefit from the global nature of the markets. The more participants, the stronger the market for those seeking to hedge risks. Open markets improve competition, keep costs affordable for customers and grow the economy. Our markets are not defined by borders—they are defined by the ingenuity and determination of buyers and sellers—no matter their location.

**Cross-Border Trading Statistics**

To illustrate the global nature of the markets, FIA has polled several of its member exchanges regarding the percentage of their volume that comes from foreign counterparties. The results are notable.

**Cross-Border Trading**



Trading originating outside the home jurisdiction as a percentage of total volume during 2018.

As made clear by these statistics, the ability to access customers on a cross-border basis strengthens markets. CME Group reports 42 percent of its metals contract vol-

ume originating in jurisdictions outside the U.S. ICE Futures U.S. data shows that approximately 35 percent of the volume in its agricultural business comes from overseas. Without access to global markets, end-users—including farmers and ranchers seeking to hedge their risks in the derivatives markets—are harmed.

#### **A Cause of Global Market Fragmentation**

At the time of the financial crisis in 2008, I was serving as the Chairman of the CFTC. I vividly remember the panic and pain felt by so many Americans. The entire financial system was on the brink of collapse, and I was being called to the White House weekly as the President, the Treasury Secretary and policymakers of the highest levels searched for answers.

In the aftermath of the crisis, the member nations of the Group of Twenty (G20) engaged in a fundamental restructuring of the regulatory framework for OTC derivatives markets. The goal was simple: to improve transparency, mitigate systemic risk and protect against market abuse.

When the G20 held a summit in Pittsburgh in 2009, jurisdictions from across the globe were on the same page. They agreed on general principles and reforms, including mandates to clear all standardized over-the-counter derivatives.

For a time following the summit, implementation of the core principles and reforms agreed upon at the summit was going smoothly. There was an understanding that global implementation of identical rules, on a line-by-line basis, was impracticable. Rather, the G20 sought to ensure the principles and reforms agreed upon in Pittsburgh would be implemented to achieve equivalent regulatory outcomes.

Unfortunately, intervening political events have caused this alignment to be tested over time. The best example is Brexit. Now, we find ourselves with a radically different situation in Europe with the financial center of Europe soon to be located outside the EU. This will make it even more difficult to have consistent implementation of those G20 standards.

#### **FIA Advocacy Related to Brexit**

Since the United Kingdom voted to leave the European Union (EU) in 2016, FIA has worked tirelessly to inform and work with our members, policymakers, and the general public about the operational and market impact of a possible no-deal Brexit scenario on the listed and cleared derivatives market.

Unless the UK and the EU reach an agreement that delivers a smooth transition in the Brexit process, market participants will be faced with the prospects of significant disruption, financial instability, and regulatory uncertainty. Preparations for Brexit are continuing in the EU and UK and FIA firms have taken significant steps to ensure continued access to financial services in the EU and UK after Britain leaves the EU.

As we set out to address these challenges, our focus at FIA has remained on:

- Minimizing disruption.
- Avoiding fragmentation of liquidity by regulatory actions.
- Maintaining global access to markets and counterparties.

FIA worked extensively with our member firms and other trade associations to secure a commitment from the European Commission to allow UK clearinghouses temporary continued access to the EU in the event of a no-deal Brexit. This commitment by the European Commission was announced in December 2018<sup>1</sup> and was an enormous success for market participants across the globe, including in the United States. In response, the European Securities and Markets Authority (ESMA) followed suit by adopting recognition decisions for three UK CCPs.

FIA, however, is closely monitoring several areas of concern that could impact access to European and U.S. markets as the Brexit debate continues. Recent revisions to the European Market Infrastructure Regulation legislation (EMIR 2.2) on clearinghouse supervision may require direct compliance with substantial elements of EU law and supervision by EU regulators for U.S. clearinghouses deemed systemic unless EU regulators find U.S. supervision to be equivalent.

If implemented without the proper recognition of home country supervision, this could lead to contradictory requirements, duplicative supervision and counter-reactions by global regulatory authorities. These EU consultations, which are currently out for public comment, may impact access to global markets if not properly clarified and implemented. The current Chairman of the CFTC has also announced his intention to strengthen the CFTC's ability to recognize and defer to home country super-

<sup>1</sup>Due to the extension of the Article 50 of the Treaty of the European Union deadline, an amended equivalence decision in relation to the UK CCPs was adopted by the European Commission on April 3, 2019.

vision for foreign CCPs. FIA stands ready to comment on all these proposals to ensure the proven regulatory deference and recognition approach remains the standard for cross-border regulation.

#### **Additional Examples of Cross-Border Challenges**

The listed and cleared derivatives markets are facing potential regulatory change driven by a range of geopolitical developments that pose a threat to the global markets.

As jurisdictions around the world implement G20 principles from the 2009 summit, they sometimes vary, overlap or contradict with the implementation of other jurisdictions.

I'd like to highlight some specific examples of problematic approaches which have taken place or been proposed in recent years:

*Clearing:* Japan requires certain transactions to be cleared within its borders, rather than by a third-country CCP. In this case, the level of local compliance is such that a local entity must be established, which is costly and inefficient for many market participants. These requirements greatly impact the number of market participants available to offer clearing services in a specific jurisdiction.

*Reporting:* The EU and the U.S. have introduced similar but separate derivatives trade reporting rules. Although the goals are the same, they did not coordinate the substance of what is reported nor the timing of the implementation. As a result, regulators in these two jurisdictions have imposed highly operationally intensive rules that require firms to devote significant operational resources on multiple separate occasions to ensure effective compliance with the separate rule sets.

*Capital:* Divergence in capital requirements across jurisdictions is not uncommon. However, in the world of the listed and cleared derivatives markets, this type of divergence can have vast implications.

Responding to the financial crisis, the Basel Committee for Banking Supervision adopted a leverage ratio as a backstop that requires banks to hold capital against actual exposures to loss. The Federal Reserve Board, the Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (OCC) have implemented the Basel supplementary leverage ratio (SLR) in the United States.

FIA strongly believes that capital requirements need to be recalibrated so that it reflects the true amount of risk in this activity. Unfortunately, the SLR fails to recognize the collection of customer initial margin in the central clearing process as an offset to a bank's exposures. Other jurisdictions such as the EU have recognized client cleared initial margin as exposure reducing under the leverage ratio. If the U.S. does not correct course and do the same, capital costs associated with central clearing in the U.S. will not be competitive with the EU's. This impacts end-users and businesses across a wide variety of industries that rely on derivatives for risk management purposes, including agricultural businesses and manufacturers.

It has also left end-users with less competition and access to clearing services. The number of firms providing client clearing services in the U.S. has dropped from 84 in 2008 to 55 in 2018. This result runs counter with the clearing mandates contained in Title VII of the Dodd-Frank Act. This tax on clearing places clearing firms and their customers in the U.S. at a disadvantage relative to their foreign competitors as jurisdictions outside of the U.S. have offered or plan to offer an offset for client margin.

FIA was pleased to learn that last week the Basel Committee on Banking Supervision agreed on allowing client initial margin to offset the exposure amounts under the leverage ratio. We look forward to the U.S. Prudential Regulators implementing this global revision. FIA thanks Chairmen Peterson and Scott, and Ranking Members Conaway and Scott, along with the current Commissioners of the CFTC for their leadership on this issue. FIA also thanks the Commissioners for their recent bipartisan comment letter to the Prudential Regulators supporting this needed recalibration.

The U.S. Prudential Regulators are currently consulting on a rulemaking related to implementation of the standardized approach for counterparty credit risk (SA-CCR) capital framework. FIA has responded seeking an offset for client cleared margin. In addition, FIA believes that this rulemaking raises several concerns with FIA members, including its commodity members.

Among the concerns are the very limited recognition of margin under the risk weighted asset (RWA) capital requirements and the punitive treatment of commodities trading. It is not certain when and in what form SA-CCR will be

adopted in other jurisdictions that participate in the Basel Committee process. If mandatory compliance with SA-CCR is required prior to its adoption in other jurisdictions, U.S.-based commercial end-users may be susceptible to significant competitive disadvantages. FIA is also concerned, broadly, that the SA-CCR proposal in its current form may have a significant adverse impact on the liquidity of derivatives markets, especially commodities markets.<sup>2</sup>

#### **FIA Recommendations to Reduce Market Fragmentation**

To better identify and address these growing concerns and the cross-border uncertainty driven by a range of geopolitical developments, FIA published a white paper in March 2019 titled: *Mitigating the Risk of Market Fragmentation*.<sup>3</sup> To summarize, we encouraged regulators around the world to:

- Rely on counterparts in other jurisdictions to supervise certain cross-border activity through “deference” or “substituted compliance”;
- Work collectively to develop international standards and implementation guidelines while recognizing local flexibility and conditions; and
- Put in place mechanisms for cross-border cooperation, information-sharing, and crisis-management planning, which is critical for the day-to-day supervision of cross-border business.

As noted in our March white paper, FIA strongly supports the regulatory recognition and deference model that has been the foundation of the futures industry for years. Deference raises standards in global markets as it is used to assess whether jurisdictions have adopted comparable rules to those in the U.S. This tested tool is one way to bring other countries into compliance with global standards and make the market safer.

We were excited to see that earlier this month, the Financial Stability Board (FSB) published a report, which was delivered to G20 Finance Ministers and Central Bank Governors ahead of their meetings in Fukuoka, Japan on June 8 and 9, 2019. The report lays out approaches and mechanisms to improve international cooperation and mitigate market fragmentation.<sup>4</sup>

Additionally, we are pleased to see that the issues of market fragmentation will be discussed at the highest levels of government as it will be on the agenda for the upcoming G20 Summit in Osaka, Japan later this week. We hope that regulators will take from this meeting the same commitment to working across borders as they did at the 2009 G20 meeting in Pittsburgh.

#### **A History of the CFTC’s Approach to Cross-Border**

The CFTC has been a global regulatory leader in promoting the principles of deference and regulatory recognition. In 1980, the CFTC was one of the first regulators to put in place a cross-border recognition approach for market participants. At that time, the CFTC adopted a position that, notwithstanding the potential broad scope of the CFTC’s jurisdiction under the Commodity Exchange Act (CEA), “it is appropriate at this time to focus [the CFTC’s] activities upon domestic firms and firms soliciting or accepting orders from domestic users of the futures markets and that the protection of foreign customers of firms confining their activities to areas outside of this country . . . may best be for local authorities in such areas.”

Congress also deserves credit for the agency’s historical support for the principles of recognition and deference.

In 1982, Congress amended the CEA to authorize the CFTC to adopt rules governing the offer and sale of foreign futures to persons located in the U.S. Congress was careful to limit the CFTC’s authority to the regulation of intermediaries that deal directly with persons located in the U.S., while expressly prohibiting the CFTC from adopting any rule that “(1) requires [CFTC] approval of any contract, rule, regulation, or action of any foreign board of trade, exchange, or market or clearinghouse for such board of trade, exchange or market, or (2) governs in any way any rule or contract term or action of any foreign board of trade, exchange, market or clearinghouse for such board of trade, exchange or market.”

The CFTC has allowed U.S. participants direct electronic access to foreign markets if the non-U.S. entities have rules that are comparable with the CFTC’s. That process was formalized by Congress in the Dodd-Frank Act, which authorized the CFTC to register Foreign Boards of Trade (FBOT) that wish to permit direct access from the U.S. but deferring to the home country regulator and rules where the rules are comparable. Today, there are 18 registered FBOTs with the CFTC.

<sup>2</sup> [https://fia.org/file/8709/download?token=R\\_6EtXRk](https://fia.org/file/8709/download?token=R_6EtXRk).

<sup>3</sup> [https://fia.org/sites/default/files/FIA\\_WP\\_Mitigating%20Risk.pdf](https://fia.org/sites/default/files/FIA_WP_Mitigating%20Risk.pdf).

<sup>4</sup> <https://www.fsb.org/wp-content/uploads/P040619-2.pdf>.



Finally, earlier this month, at FIA’s annual International Derivatives Expo conference in London, CFTC Chairman Christopher Giancarlo highlighted the principles of his cross-border policy. Specifically, he stated “the CFTC should act with deference to non-U.S. regulators in jurisdictions that have adopted comparable G20 swaps reforms.” He went on to say, “Mutual commitment to cross-border regulatory deference ideally should mean that market participants can rely on one set of rules—in their totality—without fear that another jurisdiction will seek to selectively impose an additional layer of particular regulatory obligations that reflect differences in policy emphasis, or application of local market-driven policy choices beyond the local market. This approach is essential to ensuring strong and stable derivatives markets that support economic growth both in the U.S. and around the globe.”

FIA agrees with Chairman Giancarlo and looks forward to working with the CFTC on future cross-border rulemakings

The CFTC has for decades, under Chairs from both parties, understood that market fragmentation created through a patchwork of international regulation undermines the resilience of the clearing derivatives system and therefore weakens the safety mechanisms built into the clearing system.

#### **Cross-Border FinTech Challenges**

With the international focus of this hearing, I would like to take a moment to recognize an area where the CFTC is lagging other international regulators, by no fault of its own.

According to CFTC Chairman Giancarlo, the agency has limitations in its ability to test, demo, and generate proof of concepts around emerging technologies and systems. At a recent hearing before this Committee he said, “Specifically, the CFTC lacks the legal authority to partner and collaborate with outside entities engaging directly with FinTech within a research and testing environment, including when the CFTC receives something of value absent a formal procurement.”<sup>5</sup>

This is problematic and prevents the CFTC from keeping pace with emerging technologies and puts the U.S. at a competitive disadvantage relative to its overseas counterparts. For example, the UK offers regulatory sandboxes where FinTech firms can work with the regulator and receive feedback and answer questions about their products.

Given the global nature of our markets, it is important that regulators in the U.S. have access to the same emerging technology available to regulators in the UK and elsewhere.

That is why I would like to recognize and thank Ranking Member Austin Scott (R-GA) for his legislative efforts to provide the CFTC with the necessary transaction authority to engage in public-private partnerships with financial technology developers. FIA stands ready to work with the Committee on solutions that provides the tools needed by the CFTC and market participants alike.

#### **Conclusion**

FIA greatly appreciates the Subcommittee’s interest in these critical topics that affect the global financial markets and the end-users who rely on derivatives products for price certainty and to hedge their risks.

FIA strongly supports the regulatory recognition and deference model that has been the foundation of the futures industry for years. Identical rules, on a line-by-line basis, implemented globally across jurisdictions is impracticable. Rather, the goal we should strive to achieve is ensuring equivalent regulatory outcomes.

The good news is we have a window of opportunity to reset the global approach to cross-border regulation. It is imperative we get these cross-border issues right, especially with Brexit looming. The stakes are incredibly high. Without common ground, we may find ourselves with fragmented markets and regulation. That doesn’t benefit anyone, especially customers and end-users.

I appreciate the Committee’s attention to this important topic.

ATTACHMENT

### **Mitigating the Risk of Market Fragmentation**

March 2019

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<sup>5</sup> <https://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo70>.

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#### About FIA

*FIA is the leading global trade organization for the futures, options and centrally cleared derivatives markets, with offices in Brussels, London, Singapore and Washington, D.C.*

*FIA's mission is to:*

- *support open, transparent and competitive markets,*
- *protect and enhance the integrity of the financial system, and*
- *promote high standards of professional conduct.*

*As the leading global trade association for the futures, options and centrally cleared derivatives markets, FIA represents all sectors of the industry, including clearing firms, exchanges, clearing houses, trading firms and commodities specialists from more than 48 countries, as well as technology vendors, lawyers and other professionals serving the industry.*

#### Introduction

Cleared derivatives markets today are grappling with the challenge of market fragmentation caused by regulation.

In modern derivatives markets, cross-border regulatory cooperation is a necessity. Post-financial crisis reforms by the G20 nations acknowledged as much when they enacted central clearing mandates and put a vision of pragmatic oversight and regulatory deference above a patchwork, country-by-country approach to derivatives regulation.

Lately, however, markets have become increasingly fragmented as different jurisdictions have moved to implement G20 reforms on their own. Some policymakers are exerting their national or regional authority on third-country exchanges, clearinghouses, market participants and transactions. The unfortunate result is market fragmentation caused by regulation such that the original goal of holistic cross-border solutions has been replaced by a siloed regulatory and commercial landscape.

We see several types of regulatory issues causing market fragmentation.

- First, there has been divergence in the *content* of implementation as policymakers have adapted the reforms to local conditions and political priorities. The resulting variations have made it more difficult for regulators to make a determination that foreign financial institutions are subject to equivalent regulation.
- Second, there has been divergence in the *pace* of implementation, causing some early-adopter nations to justify imposing extra-territorial requirements on activity or participants in jurisdictions that have not yet implemented these reforms.
- Third, *new issues* have arisen, such as Brexit, which have caused policymakers to reconsider their implementations of the G20 reforms and rethink their views on cross-border cooperation.

As a result, we have seen a growing trend toward more direct regulation of foreign activity and participants rather than reliance on a foreign regulator to supervise that activity when such jurisdiction has implemented a regulatory regime that achieves comparable outcomes (an approach sometimes referred to as “deference” or “substituted compliance”). This issue is not unique to the derivatives markets, but it is particularly acute because of the cross-border nature of this industry.

More disturbingly, fragmented derivatives markets can also create barriers to entry which, in turn, lead to a fall in the number of participants that are able to mutualize risk and collectively withstand the next adverse market event, minimizing the impact of the financial crisis market reforms.

As an example, regulation which requires a market participant active in two different jurisdictions (such as the U.S. and a European jurisdiction) to comply with conflicting and duplicative rules limits choices and increases costs for commercial end-users who are seeking to hedge marketplace risks beyond their control. With costly and limited options, market participants may choose to forgo hedging altogether further contracting markets and liquidity.

The benefits of central clearing are well recognized by policymakers. It is one of the central pillars of the G20 post-crisis reforms to reduce the systemic risk associ-

ated with derivatives markets and market data shows these efforts are succeeding. According to the Bank for International Settlements, the use of clearing in the global interest rate derivatives market rose from 24% in 2009 to 62% by mid-year 2018. In the global credit derivatives market, the clearing level rose from 5% to 37% over the same time period.

FIA believes strongly that derivatives markets must protect and advance market participants' access to cross-border central clearing by supporting regulatory reliance (deference), with national rules benchmarked to internationally-agreed-upon standards. Such supervisory reliance has been proven to be effective and remains a key plank in ensuring open access to global cleared markets, reducing risk and increasing market efficiency through competition.

An adherence to international standards enables pursuit of legitimate public policy goals in respect of cleared derivatives markets without causing market fragmentation. However, such an approach depends on international standards being specific enough to enable a reliance model. The CPMI–IOSCO Principles for Financial Market Infrastructures (PFMIs)<sup>1</sup> are a good example of international standards that are sufficiently detailed, allowing for a reliance model by national regulators.

To be effective, a reliance approach also requires a high level of cooperation and information-sharing among regulators. If the host supervisor requires a right to supervise the entity, home and host supervisors should coordinate their supervisory activities to improve the effectiveness and efficiency of supervision of entities with a cross-border footprint. In addition, periodic evaluations must take place to ensure that regulatory regimes continue to pass the test of equivalence.

In *Part I* of this paper, we describe the issue of market fragmentation in cleared derivatives markets, explain why it is a threat and provide examples. In *Part II* of this paper, we explain the meaning of reliance, as our preferred solution to the risk of market fragmentation. In *Part III* of this paper, we outline our recommendations on the best approaches to reliance, building on the work carried out so far by IOSCO, multilateral arrangements and the bilateral achievements of regulators, and we set out specific substantive recommendations for regulators.

### **Part I—What Is Fragmentation and Why Does It Matter?**

For the purpose of this paper, market fragmentation is where participants in an organic, shared market which crosses jurisdictions are less able to interact freely with one another in one or more of such jurisdictions. Thus, market participants are limited to interacting in silos that are less liquid, less diverse and less competitive.

*In the context of cleared derivatives markets, fragmentation results in both short-term economic costs, with reduced levels of liquidity, and long-term threats to financial stability thanks to inefficient risk management.*

Market fragmentation can be caused by regulation—either purposefully or inadvertently. Regulation that conflicts or overlaps will necessarily require differing forms of compliance from the same market participants (or even be impossible to comply with) and thus may cause participants to operate in silos in order to meet their regulatory requirements rather than operate in a shared market.

This is a particular concern in the cleared derivatives markets, due to their cross-border nature. In the context of cleared derivatives markets, fragmentation results in both short-term economic costs, with reduced levels of liquidity, and long-term threats to financial stability thanks to inefficient risk management. Cleared derivatives are an essential product in today's financial markets and comprise a significant proportion of global financial activity.<sup>2–3</sup> As stated by the President of the European Central Bank Mario Draghi: “open markets are conducive to freeing human potential, expanding opportunities, and improving well-being.”<sup>4</sup>

One measure of cross-border activity is the amount of trading on derivatives exchanges that originates from outside their home countries. Derivatives markets benefit from network effects; the more participants, the stronger the market. Open markets improve competition, keep costs affordable for customers, and grow the economy. Our markets are not defined by borders—they are defined by the ingenuity and determination of buyers and sellers—no matter their location. To illustrate, FIA has polled several major exchanges regarding the percentage of their volume that comes from foreign counterparties. The results show that cross-border trading makes up a very significant percentage of the total volume at these exchanges.

<sup>1</sup> [https://www.bis.org/cpmi/info\\_pfmi.htm](https://www.bis.org/cpmi/info_pfmi.htm).

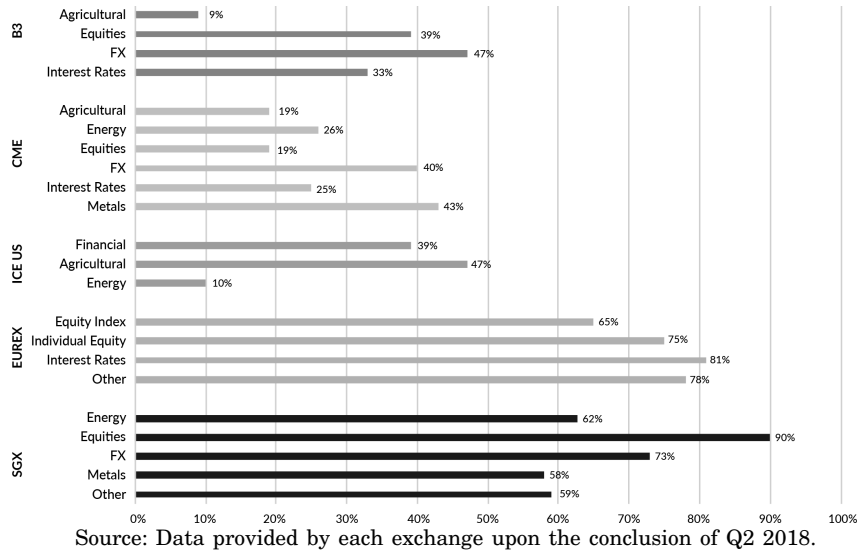
<sup>2</sup> [https://www.bis.org/statistics/about\\_derivatives\\_stats.htm?m=6%7C32](https://www.bis.org/statistics/about_derivatives_stats.htm?m=6%7C32).

<sup>3</sup> [https://www.bis.org/publ/qtrpdf/r\\_qt1612b.htm](https://www.bis.org/publ/qtrpdf/r_qt1612b.htm).

<sup>4</sup> <https://www.ecb.europa.eu/press/key/date/2015/html/sp151111.en.html>.

### Cross-Border Trading

*Trading Originating Outside the Home Jurisdiction as a Percentage of Total Volume During Q2 2018*



Source: Data provided by each exchange upon the conclusion of Q2 2018.

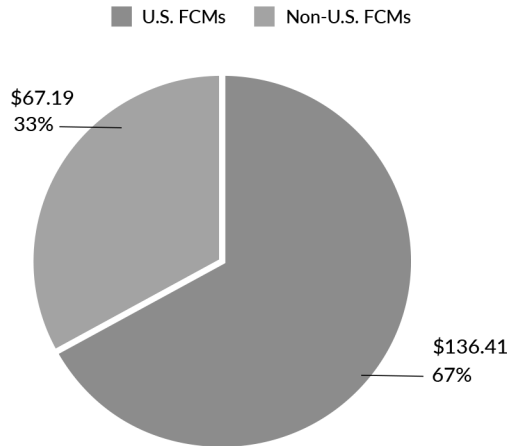
A second measure of cross-border derivatives activity comes from a set of statistics published by the Commodity Futures Trading Commission (“CFTC”), the primary regulator of derivatives markets in the U.S. These statistics track the amount of customer funds held at clearing firms, known in the U.S. as futures commission merchants (“FCMs”). The funds are collected from customers for the purpose of meeting the margin requirements set by U.S. clearinghouses for their derivatives clearing. They represent one of the core protections against systemic risk in the U.S. derivatives markets. These CFTC-registered FCMs can be subsidiaries of banks or other financial companies that can be headquartered anywhere in the world. FIA has conducted an analysis of the market share held by all FCMs, using data published by the CFTC as well as other sources of information. Our analysis shows that foreign institutions are an important part of the FCM community in the U.S.

As of December 2018, there were 54 FCMs holding a total of \$295.3 billion in customer funds, of which \$203.6 billion was held in segregated customer accounts for exchange-traded futures and options and \$91.7 billion for cleared swaps. Non-U.S. owned FCMs held 33% of the futures-related customer funds and 21% of the swap-related customer funds.<sup>5</sup>

This data shows cross-border activity is important to intermediaries as well as to end-users. Customers rely on clearing firms to provide access to markets as well as the services they need to meet the requirements of central clearing. In the U.S., the population of intermediaries includes a large number of institutions that are headquartered in Europe and Asia-Pacific. The impact for the world economy of fragmenting cleared derivatives markets will be significant since a reduction in the efficiency and/or liquidity of these markets will not only drive up costs for economic actors (including non-financial services firms) but reduce financial stability.

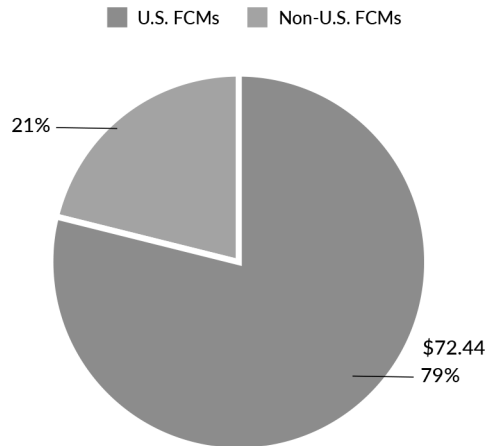
<sup>5</sup> <https://fia.org/fcm-tracker>.

### Market Share of Customer Funds in Futures Accounts



Source: U.S. Commodity Futures Trading Commission.

### Market Share of Customer Funds in Cleared Swaps Accounts



Source: U.S. Commodity Futures Trading Commission.

*Conflicting and overlapping regulations discourage or even prevent deep, efficient and liquid derivative markets from functioning and direct market activity to national silos.*

Due to the cross-border nature of the global financial crisis, there is considerable public policy interest by regulators in cleared derivatives markets. Although the CFTC's data on FCMs active in the U.S. shows the global nature of derivatives markets, the challenge is that local regulators may deal with issues relating to cleared derivatives markets in different ways and at different times. Market fragmentation results when separate regulations deal with the same type of activity differently, because regulators narrowly concern themselves with the impact of such activity in their own jurisdiction. Conflicting and overlapping regulations discourage or even prevent deep, efficient and liquid derivative markets from functioning and direct market activity to national silos.

Complete consistency between all major jurisdictions is not possible, and regulators have legitimate public policy reasons for their national approaches. However, FIA believes this must be balanced against the clear risks of market fragmentation caused by divergent, overlapping or conflicting rules.

**Regulation causing market fragmentation can be seen to emerge in three key ways.**

First, regulators may deal with existing, known issues in a market in different ways from one another—even where there is agreement at a global level as to the broad outline of how the issue should be dealt with. This form of divergence is in respect of the *content* of regulatory implementation. It may be caused by regulators fitting global standards to existing national rules and law; by some regulators prioritizing certain aspects of global standards while other regulators take a contrary position; regulators choosing to deviate from global standards for public policy reasons; or, regulators in different countries developing different rules in respect of existing issues where global standards do not exist or are insufficiently detailed to form a basis for national rules.

Second, regulators may diverge on the timing of national implementation of some or all parts of otherwise agreed global standards. This form of divergence is in respect of the *pace* of regulatory implementation. It may be caused by regulators attributing different levels of priority to agreed global standards or simply different levels of capacity on the part of regulators in different jurisdictions.

Third, regulators may react differently to novel issues where global standards or agreements have not been agreed. This form of divergence is in respect of *new issues* that require a regulatory response. It may be caused by political change that results in governments or legislators demanding action for public policy reasons or it may be caused by developments in the market, such as technological change, which have occurred before consensus between different regulators can form.

Here are examples of problematic approaches which have been taken or proposed in recent years:

- An example of *content* driven divergence relates to requirements for offering clearing services in a specific jurisdiction; for instance, Japan requires certain cleared transactions to be cleared within its borders, rather than by a third-country CCP—in this case the level of local compliance is such that a local entity must be established which is costly and inefficient for many market participants.
- An example of *pace* driven divergence relates to requirements for trade reporting; the EU and the U.S. have introduced derivatives trade reporting rules, but they did not coordinate the timing of the implementation. As a result, regulators have imposed highly operationally intensive rules that cover the same general topic but that ultimately required firms to devote significant operational resources on multiple separate occasions to ensure effective compliance with the separate rule sets.
- An example of a *new issue* driving divergence is Brexit. Brexit has in the eyes of some policymakers necessitated changes to current regulations and even market structures. Thus, several EU proposals in response to Brexit, such as EMIR 2.2 and the Investment Firm Review, have included elements requiring direct compliance with substantial elements of EU law or supervision by EU entities in order for UK market participants to be able to continue with their existing business models, even where UK law would be substantively equivalent to EU law.

**Part II—The Value of Co-Operation and the Importance of Reliance By Regulators in Preventing Fragmentation**

Regulatory reliance can prevent fragmentation by averting overlaps and conflicts. In the context of clearing and derivatives regulation, we view supervisory reliance as a decision by one regulatory authority not to seek to apply its regulations to activities conducted in another jurisdiction, but, instead, to depend on the regulatory authorities in the latter jurisdiction.

The process of supervisory reliance should comprise several steps:

- First, a regulator should consider whether it has a genuine need to oversee an activity or entity in another jurisdiction.
- Second, if such a need is identified, then there should be an assessment of the rules of the foreign regulator to determine whether they are comparable in the outcomes they achieve.
- Third, if the rules are comparable, the regulator should recognize those host country requirements as sufficient and that oversight of such compliance by the relevant foreign regulator is appropriate. This process will necessarily avoid regulatory conflicts and overlaps where the two regulators have comparable rules.

A regulatory authority seeking to rely on another authority will thus need a basis to conclude that regulatory regime of the other jurisdiction is comprehensive and achieves comparable outcomes, such that the supervision and regulation of activities in accordance with such regime's rules would be appropriate.

In coming to this conclusion, a jurisdiction's analysis should center on an outcomes-based approach rather than a line-by-line examination of the other jurisdiction's rules. Such an analysis can be driven by a comparison of the foreign jurisdiction's regulatory objectives, goals and outcomes to those of the domestic jurisdiction. This approach has been applied successfully to a number of areas, such as the EU's efforts with respect to EMIR equivalence and the CFTC's Part 30 process for FCM registration exemptions, a longstanding model dating to the late 1980s. Alternatively, the analysis can be driven by a comparison of the foreign jurisdiction's approach to international standards, such as the CPMI-IOSCO PFMI's.

The principal benefit of the reliance model is that it avoids the market fragmentation that can arise when two authorities attempt to regulate the same activity in different ways and ultimately create legal complexity, operational risk, and added compliance costs. In addition, the reliance model can strengthen the resilience of the cleared derivatives markets by reducing the barriers to accessing market infrastructure.

The market fragmentation created by the direct regulatory model also undermines cooperation among regulatory authorities, weakening the ability of the regulatory community to respond collectively to unexpected market events such as the collapse of a globally significant financial institution.

The most direct impact of duplicative rules that characterize a fragmented market is the risk that compliance with one applicable set of rules will nonetheless result in a violation of the other set of rules. This results in increased cost borne by firms that need to comply with more than one set of rules as the outcome often can be that firms are forced to always comply with the "worst of" each rule set in all circumstances to ensure there is never a material regulatory breach; in the worst case, a particular market activity will cease when a route to compliance is not apparent. The consequences of duplicative and conflicting rules can create legal complexity, operational risk and compliance costs for market participants both due to the inherent costs of compliance with two sets of rules (seeking legal advice, developing compliant operational processes, compliance function activities) but also the costs generated through conflicts and inconsistencies in the rules. In a survey of financial services executives published by the International Federation of Accountants in February 2018, 75% said that the costs of divergent regulations were a material cost to their business.<sup>6</sup>

It should also be noted that reliance will result in savings for regulatory authorities themselves. When government authorities are faced with finite regulatory resources, those resources can be deployed more cost-effectively to its own market.

Supervisory reliance cannot exist in a vacuum, however. For the reliance model to work properly, it must take place within a framework of cooperation among regulators.

### **Part III—Recommendations for Cooperation and Reliance**

In light of the international nature of cleared markets, supervisory reliance is the ideal approach for avoiding market fragmentation. As set out in *Part II* above, the benefits of reliance are considerable both for ensuring stable, effective markets and in assisting regulators fulfill their goals.

FIA sets out below proposals for enabling and improving supervisory reliance. The proposals relate to:

1. Use of International Standards; and
2. Agreements between Regulatory Authorities.

#### *Use of International Standards*

*FIA believes clear and effective standards will increase consistency and predictability for market participants, reduce market fragmentation and ultimately result in deep, efficient, and liquid derivatives markets.*

The key plank for supervisory reliance and preventing market fragmentation, in the view of FIA, is recognition of rules that meet international standards (or where those are not available, national laws). Use of agreed international standards by regulatory authorities will limit conflicts of rules between different jurisdictions. FIA believes clear and effective standards will increase consistency and predict-

<sup>6</sup> <https://www.ifac.org/system/files/publications/files/IFAC-OECD-Regulatory-Divergence.pdf>.

ability for market participants, reduce market fragmentation and ultimately result in deep, efficient, and liquid derivatives markets.

Both the U.S. and EU, to varying degrees, currently recognize rules of other jurisdictions (U.S. rules for foreign boards of trade, foreign futures intermediaries, and swaps exemptive approach and, in the EU, EMIR equivalence) and we encourage these authorities to continue doing so. We also note that the EU and Singapore have deemed each other to be equivalent in relation to the regulation and supervision of CCPs and have announced plans for a common approach to trading venues that will result in mutual recognition of each other's venues.

FIA recommends that international standards be set through a dialogue between peer regulators in an effort to achieve better results than rules set by one country alone. The varying perspectives and experience of regulators ensure proposed rules endure greater scrutiny and do not inadvertently result market fragmentation. It is critical that these international standards go through rigorous public comment and an opportunity for input given the importance of the standards and principles in regulation.

The governance and rule-making processes for international standard-setters may need to improve if regulatory authorities are to place greater reliance on this collaborative method of rulemaking. Furthermore, buy-in from local authorities is essential if greater reliance on international standards is to occur. It should also be noted that if international standards are to form the basis for supervisory reliance, some existing international standards will need to be improved: they must be specific and granular, not simply statements of principle but provisions that can be used for outcomes-based equivalence determinations. Specificity and granularity in international standards play an important role in preventing content driven regulatory divergence, caused by regulatory authorities attempting to fill in the gaps where a relevant standard lacks sufficient detail.

International standard setters should also consider increasing their focus on monitoring implementation of standards, and benchmarking jurisdictions against best-practices set out in agreed-upon international standards. This could build on the Financial Stability Board's Thematic Reviews<sup>7</sup> and IOSCO's Assessment Committee. The level of cross-border cooperation that a jurisdiction engages in could be treated as a benchmark. The timing of implementation is also significant and should be benchmarked; coordinated implementation of standards in different jurisdictions can play an important role in preventing pace-driven regulatory divergence, caused by regulatory authorities implementing rules at different times and thus subjecting market participants to different rules at the same point in time.

#### *Arrangements Between Regulatory Authorities*

In modern derivatives markets, information sharing and cross-border crisis-management are crucial to market integrity. FIA believes that regulatory authorities should widely adopt memoranda of understanding (MOUs) in respect of information sharing.

Though the use of the standard MOU produced by IOSCO<sup>8</sup> is welcomed, the priority should be the substance of the MOUs in whatever form regulatory authorities are mutually comfortable. FIA believes regulatory authorities should provide a high level of information disclosure to one another in respect of regulated firms and infrastructure in their jurisdiction.

MOUs should be put in place both for general information sharing and in respect of specific firms in which authorities have an interest in for reasons of systemic financial stability. This partnership among global regulators goes beyond information that can be used to identify possible regulatory violations.

Perhaps most importantly, MOUs should build trust and cooperation between authorities in an ongoing effort to reduce market fragmentation and increase transparency and consistency in regulation. Regulatory authorities should remain open-minded about allowing certain inspection rights in relation to critical market infrastructure in MOUs, in this spirit of transparency and cross-border cooperation.

Regulatory authorities should also put in place mechanisms for cross-border crisis-management planning. Crisis-management processes will be much more effective if they are agreed *ex ante* rather than authorities attempting to agree them during the early stages of a crisis. Further, the process of carrying out crisis-management plans will ensure that authorities are better prepared for dealing with a crisis, even if the permutations of the crisis deviate from those subject to the plan.

<sup>7</sup> <http://www.fsb.org/2017/04/handbook-for-fsb-peer-reviews-2/>.

<sup>8</sup> <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD322.pdf>.



International regulators have historically recognized this benefit and formed crisis management groups for CCPs that are systemically important.<sup>9</sup> The working group for crisis management in respect of LCH. Clearnet Ltd. is an example of this approach.<sup>10</sup>

The global financial crisis provided graphic examples of the benefits of cooperation between regulatory authorities in dealing with crisis-stricken firms. Analysis of crisis management in respect of Dexia Bank, Fortis Bank, Lehman Brothers and Kaupthing Bank has noted the impact of cooperation and coordination by authorities (or lack thereof) on the achievement of goals by authorities.<sup>11</sup> The crisis management actions in respect of Dexia benefited from a high degree of cooperation by relevant supervisors, whereas the crisis management actions in respect of Kaupthing showed a lack of cooperation and coordination by the home regulatory authorities with affected host authorities.

Going back further, the collapse of Barings Bank in 1995 provides a case study in the problems that can arise due to a lack of cross-border cooperation.<sup>12</sup> The cross-border nature of the bank's trading activity in certain futures markets was not fully understood either by regulatory authorities or other market participants. As a result, the collapse posed a much greater threat to the stability of those markets than the authorities were prepared for. The experience inspired regulatory authorities from 16 jurisdictions to issue the Windsor Declaration in 1995 in which they stated the need to improve "co-operative measures" among regulatory authorities and in particular the need for greater information sharing. This was followed by the Boca Declaration in 1996, an arrangement under which the occurrence of certain triggering events affecting an exchange member's financial resources or exposures prompts the sharing of information among regulators. The Boca Declaration was developed with the help of industry representatives and trade associations, including FIA. It has also been noted by the Bank for International Settlements that cooperation between supervisors can also play a key role in averting crisis situations.<sup>13</sup>

Regulatory authorities should also consider the sharing of information and best practices with both peer organizations and trade associations to a greater degree. International standard-setting and cooperation should include the joint development of best practices. Networks can be established with the industry and their representatives in an informal or *ad hoc* manner for particular subjects as a way of sharing information and practices between authorities. Such networks can act as fora for particular strategies or policy proposals to be tested, before they are raised at the level of international standard setters.

### Conclusion

As set out above, reliance by regulatory authorities on agreed international standards and supervision by fellow regulators in other jurisdictions is the best way to prevent market fragmentation and ensure deep, efficient, liquid and competitive derivatives markets.

Reliance, and the consultation and cooperation which it necessitates, can demonstrate respect for the sovereignty of each jurisdiction while still encouraging competition and efficient risk-management in the era of global and interconnected derivative markets.

The benefits of legal certainty are tangible through lowered regulatory costs, increased competition and more efficient mutualization of market risk. However, the opportunity for local regimes to consult with peers around the world and collectively work towards market stability and regulatory certainty cannot be discounted.

FIA encourages all regulatory authorities to use existing international bodies such as IOSCO to further enhance international standards for the regulation of the derivatives markets. That will permit greater reliance on each other by derivatives regulators that are implementing regulations to advance the goals of the G20 commitments following the financial crisis. Furthermore, FIA believes strongly that existing international standards should be reviewed with an eye towards practical application for outcomes-based equivalence determinations and not simply a soft statement of principles.

Reliance will result in better outcomes for both regulatory authorities and market participants than attempting to restrict cross-border activity. The current landscape

<sup>9</sup> FSB Guidance on Central Counterparty Resolution and Resolution Planning, 5 July 2017, p. 16. <http://www.fsb.org/wp-content/uploads/P050717-1.pdf>.

<sup>10</sup> <https://www.cftc.gov/sites/default/files/idc/groups/public/@internationalaffairs/documents/file/cftc-lcharrangementmou090617.pdf>

<sup>11</sup> <https://www.bis.org/publ/bcbs169.pdf>.

<sup>12</sup> <https://scholarlycommons.law.northwestern.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=1536&context=njilb>.

<sup>13</sup> <https://www.bis.org/speeches/sp170918.pdf>.

of regulation for cross-border cleared derivatives markets is an opportunity for regulators to reset relations among themselves and move forwards on the basis of cooperative approaches.

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*<http://fia.org/>*

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The CHAIRMAN. Excellent testimony, Mr. Lukken. I agree with you 100 percent.

Now, we will hear from Mr. Berger.

**STATEMENT OF STEPHEN JOHN BERGER, MANAGING DIRECTOR, GLOBAL HEAD OF GOVERNMENT & REGULATORY POLICY, CITADEL, LLC, NEW YORK, NY; ON BEHALF OF MANAGED FUNDS ASSOCIATION**

Mr. BERGER. Chairman Scott, Ranking Member Scott, Members of the Subcommittee, my name is Stephen Berger and I am the Global Head of Government and Regulatory Policy at Citadel.

Citadel is a leading investor in the world's financial markets. For over a quarter of a century, we have sought to deliver industry-leading investment returns to clients, including corporate pensions, endowments, foundations, public institutions, and sovereign wealth funds.

I am here today on behalf of the Managed Funds Association and its members, and am pleased to provide testimony as part of today's hearing.

MFA represents the majority of the world's largest hedge funds, and is the primary advocate for sound business practices and thoughtful regulation of the industry. MFA has long supported Congressional reforms of the OTC derivatives markets, including central clearing. Central clearing has benefited the derivatives markets by reducing systemic risk, increasing investor protections, and promoting transparency and competition.

MFA supports a coordinated global approach to the regulation of clearing. The coordination between U.S. and European regulators on clearing implementation is crucial to its continued success and efficacy.

The United Kingdom's anticipated withdrawal from the European Union introduces new complexities for global regulatory coordination. MFA has been engaging with policy makers and regulators to highlight potential regulatory challenges and recommended solutions for the derivatives markets. I will summarize some of these.

With respect to clearing, MFA has been a consistent advocate for the central clearing of derivatives transactions. Recently, the EU

amended its derivatives regulation, dubbed EMIR, to allow EU authorities to conduct enhanced supervision of non-EU clearinghouses. In extreme cases, it also allows EU authorities to require those clearinghouses to relocate clearing activities to an EU member state.

The impact of these changes on the U.S. derivatives markets will depend on how EU authorities choose to implement their new power. The current U.S.-EU cross-border framework relies on the regulatory tools of substituted compliance, equivalence, and deference between comparable regulations. The new EU powers granted by EMIR could affect that framework.

Any deterioration in U.S. and EU regulatory cooperation could jeopardize cross-border clearing, which in turn could fragment the derivatives markets. We urge U.S. and EU regulators to work together to develop an agreed-upon approach to cross-border CCP supervision using existing tools.

Another international clearing-related concern is the Basel III leverage ratio. The current application of the leverage ratio to investors cleared derivatives positions is counterproductive and increases, rather than mitigates, risk. Bank's capital requirements should reflect the risks of their activities; however, the leverage ratio does not currently take into account the fact that with respect to banks clearing activities, customers post collateral that offsets the banks clearing-related risks. Recognizing this offset is necessary to ensure that customer clearing remains affordable, and that customers have fair and equal access to clearinghouses.

MFA was pleased by the announcement last week that the Basel Committee has finally called for an amendment to the leverage ratio to provide that offset. If the Basel Committee's upcoming published standards are consistent with that announcement, we would join CFTC Chairman Giancarlo in his call to U.S. Prudential Regulators to promptly implement the revised leverage ratio into their rules.

Next, with respect to derivatives trading, the CFTC's proposed amendments to its rules for trading on swap execution facilities is also a key area of concern. The proposal could jeopardize the current equivalence framework between U.S. and EU trading venues that was built on shared commitments to impartial access, straight through processing, and pre-trade transparency. We encourage the CFTC to make the scope of any amendments more targeted.

Last, the implementation dates of new margin rules for uncleared swaps are approaching. However, these rules are complex and involve significant compliance, expenses, and resource commitments. In the near-term, the CFTC should work with the Prudential Regulators to provide guidance to help smooth the market's transition. In the longer-term, domestic and international regulators should work to recalibrate the regime. MFA has suggested a number of regulatory measures to help avoid significant disruption to the swaps market, such as extending the phase-in timeline.

As a final note, I want to reiterate that the successful implementation of clearing in the U.S. and EU has greatly benefitted the derivatives market. The coordination between U.S. and EU regulators over the past several years has been critical to achieving the robust

derivatives clearing that we see today. It is therefore important for the U.S. and EU to find a path forward on clearing related issues.

We appreciate the Committee's oversight of international developments affecting U.S. derivatives markets, and I thank you for the opportunity to speak here today. I would be happy to answer any questions.

[The prepared statement of Mr. Berger follows:]

PREPARED STATEMENT OF STEPHEN JOHN BERGER, MANAGING DIRECTOR, GLOBAL HEAD OF GOVERNMENT & REGULATORY POLICY, CITADEL, LLC, NEW YORK, NY; ON BEHALF OF MANAGED FUNDS ASSOCIATION

Chairman Scott, Ranking Member Scott, my name is Stephen Berger and I am the Managing Director, Global Head of Government & Regulatory Policy, of Citadel LLC. Citadel is a global financial firm built around world-class talent, sound risk management, and innovative market-leading technology. Citadel is a leading investor in the world's financial markets. For over a quarter of a century, we have sought to deliver industry-leading investment returns to clients including corporate pensions, endowments, foundations, public institutions, and sovereign wealth funds. Our global team works to help our clients' capital fulfill its greatest potential across a diverse range of markets and investment strategies, including fixed income & macro, equities, quantitative, commodities and credit.

I am here today to speak on behalf of Managed Funds Association ("**MFA**") and its members regarding Brexit and other international developments affecting U.S. derivatives markets. MFA represents the world's largest alternative investment funds and is the primary advocate for sound business practices for hedge funds, funds of funds, managed futures funds, and service providers. MFA's members manage a substantial portion of the approximately \$3 trillion invested in hedge funds around the world. Our members serve pensions, university endowments, and charities, among others.

MFA's members are a valuable component of the capital markets. They provide liquidity and price discovery to capital markets, capital to companies seeking to grow or improve their businesses, and important investment options to investors seeking to increase portfolio returns with less risk, such as pension funds trying to meet their future obligations to plan beneficiaries. Our members' skills help their customers plan for retirement, honor pension obligations, and fund scholarships, among other important goals.

MFA members are also highly sophisticated investors who participate in the commodities and derivatives markets. MFA has consistently supported the reforms to the over-the-counter ("**OTC**") derivatives markets contained in Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Dodd-Frank Act**") that mitigate systemic risk, increase transparency, and promote an open, competitive, and level playing field. We welcomed the U.S. market's transition to central clearing for liquid, standardized swaps that occurred over the course of 2013. We believe that liquid, safe, and efficient derivatives markets facilitate investment to the benefit of everyone in the market place, including corporate treasurers, farmers, and ranchers who need to protect themselves against swings in crop prices, and pensioners who seek reliable returns on their retirement investments.

The hedge fund industry is a global industry active in many of the largest economic centers in the world. Most of our members are headquartered in the United States, but many also either are headquartered in foreign jurisdictions, or have established legal entities in foreign jurisdictions. Europe, and particularly the United Kingdom ("**UK**"), is an active jurisdiction for our members.

Hedge funds are well-regulated investment tools. Many aspects of our members' activities are subject to an array of regulations and oversight both domestically and abroad. Regulators in the United States, Europe, and beyond have a wealth of information about our members' investment activities. As a result, MFA has devoted substantial resources to advocating overseas—and especially in the European Union ("**EU**") given its importance—for open, efficient, and fair capital markets.

MFA strongly supports a coordinated approach to regulation that fosters capital formation, increases transparency, mitigates systemic risk, and facilitates fair and open access to financial markets. We were pleased that, following the financial crisis, there was robust coordination between the United States and the EU, and both jurisdictions implemented regulatory regimes with largely comparable requirements that mitigated potential conflicts. The cross-border regulatory tools of cooperation include deference, substituted compliance, mutual reliance, and outcomes-based

“equivalence” determinations. International convergence on regulatory outcomes makes compliance easier for U.S.-based financial firms that operate on a global basis, which in turn, facilitated the cross-border flow of capital.

The UK’s anticipated withdrawal (“**Brexit**”) from the EU will introduce additional complexities for global regulatory coordination. MFA has been actively engaging with policymakers in Brussels, London, Frankfurt, Dublin, Paris, and elsewhere to highlight potential challenges. We have also committed substantial time and resources to preparing MFA members for potential regulatory uncertainties.

MFA continues to stand ready as a constructive partner to officials in the U.S. and Europe to highlight areas of particular challenge for asset managers, and to propose policy and regulatory solutions to those challenges. We were pleased to be invited by the UK House of Commons Treasury Select Committee to provide evidence to its inquiry on “[t]he future of the UK’s financial services”, and we have also been engaging with policy officials in Brussels to provide constructive suggestions on the EU’s Capital Markets Union project. MFA also interacts with international bodies such as the International Organization of Securities Commissions (“**IOSCO**”), the Financial Stability Board, and the Bank for International Settlements and its associated committees, including the Basel Committee on Banking Supervision.

Our members allocate substantial resources to ensure they comply with the laws and regulations of all jurisdictions in which they operate and invest. However, when policymakers and regulators do not coordinate to achieve convergent regulatory outcomes, investment managers end up subject to laws and regulations in other jurisdictions that are inconsistent with, or unnecessarily duplicate, U.S. law and regulations. Divergent or duplicative rules and, in some cases, extraterritorial application of those rules, can increase costs to investors by creating barriers to investment managers doing business in multiple jurisdictions.

MFA has continuously been a constructive partner to this Committee. In that spirit, and in support of the broader policy and regulatory authorities in the United States and beyond, we offer observations on the following seven key regulatory areas that are currently presenting challenges for our members:

- (1) The EU enhanced supervision regime (“**EMIR 2.2**”) for third-country central counterparties (“**CCPs**”),<sup>1</sup>
- (2) The Basel III leverage ratio (“**Leverage Ratio**”);
- (3) Swaps market and liquidity fragmentation issues addressed by the CFTC Global Markets Advisory Committee (“**GMAC**”);<sup>2</sup>
- (4) The implementation of initial margin requirements for uncleared derivatives;
- (5) The EU General Data Protection Regulation (“**GDPR**”),<sup>3</sup>
- (6) The need for greater data protection at regulators through the Protection of Source Code Act; and
- (7) Regulatory coordination in the U.S. between the Securities and Exchange Commission (“**SEC**”) and the CFTC.

On behalf of MFA, I appreciate the Committee’s consideration of Brexit and other international developments affecting U.S. derivatives markets. MFA wishes to promote enhanced global coordination and ensure the continued stability of our financial system. We believe our views are consistent with the Committee’s public policy goals, and as investors, we would like to work with Congress, the Committee, EU policymakers and regulators, the CFTC, and all other interested parties in addressing these issues towards the goal of preserving the strength of our nation’s economy. Specific concerns about the effect of international policymaking follows, as well as discussion on certain U.S. policy matters.

<sup>1</sup> Regulation of the European Parliament and of the Council of . . . 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, available at: [http://www.europarl.europa.eu/doceo/document/A-8-2018-0190-AM-002-002\\_EN.pdf](http://www.europarl.europa.eu/doceo/document/A-8-2018-0190-AM-002-002_EN.pdf) (“**EMIR CCP Regulation**”). Please note that this link is to the final text as agreed by European Parliament and the Council, but it remains subject to the corrigendum procedure, and has not yet been published in the *Official Journal of the European Union*.

<sup>2</sup> See letter from Laura Harper Powell, Associate General Counsel, MFA, to the CFTC its response to its April 15, 2019 GMAC meeting, dated May 10, 2019, available at: <https://www.managedfunds.org/wp-content/uploads/2019/05/MFA-Letter-on-CFTC-GMAC-Meeting-on-April-15-2019-Final.pdf>.

<sup>3</sup> Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC, available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32016R0679&from=EN>.

### **EU EMIR CCP Regulation**

MFA has long championed the post-crisis reform efforts of Congress, and we broadly support the G20's efforts to apply the reforms in a consistent way across jurisdictions. A major reform that MFA strongly supports is the effort to reduce risk in the derivatives markets by transitioning standardized and liquid OTC derivative contracts into central clearing. MFA believes that central clearing has greatly benefited the derivatives markets by reducing systemic, counterparty, and operational risk, and has resulted in a well-functioning and safer system where counterparties face a well-regulated CCP.

Recently, the EU amended its European Markets Infrastructure Regulation ("EMIR"), which is the EU regulation that implemented the G20 objective of mandating central clearing of derivatives. The recently adopted changes to EMIR (commonly referred to as EMIR 2.2) allow EU authorities to conduct enhanced supervision of CCPs established outside the EU that clear derivatives denominated in one of the currencies of the EU. In extreme cases where the EU perceives excessive systemic risk, the amended EMIR regulation allows EU authorities to require CCPs to relocate clearing activities to an EU member state.

MFA understands that the EU's goal in modifying its rules for non-EU CCPs is to improve financial stability—a goal MFA shares. This goal becomes even more important as financial markets prepare for the UK's withdrawal from the EU. However, the EU approach could have wide-ranging implications for the U.S. derivatives markets depending on how EU authorities exercise these new authorities.

The current transatlantic regulatory framework is built on substituted compliance, equivalence, and the deference of U.S. and EU regulators to each other's comparable regulatory regimes. It is the product of significant effort and coordination over the last 9 years, with input from stakeholders including MFA. MFA welcomes this cross-border regulatory coherence between U.S. and EU rules, and encourages policy and regulatory officials to collaborate even more closely to avoid the risks of fragmenting derivatives markets. If cross-border trading and clearing of derivatives were to become more costly and burdensome, it would undermine the benefits that global central clearing has achieved.

Much will depend on how EU authorities choose to implement their new powers under EMIR 2.2 and how well U.S. and European authorities employ the tools of cross-border regulatory cooperation. For example, if EU authorities exercise their power to require a relocation of clearing activities into the EU, the markets for derivatives clearing would become fragmented along jurisdictional lines. If that fragmentation occurs, it would harm the financial system by, among other things, impeding competition, limiting market participants' ability to operate in certain jurisdictions, and ultimately creating barriers across the global marketplace.

Like CCPs and clearing members, the changes contained in the EMIR CCP Regulation are relevant to our members, who are a vital part of the cleared derivatives markets, and access central clearing and CCPs indirectly through those clearing members. As a result, regulatory changes that impact central clearing or CCPs also indirectly impact customers and could expose customers to increased risks.

Therefore, MFA encourages U.S. and European authorities to continue to coordinate, using tools of deference, substituted compliance, and outcomes-based equivalence to ensure that customers and end-investors who use central clearing do not experience disruptions to their investing and hedging activities due to a breakdown of existing or future equivalence arrangements. In particular, MFA urges Congress to ensure that U.S. departments and regulatory agencies continue engaging with the EU on EMIR so that there is an agreed and coordinated approach to CCP supervision such that transatlantic central clearing is not hindered and the risk-reducing benefits of central clearing remain intact.

We note that with respect to U.S. and UK markets, earlier this year, the CFTC, the Bank of England, and the UK Financial Conduct Authority issued a joint statement providing assurances that they are taking measures to ensure that the UK's withdrawal from the EU will not impede or create regulatory uncertainty regarding derivatives clearing and trading market activity between the UK and the United States. We also welcome the joint statement issued by the CFTC and European Commission in March clarifying that the updates to EMIR and the swaps regulatory framework will result in more deference as between the CFTC and the EU supervisors than is currently the case.

MFA strongly supports such efforts and the issuance of clear, unified guidance as it relates to the EMIR CCP Regulation.

### **Leverage Ratio Impact on Customer Clearing**

The ongoing success and benefits of central clearing have been at risk of being undermined by the Leverage Ratio rules of the Basel Committee on Banking Super-

vision (“BCBS” or “Basel Committee”). Without revision, these rules threaten the affordability and accessibility of customer clearing.

Specifically, the current Leverage Ratio disincentivizes derivatives clearing because it does not provide an offset for customer initial margin (“IM”). That unfavorable treatment limits the ability of customers to use centrally cleared derivatives and could limit the ability of end-users to hedge their risks. MFA was gratified, therefore, by the announcement last week that the Basel Committee has called for an offset for IM in the Leverage Ratio for customer-cleared derivatives. If the Basel Committee’s forthcoming published standards are consistent with the announcement, we would join CFTC Chairman J. Christopher Giancarlo in his call to U.S. Prudential Regulators to implement expeditiously the revised leverage ratio in their respective rules.

Customers have been key to the success of central clearing in the United States and across the globe. While some clearing of swaps between dealers existed prior to enactment of the Dodd-Frank Act, artificial barriers to entry prevented customers from similarly participating in the cleared swaps market. Implementation of the central clearing requirement eliminated many of those artificial barriers and resulted in substantial customer clearing.

At present, swaps customers exclusively access CCPs indirectly through clearing members (typically banks), rather than becoming direct members of CCPs, for a variety of reasons, both financial and operational. Swaps customers must post IM, which is the customer’s money, and CFTC rules require clearing members to hold customer funds from the clearing member’s own assets (*i.e.*, “segregate” the IM).

Unfortunately, the current BCBS Leverage Ratio rules fail to provide an offset that recognizes the exposure-reducing effect of customers’ segregated IM. According to the BCBS, the reason for the lack of an offset for customer IM that is held by the clearing member and not segregated not only offsets exposures, but also can be used by the clearing member for further leverage. In the U.S., segregation rules severely restrict the ability of IM to be held in anything other than extremely low-risk and extremely liquid assets, assuring that it is always available to absorb losses ahead of the bank. Moreover, the substantial majority of segregated IM is posted to the CCP, and therefore, is entirely outside the control of the clearing member.

The failure of the Leverage Ratio to recognize the purpose of segregated IM discourages the use of cleared derivatives by customers. The lack of offset will result in clearing members incurring large Leverage Ratio exposures, which will likely raise prices for customer clearing significantly. As the CFTC stated in its recent letter to the U.S. Prudential Regulators, “[f]ailing to reduce a clearing member’s exposure by the segregated client margin it holds results in an inflated measure of the clearing member’s exposure for a cleared trade.”

In addition, the Leverage Ratio’s current overstatement of a clearing member’s actual economic exposure in a cleared derivative transaction has disincentivized banking organizations from providing clearing services to many customers. The Leverage Ratio is estimated to increase significantly the cost of using cleared derivatives. As a result, MFA members expect reduced access to clearing services and higher prices for such access without an appropriate revision to the Leverage Ratio. This substantial cost increase may cause customers to reduce their hedging activities to levels that are inadequate to manage their risk, which could result in price increases and volatility for food, gasoline, and other consumer goods.

In MFA’s view, prudential requirements that inflate the economic risk of derivatives, particularly the Leverage Ratio, impose artificial barriers for clients to access cleared derivatives and work at cross-purposes with mandates to clear. We commend Chairman Scott for recognizing the adverse impact of the current formulation of the U.S. supplementary leverage ratio on customer clearing, and for serving as a lead cosponsor in the last Congress of H.R. 4659 to require the appropriate Federal banking agencies to recognize the exposure-reducing nature of client margin for cleared derivatives.

Therefore, to ensure the continued affordability and robustness of customer clearing in this country, we urge U.S. prudential regulatory authorities to implement a similar offset for U.S. clearing members to the announced BCBS revision to the Leverage Ratio. To avoid competitive disadvantage to U.S. banks, U.S. Prudential Regulators should act promptly.

#### **CFTC GMAC Discussion of Swaps Market and Liquidity Fragmentation**

During a recent CFTC GMAC meeting, MFA noted that much of the discussion focused on the need for global regulators to address purported market or liquidity fragmentation in swaps trading activity. MFA would like to provide buy-side perspectives to the Committee on the current state of global swaps market liquidity and liquidity fragmentation.

MFA believes that, on the whole, the introduction of central clearing, organized trading, and greater pre- and post-trade transparency in the standardized interest rate swap and index credit default swap (“CDS”) markets has improved—rather than fragmented—liquidity. In these markets, central clearing has made it easier for investors to transact with a wider array of trading counterparties while organized trading has improved pricing and competition, among other benefits. However, in other segments of the swaps market where central clearing and organized trading are not as prevalent, such as the single-name CDS markets, MFA members report that market liquidity has suffered due to lack of participants and lack of breadth of names traded.

MFA is concerned that, if implemented, the CFTC’s proposed comprehensive reforms for swaps trading on swap execution facilities (“SEFs”) would result in the fragmentation of the swaps market. To avoid this fragmentation, the SEF reforms should be targeted in scope. A targeted approach is necessary to preserve the CFTC–EU mutual recognition agreement on derivatives trading venues and to minimize regulatory fragmentation where possible by reducing regulatory divergence and related burdens on existing and potential participants in OTC derivatives markets. Disruptions to such mutual recognition/equivalence agreement may jeopardize impartial access to derivatives trading venues, straight-through processing efficiencies, price discovery, and post-trade transparency. MFA submitted a recent comment letter on the CFTC’s SEF proposals with alternative recommendations that would preserve and enhance the CFTC–EU mutual recognition agreement and its important benefits for investors in facilitating cross-border swaps trading.<sup>4</sup>

While the current SEF regime has improved conditions for investors, it has failed to provide buy-side market participants with true impartial access to the unique trading protocols and liquidity available on inter-dealer (“IDB”) broker SEFs that historically served the “dealer-to-dealer” segment of the market. For example, buy-side firms do not have true impartial access to voice-based execution protocols on IDB SEFs that may be best suited for their specific trading activity. The continuing access barrier of post-trade name give-up on IDB SEFs that offer anonymous execution for cleared swaps reduces pre-trade transparency for investors regarding available bids and offers on such SEFs and limits their choice of trading protocols to those offered by a few viable SEFs serving the “dealer-to-client” segment of the market.

We respectfully urge the Committee to support targeted reforms to the CFTC’s swaps trading regime to avoid the risk of introducing swaps market and liquidity fragmentation.

#### **UMR Initial Margin Implementation**

The implementation of the final phases of the IM requirements under the uncleared margin rules (“UMR”) adopted by the CFTC and other U.S. regulators has presented a myriad of challenges for buy-side firms. We are concerned that outstanding issues might result in prohibitive price increases and decreases in liquidity. MFA has recommendations for various short-term and long-term measures that are necessary to provide certainty and clarity for market participants.

While our members support incentives for central clearing of standardized OTC derivatives, we recognize that market participants have an ongoing need to be able to enter into bespoke and customized derivatives contracts that cannot be easily cleared by a CCP (so-called “uncleared derivatives”). MFA supports requiring buy-side firms to collateralize these uncleared derivatives through the posting of margin. Many MFA members already post IM for their uncleared derivatives, but currently, most do not collect IM from their swap dealer counterparties. Under UMR, buy-side firms will be required to receive regulatory IM from their swap dealers and segregate it with a third-party custodian bank.

For the last several years, MFA has engaged with U.S. and international regulatory bodies on implementation of UMR. Our primary concern with UMR implementation is maintaining reasonable costs and sufficient market liquidity for this important part of the swaps market. If the cost of trading uncleared derivatives is disproportionately increased by UMR implementation, it could reduce liquidity and adversely impact market participants’ ability to invest and properly hedge their portfolios using these instruments. Moreover, for products where no central clearing offering is available and/or where central clearing is not appropriate, calibrating UMR to incentivize such clearing is unrealistic, and accordingly, may need to be re-

<sup>4</sup>See MFA letter in response to the CFTC’s Proposed Rule, “Swap Execution Facilities and Trade Execution Requirement” (RIN 3038–AE25), submitted to Christopher Kirkpatrick, Secretary of the Commission, on March 15, 2019, available at: <https://www.managedfunds.org/wp-content/uploads/2019/03/MFA-Comment-Letter-on-CFTC-SEF-Proposed-Rule-Final.pdf>.



visited. UMR should be designed to properly mitigate the risks associated with uncleared derivatives, not to penalize market participants for using uncleared derivatives to meet their trading needs for prudent risk management, including entering into customized transactions where warranted.

On March 5, 2019, BCBS and IOSCO<sup>5</sup> issued a public statement that the BCBS–IOSCO international margin framework does not specify documentation, custodial or operational requirements if the bilateral IM amount does not exceed the framework’s 50 million U.S./Euro IM threshold. Although the BCBS–IOSCO Guidance is a good first step in providing needed clarity to market participants, MFA urges the CFTC, the U.S. Prudential Regulators, and other regulators to adopt expressly the BCBS–IOSCO Guidance this summer.

Although the UMR does not require an in-scope entity to post regulatory IM until its bilateral IM amount in a counterparty relationship exceeds \$50 million, the requested guidance would, nonetheless, help clarify the obligations of market participants and manage and prioritize their resources. MFA believes the issuance of the requested guidance this summer is critical to ease resource burdens and avoid trading disruptions for swaps market participants in the final phases, especially for the relatively large influx of newly in-scope entities, including many MFA members, on the September 1, 2020 implementation date for Phase 5.

MFA also requests that the CFTC coordinate with the U.S. Prudential Regulators and other regulators to provide a forbearance period of 6 months after a Phase 5 entity’s counterparty relationship that was initially below the \$50 million regulatory IM exchange threshold later exceeds such exchange threshold. Such forbearance is necessary to allow the Phase 5 entity to put the necessary bilateral collateral documentation and trilateral custodial arrangements in place to both post and receive regulatory IM and avoid trading disruptions. A reasonable forbearance period would help to alleviate the complexities, compliance expenses, and resource constraints facing Phase 5 entities, including with respect to separately managed accounts and associated risks.

In addition to these near-term measures, MFA urges the CFTC to coordinate with the U.S. Prudential Regulators and other regulators through the BCBS–IOSCO Working Group on Margining Requirements (“**WGMR**”) to implement broader regulatory solutions that would involve targeted recalibration of UMR IM requirements. MFA recommends that the CFTC and other WGMR members consider:

- Excluding physically settled foreign exchange swaps and forwards in calculations of aggregate average notional amount thresholds for determining whether counterparties are in-scope of the UMR IM requirements. This recalibration is logical and would smooth implementation by avoiding the inclusion of products that should not otherwise be affected by the rules into the process.
- Adopting another phase-in threshold between 750 billion U.S./Euro and 8 billion U.S./Euro; specifically, MFA recommended a Phase 5.a. threshold of 100 billion U.S./Euro in 2020, with 8 billion U.S./Euro pushed back to 2021 as Phase 5.b. A more gradual and orderly staging would ensure that there is market infrastructure in place to support the final stages of IM phase-in and avoid market disruption. Such a further phase-in would also be preferable to a blanket delay of Phase 5, which would simply defer the cliff-edge effect of the threshold dropping from 750 billion U.S./Euro to 8 billion U.S./Euro without further facilitating the industry’s transition.
- Enhancing the use and risk-sensitivity of approved IM models, including the ISDA SIMM<sup>TM</sup>, by:
  - Exempting Phase 4–5 non-dealer counterparties from prudential-style governance of IM models designed for bank capital standards;
  - Enhancing portfolio margining in IM models;
  - Accelerating regulatory approvals of business-specific IM models to avoid model herding to a single standard IM model; and
  - Authorizing opt-in margining of non-regulated products to enhance portfolio offsets in IM models.
- Requiring robust data security protections by third-party software vendors that provide functionality for regulatory IM calculations, reconciliation, and margin workflows.

<sup>5</sup> Available at: <https://www.bis.org/press/p190305a.htm> (the “**BCBS–IOSCO Guidance**”).

We respectfully urge the Committee to encourage the CFTC to coordinate with other regulators and the WGMR to implement our requested regulatory measures as soon as possible to avoid significant swaps market disruption.

#### **EU General Data Protection Regulation**

MFA supports robust data privacy and protection of confidential or sensitive data. GDPR took effect in May 2018 and seeks to protect the personal data of EU citizens. Because the rules under GDPR extend beyond the EU's geographical borders, GDPR has had a significant impact on the operations of many U.S. businesses.

MFA members are subject to a panoply of U.S. Federal and state privacy requirements because most are registered with the CFTC and/or SEC as commodity trading advisors ("CTAs"), commodity pool operators ("CPOs"), or investment advisers. Nevertheless, many U.S.-based investment managers that do not have EU offices are, or may be, subject to GDPR as well because it has broad extraterritorial application that extends to non-EU businesses that offer goods or services to individuals in the EU.

While GDPR does not appear to directly conflict with U.S. privacy regulations, it has imposed requirements on U.S.-based investment managers and other U.S. businesses that are significantly more stringent than what U.S. privacy rules impose. As a result, U.S. firms have had to modify their operations to comply with GDPR, notwithstanding their compliance with existing U.S. privacy laws. In effect, GDPR has become the primary privacy rule with which firms must comply with because it sets more stringent and prescriptive compliance standards than the U.S. privacy regimes prescribed by Federal agencies through the Gramm-Leach-Bliley Act and other Federal legislation, as well as by state law.

GDPR is an example of an EU law that has a significant impact on U.S. businesses and markets. While MFA does not take a position on whether GDPR is the appropriate rulemaking for U.S. entities, we note that Congress may wish to consider that it is now effectively a set of rules with which many U.S. firms must comply even though U.S. actors had little or no influence over the EU's rulemaking in this important area. Once again, MFA strongly encourages U.S. and EU authorities to engage in active regulatory collaboration to ensure coordination of approaches on privacy matters across jurisdictions, and we encourage Congress to exercise its oversight and lawmaking powers as appropriate.

#### **Enhancing Data Protection**

For several years now, MFA has engaged with regulators, including the CFTC, on the issue of data security and treatment of confidential information. MFA and its members have significant concerns about information security at regulatory agencies. Information security vulnerabilities at a regulator jeopardize not only market participants and their investors, but also the U.S. economy through the loss of domestic trade secrets and confidence in the integrity of the regulatory framework. This month, the CFTC Office of Inspector General issued a report highlighting the vulnerability of the CFTC's Integrated Surveillance System to hacking, which reinforces this concern.

Over the last several years, due to both statutory mandates and regulatory discretion, agencies have expanded the scope and breadth of the types of information that they request of registrants. These agencies, however, have generally continued to rely on the same frameworks for information collection and protection. Thus, we were especially pleased with the announcement earlier this year of CFTC Commissioner Dawn Stump's data protection initiative. That initiative aims to ensure that the CFTC only collects data required for its regulatory responsibilities, removes duplicative reporting streams, explores alternative mechanisms for accessing sensitive information, enhances internal controls for interacting with data, examines response procedures for cyber incidents, and updates data retention best practices.

MFA believes that the Committee should also consider legislative solutions with respect to enhancing data privacy, protection, and collection. We commend Chairman Scott for his leadership during the 115th Congress in supporting the "Protection of Source Code Act", and for cosponsoring H.R. 3948, companion legislation that would amend securities statutes to apply the same scheme proposed for the CFTC to the SEC. The Protection of Source Code Act would amend the Commodity Exchange Act to require the CFTC to issue a subpoena before compelling a person to "produce or furnish source code, including algorithmic trading source code or similar intellectual property that forms the basis for design of the source code."

MFA believes that legislation such as the Protection of Source Code Act and companion Senate legislation introduced in the 115th Congress (S. 3732 and S. 3733) would be an important and constructive step for implementing and ensuring that regulators have a robust process in place when it comes to determining the neces-

sity of highly sensitive, confidential information. Significantly, the legislative measure does not impede regulators from seeking the information they need, it only ensures that regulators have a process in place before seeking certain types of information, balancing the needs of regulators and registrants.

As such, MFA supports the policy of the “Protection of Source Code Act” and recommends that the Committee consider proceeding with such legislation during this Congress.

#### **A Harmonized U.S. Approach to Regulation**

MFA supports the harmonization efforts that CFTC Commissioner Brian Quintenz and SEC Commissioner Hester Peirce have undertaken to enhance regulatory efficiency and effectiveness between the SEC and CFTC. To support this initiative and the goals of the CFTC, SEC, and Treasury that relate to promoting coordination, harmonization, and efficiency across regulators, MFA developed a proposal for a harmonized approach to CFTC and SEC regulation of firms that are registered with both the CFTC as CPOs or CTAs and with the SEC as investment advisers (“**dual registrants**”).<sup>6</sup> We have urged the CFTC and SEC to enhance coordination and efficiency in the regulation of dual registrants, and we believe that this Committee has an important oversight role to play in ensuring that regulators take a more harmonized or coordinated approach to regulation of dual registrants.

Dual registrants are subject to a wide range of related, but not identical, requirements arising from CFTC, SEC, and National Futures Association (“**NFA**”) rules. These requirements include systemic risk reporting, examinations, advertising, marketing, sales practice and promotional materials, recordkeeping, privacy policies, information security and cybersecurity, self-assessment, business continuity and disaster recovery planning, ethics, and registration forms.

Under our proposed CFTC–SEC approach to harmonized regulation, currently dual registrants would continue to be registered with, and subject to oversight by, both agencies. All trading activities in the futures and swaps market would continue to be governed by CFTC rules and all securities market activities would continue to be subject to SEC rules. However, through an exemptive-relief safe harbor, each agency would provide substituted compliance for CPO/CTA and adviser regulations, whereby a registrant would be able to satisfy its compliance obligations with one agency by complying with the other agency’s rules that serve the same purpose. A dual registrant would determine which agency’s rules it would need to comply with based upon an assets under management test. For example, if a majority of a registrant’s exposure was from derivatives overseen by the CFTC, it would comply with the CFTC and NFA regulations, and would be granted substituted compliance by the SEC for certain investment adviser regulations.

MFA believes that a harmonized approach to CFTC–SEC regulation of dual registrants could significantly enhance regulatory efficiency and effectiveness, and reduce regulatory burdens by streamlining systemic risk reporting and implementing joint or coordinated exams of dual registrants. These aspects to dual regulation create the greatest additional ongoing cost and burden. A harmonized approach would also provide clear and quantifiable benefits to the CFTC and SEC, registrants and the investing public, as well as conserve valuable government resources, reduce waste, promote good governance, and greatly enhance regulatory efficiency and effectiveness.

MFA continues to engage with CFTC and SEC staffs to discuss an optimal framework for a harmonized approach to CFTC and SEC regulation of dual registrants. MFA has recommended that the CFTC and SEC prioritize adopting a harmonized framework approach to regulation of dual registrants that would decrease duplicative regulation, allow for substituted compliance, joint, or coordinated exams, and permit the submission of a single systemic risk report to the CFTC, SEC, and NFA.

We respectfully request that the Committee exercise its oversight role in ensuring that regulators take a more harmonized or coordinated approach to regulation of dual registrants.

#### **Conclusion**

On behalf of MFA, I appreciate the Committee’s consideration of Brexit and other international developments affecting U.S. derivatives markets. As discussed, we strongly support global regulatory coordination and regulatory efforts to define con-

<sup>6</sup>See letter from the Honorable Richard H. Baker, President and CEO, MFA, and Jennifer W. Han, Associate General Counsel, MFA, to the Honorable Jay Clayton, Chairman, SEC, and the Honorable Christopher Giancarlo, Chairman, CFTC, dated November 15, 2018, on “A Proposal for a Harmonized Primary Regulator Approach to SEC and CFTC Regulation of Dual Registrants”, available at: [https://www.managedfunds.org/wp-content/uploads/2018/11/MFA-Proposal-for-Dual-Registrants.final\\_11.15.18.pdf](https://www.managedfunds.org/wp-content/uploads/2018/11/MFA-Proposal-for-Dual-Registrants.final_11.15.18.pdf).

sistent, effective, and fair cross-border rules that foster capital formation, increase transparency, mitigate systemic risk, and facilitate open access to the financial markets. To prevent the financial markets from becoming fragmented along jurisdictional lines and otherwise undermining the progress made in safeguarding the financial system against another financial crisis, we urge Congress, through its oversight powers, to examine and encourage Treasury and regulators to formulate positions in each of these important areas, and then work with their international counterparts to resolve impediments to the objectives of open, efficient, and fair capital markets.

In addition, to strengthen the U.S. financial system, we would appreciate Congress' continued oversight on harmonization issues by requesting that the CFTC and SEC implement a more harmonized and coordinated approach to regulation of dual registrants. We also request that Congress consider adoption of measures to enhance protection of U.S. intellectual property.

MFA is committed to working with Members and staff of Congress, the Committee, and regulators to address these issues towards the goal of preserving the strength of our nation's economy. MFA is also committed to its role as a constructive partner to policy and regulatory officials in overseas jurisdictions, including in Europe. Thank you for the opportunity to appear before you today. I would be happy to answer any questions that you may have.

The CHAIRMAN. Well thank you. Thanks to each of you for your very informative remarks and information you relayed. I certainly at this time want to thank my staff, our Agriculture Committee staff, for pulling such a distinguished panel together. Thank you all very, very much.

Now, Members will be recognized for questioning in order of seniority for Members who were here at the start of the hearing. After that, Members will be recognized in order of arrival.

I will start with myself for 5 minutes.

As I said at the outset, we want to really find out from you what we should do in this situation as Members of Congress, what we can do to make sure that there are no impediments.

And from each of your testimonies, you have shared with us some impediments, some things that are standing in the way that need to be removed because of this Brexit situation. And so, we want you to be frank. We want you to give us some direction in how we can make sure that our market participants in the cross-border are not inhibited by this divorce that is going on, and also, this kind of untoward activity that the EU in and of itself is doing, that appears to be some sort of power play. And we want to be knowledgeable from you so we can put into action the necessary movements that can help make sure that our market participants, the United States financial industry, are not put at a disadvantage with what is happening with the European Union and Brexit.

But first and foremost, I would like to get the panel's take on what you think about the most recent and timely news from the CFTC. What are your thoughts on the CFTC's announcement yesterday of the creation of a process to terminate the exemptive relief they have offered to foreign firms under their Part 30 rules?

We will start with you, Mr. Duffy, and then I would just like very quickly to get each of your take on this. The CFTC's movement yesterday is very important. I want to kind of find out how you all feel about it.

Mr. DUFFY. I will save my comments on what you should do. I think that was the original question. But I will talk about what the question you just asked is. What do we feel about what the action that was taken yesterday? I think it was very significant for a couple of reasons there, because I think it was the first time we have

seen a unanimous decision come out of the Commission for all five Commissioners from both sides of the aisle to agree that this is a big issue. Not to just somewhere, what we are hearing from your Committee here today.

I think that was a very, very strong positive message. And if they were to enact to take away the exemption of the Part 30, it would make it very, very difficult obviously for European brokers to deal with U.S. clients. They would have a whole host of new hurdles they would have to go under, which in return would be a lot of costs associated with them.

I was very heartened to see that the Chairman and the rest of the Commissioners put that out for comment, and that is their position. I think that is a really good strong starting point.

The CHAIRMAN. Very good. Mr. Edmonds, advice?

Mr. EDMONDS. I certainly recognize what they did yesterday was adding a tool to the tool chest they had. I think on an historical basis, everyone has looked at that as something that would not be touched. But now, they have been very clear about what they put out there, giving them the opportunity to take advantage of that, given certain circumstances once it is warranted. I think there is going to be a lot of collection of tools that go in the tool box before we get through this conversation at a holistic level.

The CHAIRMAN. All right. Mr. Maguire?

Mr. MAGUIRE. Thank you, Chairman Scott. I will be brief.

To reiterate what Chris said, I think it is a tool in the tool box. I think that is clear. From our perspective, we are clearly a known U.S.-domiciled CCP. It doesn't directly impact, as we operate here, as I mentioned in my testimony, under a direct registration model, which we are strong advocates of. We are fully compliant with all the rules and don't rely on elements of this.

What I would encourage, though, I think it is a potential tool and a potential set of circumstances. There is definitely a need all around to consider this—how do I put it? To think about not having an arms race and thinking about more cooperation. I think the danger as this thing escalates, things get turned into an arms race and it is very important that we take the temperature down in time. But I understand the motivation for doing the change in the rule.

The CHAIRMAN. Right. Mr. Lukken?

Mr. LUKKEN. Yes, Part 30 is the regulation the CFTC has to allow U.S. customers access to foreign markets through foreign brokers that are deemed comparable. Their action yesterday was codifying how you would revoke a Part 30 comparability analysis if certain conditions arose. This was codifying, I think, what was already a regulatory practice. Again, it is a tool in the tool box. If you are looking at carrots and sticks, regulators need carrots and sticks. This was a stick. The regulator, and Chairman Giancarlo has also talked about some carrots as well, which is we need to get to a more comparable regulatory structure so we don't have to register DCOs around the globe. I am looking forward to the holistic package that he is planning to put out, both Part 30 yesterday as a stick, and hopefully some carrots in the coming weeks.

The CHAIRMAN. Right, and Mr. Berger?

Mr. BERGER. Thank you.

As you noted, Mr. Chairman, the proposal was voted out yesterday, so MFA looks forward to reviewing and commenting during the public comment period. I would note, seconding what Mr. Duffy said, there was a unanimous and bipartisan vote by the CFTC Commissioners to move forward. And as a general matter, I think it is good public policy to codify powers that currently only exist as part of exemptive relief.

The CHAIRMAN. Right. Thank you very much. My time has expired on that; but hopefully, I will have a chance to maybe get to it with one or the other. But what I may want to come back on is that I want to make sure that we get back to this EMIR 2.2, and what we in Congress need to do in terms of this. I have talked with the CFTC and there may be a move that we have to put in place to retaliate, and we will examine that, and perhaps Mr. Scott and some of the others will get to that.

I now recognize the Ranking Member for his questions.

Mr. AUSTIN SCOTT of Georgia. Thank you, Chairman Scott, and Mr. Maguire, I appreciate your comments about reducing the temperature. I think that would certainly be the desire of the Committee, and many of the others.

Mr. Duffy, you discussed the idea of regulatory sovereignty and how infringement on the CFTC's ability to regulate U.S.-domiciled entities could be harmful. Can you expand on the dangers you see when you look at the potential of having two regulatory masters?

Mr. DUFFY. Yes, sir, and thank you for the question.

Having—first of all, it is against the law for the CME to be in compliance with EMIR 2.2 because under the U.S. law, the CFTC is our primary regulator and that is it. We would actually be in technical violation of U.S. law if we were to be in compliance with EMIR 2.2. That is just for starters.

So, the answer to that is what do we do? Well, we can not do business in Europe, but that doesn't make any sense for all of the reasons that we outlined. Having duplicate costs associated with this, again, I don't think anybody can understand really what that is going to do to the ultimate consumers, and it is not just in the U.S., it is everywhere.

When these spreads widen those costs have to be borne by somebody, and market participants will bear them and they will bear them in a way that they can widen their spread, so that is how they do it. And that puts the cost on the consumers. I think that is very damaging. And again, as I said earlier, this is just not agricultural products. This is your home mortgages. This is your 401(k)s. The illiquidity that you mentioned earlier, sir, that is a big, big issue. Duplicate regulation makes absolutely no sense, and for a company like CME, which is the largest exchange in the world, we have roughly less than five percent euro-denominated products traded in Europe. How are we possibly deemed systemically important to the European Union when we have less than five percent euro-denominated products?

This is nothing more than what Ranking Member Conaway said earlier. This is a little retribution from 2010, 2012, but also, this can't go forward, and I think hopefully we are past that. I thought we were past it in 2016. I am very hopeful that this Congress will be very much involved.

Mr. AUSTIN SCOTT of Georgia. Thank you, Mr. Duffy.

Mr. Edmonds, as you noted, Chairman Giancarlo has recently proposed changes to how it interacts with overseas clearinghouses. How would the changes that he is proposing change the regulation of clearinghouses?

Mr. EDMONDS. Well, the proposal that is out there now is really more around what we thought we had in 2016 in the agreement, and where that is headed. We have spent the better part of the last 2 decades—Terry will say it is longer, and that is fine—creating a global market, and everything we are doing right now is trying to combat the balkanization of that market and all the costs that come along with that on the ride. I agree with Terry's comments that the risk it faces on the widening spread.

But, Chairman Giancarlo and what he is trying to propose is to take that down and get that—we know what we do really well here in the U.S. We understand what the Europeans do really well, and to take advantage of that on both sides of that so we have a very harmonious global financial system. And if we are not going to do that, as you have articulated and as other members of this panel today have articulated, there is a risk of an arms race. And I don't think as any market practitioner, we are looking for that. And if you think about it from a cost perspective, how are we making the markets safer? I mean, it is very difficult for either side of the aisle to say the market is safer at the end of the day because we are balkanizing it. I think that is going to be a challenge for all of us to look at.

If I look at the Chairman's comments earlier about what we can encourage Congress to do is make sure not only at the regulatory side but also on the market operators that we are walking down a path to one that is comparable. And if we are there, then we can manage a global financial market pretty well.

Mr. AUSTIN SCOTT of Georgia. Would any of the rest of you like to comment on that in the last 50 seconds?

Mr. LUKKEN. I would just mention risk management. I think the fear, as much as we can talk about costs and access, but during a crisis when a CCP is trying to preserve the safety and soundness of the system and you have two regulators telling you conflicting things, I think that is, to me, the scariest part of this. And we want to make sure that in this deference approach that it is clear who the principle regulator is and who CCP has to listen to so they are not conflicted during a time of crisis that could have significant market disruption.

Mr. AUSTIN SCOTT of Georgia. Thank you. Mr. Chairman, my time has expired, but it is pretty clear to me the extreme risk and cost that comes with not having the harmonization not just the U.S. markets, but the global markets and the end-users out there, and that, again, is very, as you know, damaging to the global economy.

With that, I yield the remainder.

The CHAIRMAN. I certainly agree with you, Ranking Member. That is an excellent comment.

And now we will hear from Ms. Spanberger, please.

Ms. SPANBERGER. Thank you, Mr. Chairman. Good afternoon to our witnesses.

I represent central Virginia, home to farmers and producers across the 7th District of Virginia. We have touched on some of the risks to global markets that would be created in the event of a hard Brexit, and some of the steps that might be taken to mitigate those risks. But given the lack of certainty that we have about the future and what we could be facing, I would love to hear from anyone on the panel who would like to comment on this. What could be the possible outcomes and scenarios facing some of the folks in my district? I am concerned about the farmers who mitigate commodity price risk through future markets that trade on your exchanges, and other constituents from my district who may have pensions that are affected by these regulatory changes.

Could you comment on how a soft Brexit might affect U.S. commodity futures and pensions, and how this would compare to the risks of a hard Brexit and what some of my constituents on an individual basis might face in the future?

Mr. LUKKEN. This is something that FIA has taken a lead on, both in Europe and the United States, on preparing for Brexit. At the marketplace, we have worked with all these exchanges and buy-side members at the panel to make sure that either a hard Brexit or a soft Brexit, that there is transitional relief. In a hard Brexit, of course, there is no transition. But, we have received from the Europeans regulatory relief that will allow people to continue to access clearing in a hard Brexit scenario. We are hopeful that the two parties reach a soft Brexit and there is a long lead time that will allow us to transition to the new arrangement.

But I think the biggest fear is just the political risk involved with this, things outside of our control. I think this industry has done a very good job of planning for either a hard or a soft Brexit; but, during a hard Brexit, they will cause market volatility most likely, and that volatility could impact prices, including agricultural prices.

We have done about as much as we can to prepare for this, but there are certain things we just can't know, especially in a hard Brexit volatility situation.

Mr. DUFFY. I will say, Congresswoman, from our standpoint, CME has already set up operations outside of the UK so we are incurring duplicate costs in order to be in compliance with whatever happens, whether it is a soft Brexit or a hard one. But I think for the good people of Virginia, the good news is that they will have access to the U.S. clearing entities today completely uninterrupted to mitigate their risks as they continue to run their business.

I don't see much of a risk to your constituents, thankfully, but the risk is the liquidity issue that I think we have all talked about, because there is a continuity of liquidity in the ecosystem that could have an impact on prices. But I am fairly confident that because of some of the moves that we have made and others, that it should be relatively not interrupted for your constituents.

Ms. SPANBERGER. Okay, thank you.  
Would anyone else care to respond?

Mr. MAGUIRE. Thank you, Congresswoman. Yes, just briefly.

Ms. SPANBERGER. Thank you.

Mr. MAGUIRE. We say we are hopeful of a soft Brexit. We are prepared for a hard Brexit, clearly. And to echo comments about



this, there has been a lot of great work done by many across the industry to prepare for that.

I think really the area to focus then is on EMIR 2.2, which has been referred to already, which is not specifically Brexit but is sort of interlinked with that.

The outcome of, and I always raise the outcome of a lack of harmonization that has been referred to, is that markets fragment. The outcome of markets fragmenting is liquidity splits; therefore, supply goes down, demand stays the same, and in very simple first grade economics, if supply is down and demand is the same, the price increases.

Certainly, in the financial products that we clear, I am not really clear on agriculture, but things that would affect pensions, loans, 401(k)s and mortgages and other things, if markets do fragment as a result of EMIR 2.2, we will see an impact to the end-user and the customers and the constituents using those financial products.

Ms. SPANBERGER. Thank you very much. My time is starting to get close to running down, but I was wondering, Mr. Berger, if you could comment on the risks that uncleared swaps pose, and how well you expect the uncleared margin rules will work to mitigate this risk?

Mr. BERGER. Implementing new margin and collateral requirements for uncleared swaps was a key component of the G20 reforms to the OTC derivatives markets, and we are in the process of phasing that in through a phased timeline that extends into 2020. And I think what the industry has experienced is the last phase includes the largest number of counterparties, so all those counterparties kind of getting ready and getting through the gate is proving to be a little bit of a challenge. Providing some additional time to phase-in the buy-side would be a welcome development.

Ms. SPANBERGER. Thank you, and my time has expired. I yield back. Thank you.

The CHAIRMAN. Mr. Crawford, you are recognized.

Mr. CRAWFORD. Thank you, Mr. Chairman. I appreciate you convening this hearing today.

Mr. Duffy, I was at the 2012 hearing that Ranking Member Conaway mentioned. At that hearing, Patrick Pearson testified on behalf of the European Commission, and raised an important point about the danger of unenforceable regulations. He said: "If the European Union were to try and enforce its rules on all of its affiliates in the United States of America, we would be doing two things that are horribly wrong. We would be trying to enforce something we can't enforce in practice. Even worse, we would be giving the impression that we will be able to enforce it. And if something goes wrong, where will the plane land? Will it land here in the United States, or with a regulator in Europe? That is the thing that we are trying to avoid. We do not afford ourselves the luxury of putting in place a regulatory system that we know we cannot enforce."

Is the EU in danger of putting in place a regulatory system it can't enforce?

Mr. DUFFY. I am not so sure it is in danger of putting in something that it can't enforce. I think what it is doing, it is trying to

put something in place to displace you and the rest of the United States and take over as the regulators.

In today's global market, they probably could enforce it, and I think that is one of the main reasons why we are here today is because of the concern that U.S. entities are going to be regulated by European oversight, and it will displace the United States Congress and its own government agencies. We think that is the damaging part.

Whether they could do it, or not, is something that is yet to be decided, because they haven't done it. I would not be able to pass judgment on that just yet.

Mr. CRAWFORD. Well, let me thank you for your candor. You indicated this. I do think there is a political dynamic here. I appreciate your candor on that subject, but in the bigger picture here, what we are talking about today, we have heard this recurring theme about liquidity and things of this nature, and quite frankly, what we are discussing here today, if we don't get it right, we are scaring a lot of liquidity out of the market.

I have some concerns about my farmers back home who have over the years, particularly since Dodd-Frank, have been literally scared out of the market, and at the same time, we in this Committee have been told we need to move to a market-based system of agriculture support. And what is the market-based system? It would be obviously using the tools that CME offers. And yet, farmers are afraid to get in it. There is a liquidity problem which creates more volatility, which further exacerbates the problem for farmers that have become relegated to price takers.

I don't think a local basis contract is a sufficient risk management tool. Do you?

Mr. DUFFY. Well, I don't know if it is not, but I will tell you that your comments are not on deaf ears. We have worked very, very hard with the community. That is our roots, is in agriculture, as you know.

Mr. CRAWFORD. Sure.

Mr. DUFFY. And we want to continue to make sure we provide a level playing field for people to manage their risk in the farm community. We are talking about feeding nine billion people by 2050, and the American farmer is a big part of that. But they are not going to be able to be a big part of that if they don't have good risk management tools to do so.

We need to do more with less, as you know from your community, and we are in a very difficult situation. What I said at the outset, why in the world would this Congress or our government agencies sit back as somebody from another country is trying to take away the jurisdiction and create more uncertainty for the farmers of the United States *versus* the certainty they need? Because you know what, sometimes you can't blame them for not wanting to dip their toes in the water, because if you don't know the rules of the road, you are not going to drive.

Mr. CRAWFORD. Well, I will tell you, I think what we have to do in this Committee and then broadly in this Congress is we have to prepare ourselves to direct ag policy in that direction with regard to utilizing these free market tools. In the end, that is the only thing that is going to be left available to farmers. If we don't get

that right now, if we scare that out of the market, what are we left with? And farmers are behind the eight-ball and have been for quite some time.

And so, when we talk about this in the context of hedge funds and all the terms that we have heard used, sort of the industry vernacular, that creates even more discomfort, for lack of a better term, among the very folks that these markets were designed to help protect with regard to risk management strategies.

As we move forward in that, I want to work with you on this because I think we most definitely need to be incentivizing farmers to use these risk management tools. And this is a much more relevant question here in this Committee to advocate for farmers. I have nothing against hedge funds. I think they are important. They are important parts of the market, but the very basis of this, the very basic level, if we get this wrong, we have done maybe irreparable damage to our farmers.

I appreciate your work on this and look forward to working with you, going forward.

Mr. DUFFY. Thank you, sir. I completely agree with you. I will also say one thing. The sophistication of the American farmer on risk management is at an all-time high right now, and good for them. They are really doing an amazing job.

Mr. CRAWFORD. Thank you, and I yield back. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Mr. Crawford, and now, I will recognize the gentleman from New York, Mr. Maloney.

Mr. MALONEY. Thank you, Mr. Chairman. I apologize for arriving late. I want to thank the witnesses for being here on this important subject, and I wouldn't have missed the first part of the hearing if I hadn't been shepherding a bill for my Subcommittee on the Coast Guard through the Transportation and Infrastructure Committee this morning at a markup. But I appreciate the opportunity to be here. I appreciate the testimony you have all submitted.

I am curious, Mr. Berger, from the buy-side perspective, and forgive me if some of these questions have been covered already. But from a buy-side perspective, could you elaborate on some of the harm, from your perspective, with the EU proposals?

Mr. BERGER. As I have noted in my testimony, MFA is a proponent of central clearing of derivatives. We think that central clearing mitigates systemic risk, increases investor protections, and provides for a more transparent and competitive marketplace.

Our derivatives markets are global markets, and for buy-side market participants, we want to have the ability to conduct our investment activities, our hedging activities in the largest possible liquidity pools with the most diversity of other participants. That ensures we can get the best pricing for the folks that we are investing on behalf of.

That means that it is important for us to have access to CCPs, to clearinghouses, whether they are headquartered in Chicago, Atlanta, New York, London, Paris, or Frankfurt. And so, it is essential for our members that regulators work together to use the tools of substitutive compliance, deference, and equivalence to ensure that there is that access.

Taking to the extreme the concern with the EMIR 2.2 proposal is that it would require the relocation of certain clearing activities, exclusively to a certain jurisdiction, which would fragment that global liquidity pool that we all benefit from operating in.

Mr. MALONEY. I appreciate that.

Mr. DUFFY. CME is certainly systemically important in the U.S. ESMA seems to want to give you that designation in Europe. Why do you think they want to do that?

Mr. DUFFY. Well, as I said earlier, Congressman, I think it is more of a *regulatory grab*, for lack of a better term. I think they are looking to become the regulators for the world, and when they want to deem a systemically important institution like CME here in the United States and give us that same designation in the EU, and as I said earlier, roughly less than five percent of CME's products are euro-denominated. It is kind of a stretch to say that we are a threat to the European economy.

There is nothing else other than they want to have one set of rules and they want the rest of the world to fit into their rules, and as we have heard earlier, they were testifying here in 2012 how that didn't work, but now all of a sudden, that is the model they want to apply. They want to deem us systemically important because of our designation here in the United States, and that has no bearing whatsoever with what CME brings to the European Union.

Mr. MALONEY. Right. As a proponent of central clearing believes it is one of the kind of wonders of the world, the fact is, is that some of us are worried about clearinghouse risk. What are the risks that we should be worried about today in terms of your business?

Mr. DUFFY. Well I mean, there is risk associated with everything we do, Congressman, as you well know. I think what we do is we are a neutral facilitator of risk management, so we do not participate in the markets—

Mr. MALONEY. Yes, I understand your business model, sir, and I understand the role you play. What are the risks?

Mr. DUFFY. Well, the risks are, if there is a major default by more than two of the biggest counterparties in the business. If you had two or three major banks go down at the same time, that would be a risk not only to CME, but to the entire financial system.

Mr. MALONEY. And what would happen in that scenario? What would—

Mr. DUFFY. I don't even want to make a comment of what I think could happen, sir, because I don't think it would be very pretty.

Mr. MALONEY. And would the European approach to this be justified by those risk scenarios, or are those likely to be outside of their purview?

Mr. DUFFY. Well, if there, and I am referring to U.S. entities. I am not referring to European entities.

Mr. MALONEY. Right.

Mr. DUFFY. I am referring to U.S., so I don't know what the European entities would have any say in that matter whatsoever.

Mr. MALONEY. It wouldn't support their position that there might be systemic risk here? Even if we were concerned about clearing-

house risk in the United States, would it support their position in designating you systemically important?

Mr. DUFFY. No.

Mr. MALONEY. Right. I yield back, Mr. Chairman. Thanks.

The CHAIRMAN. Thank you very much, and now the gentleman from Illinois, Mr. Bost. Thank you.

Mr. BOST. Thank you, Chairman.

Mr. Duffy, when you closed out your testimony, you encouraged Congress and the CFTC to consider whether additional regulatory and statutory tools might be useful or necessary. As you know, the Committee right now, we are preparing to reauthorize the Commission again this year.

That being said, as we do so, what remedies might—and I think this is what the Chairman asked earlier and I would like to get into that. What remedies might be effective to protect U.S. markets and participants from ill effects of the EU's overreach?

Mr. DUFFY. Thank you, sir, and I think when you look at the reauthorization process, you can definitely implement new tools that the CFTC can have in their tool chest, as was referred to by Mr. Edmonds. I think what the U.S. Congress can do is a lot more aggressive than just on reauthorization putting in things to the CFTC. I think the United States Congress, who does a lot with the European Union on a whole host of issues, should put this in their side of the ledger sheet, saying we need to make sure this is fixed. We have other big issues as it relates between the European Union and the United States. Let's deal with them, but we also have this issue, and we are not going to have duplicate regulation associated with our products by your people. We are not doing it to you, so don't do it to us.

There is something that the Congress can take to the next level, and I think that is exactly why, and I applaud the Chairman for holding this hearing, because when the CFTC voted yesterday unanimously in a bipartisan way, and I am hearing nothing but bipartisan by this Committee, this is what the Congress, I am hopeful, will continue to do and send a very strong message to the European Union that we have a whole host of issues we have to deal with outside of financial services that we are dealing with you on, and that we are going to put financial services and regulation in that bucket, so make sure you get this accomplished.

Mr. BOST. Thank you. I am letting you know that this Committee is really in agreement with you. We just want to make sure we are positioned correctly.

Mr. Edmonds and Mr. Duffy and Mr. Maguire, now while all your operations, all of you operate clearinghouses that welcome participation from international clients, the mix of products that you clear is a bit substantially different. Can you describe those differences, as well as the differences in the regulatory and international coordination for these products so we know the difference?

Mr. EDMONDS. Well, I think if we were going to describe the differences in all of our products, we might need more than this hearing allows today.

Mr. BOST. Probably more than 5 minutes, too, correct?

Mr. EDMONDS. A little more than 5 minutes. I think I would sum it up for you this way and I am happy to follow up with you offline, if greater detail is needed.

From an ICE perspective, when we look around the globe, we are not going to tell anyone how to trade, where to trade, or what to trade at the end of the day. What we want is the opportunity to earn your business when you make a decision to trade. If you want to be in a certain regulatory jurisdiction, we provide services in that. Some people do, others don't. My colleagues up here who we compete with head-to-head on a daily basis, they have slightly different philosophies from time to time. But once you get at the philosophical level, you are going to pick your jurisdiction as a customer. You are going to understand exactly how you are going to manage the risk that is most important to you and the business that you are running at that time. We want to give you all the tools necessary to do it within that jurisdiction. Slightly different perspective than others have, both work, and that creates competition across the marketplace, and ultimately benefits the consumer at the end of the day for having that choice.

Mr. MAGUIRE. If I may embellish, Congressman.

The LCH Group, I won't, again, give you the full plateau of the products we clear and the differences, but our focus is predominantly on interest rate swaps, which is really the preeminent service that we clear and are responsible for.

The swaps market is very much a global market. It has active participants globally for many different jurisdictions, and these are tools, as I referred to earlier, that are used for real economy hedging purposes. That is the product that we have a material position in.

And that product is traded globally and is overseen globally, so it is a slightly different fact pattern, different sort of slightly unique organization in that regard. We have oversight through direct registration in many different jurisdictions, where we have worked through that over many, many years. As I mentioned in my testimony, we have been a registered DCO here in the states for 18 years. That is proven through the test of time through Lehman Brothers, through MF Global, the coordination not just at an operating level, but between the regulatory supervisory authorities of CFTC and Bank of England have operated well there.

We have a regulatory architecture that we sit within, which is maybe not the architecture you would apply for some of the futures markets. It is very much a global OTC market. I think there is definitely a case here for different regulatory architectures for different types of markets and different types of products. That would be my main contribution.

Mr. DUFFY. If I may, sir? CME Group is the largest exchange in the world, and it lists all the major asset classes that touch everyone's lives on a daily basis. To give you an example of how important this is, CME Group had 44 percent of the notional value of trade of the U.S. Treasury market 5 years ago. Today, CME has 118 percent of the notional value of trade of the U.S. debt market.

What does that mean? When you have inverted rates going on right now, when you have the rates that are happening in Germany and other parts of Europe, people are looking to invest in

certain types of issuance, such as U.S. debt products. They are using CME to manage that risk. That is a very big deal for European participants that participate in U.S. markets, which as you know, helps benefit us by running our economy, by selling our debt to them as well.

Mr. BOST. I want to just say thank you to all of you. My time has expired. Thank you, Mr. Chairman. I yield back.

The CHAIRMAN. Thank you, and now the gentleman from Kansas, Mr. Marshall.

Mr. MARSHALL. Thank you so much, Mr. Chairman. I think for my first question I am going to go with Mr. Maguire.

Mr. Maguire, my farmers, my cattlemen, pork producers back home use the derivatives market a lot, and I have talked to hundreds of them. They say it is not broken. It is working fine. This Committee and many of us individuals have tried to understand the swaps and derivatives market, and I think it is going along great.

When I study big picture analyses, I like to understand the culture of what is happening. I am afraid the culture with the European Union is going the wrong direction. I feel like maybe they are being a bully. They won't let us do trade with agriculture in the next trade agreement, and this is another example, it feels like, of them pushing us around and taking advantage of Brexit.

Tell me what is going on with the cultural relationship with United States and the European Union through your eyes sitting there in London?

Mr. MAGUIRE. This could take longer than 4 minutes.

We have a unique position in the UK. We are exiting. We are now going to become a third-country, much the same as the U.S. I think it sort of really echoes some of the points that have been raised already in that this seems to be an increasing—I will use that phrase again, I don't use it lightly—that *arms race* where there are different incentives or different positions being taken maybe than there were historically.

Our position is that I think you need to take the temperature down. I think there were views historically that may be in the first instance when we had the legislation after the crisis in the G20 committee in 2009, Dodd-Frank went first, that sort of—the pendulum shifted one way and I think there is a feeling now that Europe is shifting the pendulum the other way. I think you need to bring things back to more of an equilibrium where actually in the eventuality of this arms race continues to escalate, what we are going to end up with is fragmentation, which is going to be a bad impact for all.

There is really a need to take the temperature down. It is hard for me to say as I am not involved in the U.S.-EU negotiations and discussions directly. It would be wrong for me to comment, but it does strike me that we need to sort of deescalate rather than continue to escalate for the benefit of the end-users that are involved here.

Mr. MARSHALL. Okay. Next question, as the dollar, the euro, and the British pound is, they fluctuate in values. Does that give anybody any heartburn as we make this transition, going forward? Maybe I am worried about nothing.

Mr. EDMONDS. There are always macroeconomic events at the end of the day that impact volatility as it relates to currency markets in any one of those sovereign nations that you make reference to in your question. I don't know that anything and what we are doing here is any different than what you see on a daily basis. There could be individuals that have an opinion and choose to express that opinion through risk management tools and trading the products that any of us offer at that moment in time, based on their opinion of where our market is heading or isn't. But that is a moment in time decision they will make and they will either profit from that or they will lose.

Mr. MARSHALL. All right. I will go to Mr. Lukken next.

If a CCP is faced with two regulators that are unwilling to defer to one another, is it possible that a foreign regulator, such as in the European Union, could impose requirements not for safety and soundness, but instead for competitive reasons? What does that look like? How would they take advantage of us on this, and how would it impact my farmers back home?

Mr. LUKKEN. Well, that is what we are really trying to avoid here is that type of duplicative situation. There have been situations in the past where two competing regulators have been talking to clearinghouses—LCH has had examples of this in the past—during systemic events, and thankfully during those times one regulator deferred to the other and they were allowed to do what was in the best interest of the clearinghouse.

These are the things that regulators need to work out now. This is a level, it comes down to as much as we can paper this with agreements, it comes down to trust. And for some reason right now, there is a lack of trust between the Europeans and the United States that we are trying to figure out how do we get back to that level of cooperation that has existed for a long period of time between our two jurisdictions.

Our hope is, and EMIR has the capability of, the Europeans recognizing the 2016 equivalence agreement and agreeing to defer to U.S. regulation. And I hope they take that common-sense approach so that we avoid the situation that you are talking about.

Mr. MARSHALL. Mr. Duffy, I just have a second left.

CME has been around a while, a great reputation. How do you see this culturally, is this something new or just another chapter of this relationship with the EU?

Mr. DUFFY. I think it is a bit of another chapter, and we have been around 175 years, so you are right, a long time.

I really believe people want to do the right thing, sir, to be honest with you, and I think people understand that there is a regulatory regime and it is not a one-size-fits-all, and we can all get along together and operate in a global marketplace, because that is truly what it is today. It is not a centric marketplace. It has grown exponentially, and it has benefitted everybody. I think when cooler heads prevail so the good people that you represent will be able to sell their products internationally without somebody maybe manipulating their currency to avoid a tariff, things of that nature. Those are all big, big issues that this Congress needs to address, but I don't believe that the European Union is doing anything other than when you look at what happened in 2010 with Dodd-



Frank, when you create new legislation, the pendulum always goes to a certain way. And it did it in 2003 with Sarbanes-Oxley. It doesn't make it wrong, because you can always walk it back. It is hard to walk it forward.

What is going on right now is you are seeing the same thing happening in Europe, and I think they are going for a little bit of an overreach right now. And I think just alone with Congress being involved, you can walk them back to where they need to be.

Mr. MARSHALL. Great insight. Thank you.

Mr. Chairman, I yield back.

The CHAIRMAN. Thank you, and now we will hear from the gentleman from Florida, Mr. Dunn.

Mr. DUNN. Thank you very much, Mr. Chairman.

I think we all see the problems in the risks in the proposed EU regulations. I want to highlight several of those problems.

Mr. Duffy, the EMIR 2.2 proposal does not provide ESMA with oversight over European clearinghouses, rather, it defers oversight to what they recognize as competent national regulators in the EU member states. But that does make ESMA in the space of clearinghouse oversight an international regulator focus really only on the third-country clearinghouses. And while that is strange enough, the proposal also envisions fees on these third-country CCPs would cover the entire cost of this activity. It means the CCP in the United States, for example, would pay for the privilege of being regulated by a foreign entity and pay handsomely indeed.

I believe that that is an egregiously bad infringement on U.S. sovereignty, and you said earlier in your testimony, a crime under U.S. law. If we are honest with ourselves, I think this entire regulatory exercise is an attempt to punish the UK for Brexit and to ensure that the punishment is so severe that subsequent members will never attempt to leave the Union. Because ESMA's proposal caps the fees on Tier 1 CCPs and divides the cost of ESMA's clearinghouse budget between all the Tier 2s, and they designate who is a Tier 2, does that not seem to incentivize them to designate more CCPs as Tier 2 in order to expand their staff, build their regulatory footprint, a sin we frequently see in bureaucracies?

Mr. DUFFY. Spot on, sir. I mean, that's all I can say is spot on.

When you are talking about a proposal that doesn't even charge the local entities for their own regulatory cost and they want other parts of the world to pay for it for them that are not even systemically important to that part of the Union in order to do business, it doesn't pass the ha-ha test, as they say in the business. I think you are spot on with the fee issue, and it is really a shame what the European Union is trying to do right now.

Mr. DUNN. Thank you very much.

Mr. Lukken, your testimony contains a chart detailing the cross-border activity that occurs at several of the FIA's membership. If I am reading correctly, it looks like the Eurex has well over 50 percent of its transactions originating outside its home jurisdiction.

I would like a sense from you, either now or in writing later, of what those percentages represent in a dollar value, and what percent of the overall business in the European CCPs is dollar-denominated derivatives and futures originate in the United States. Also, if we are threatening the concept of equivalence between the

United States and Europe, what does that impact look like on European exchanges? And I ask that because the U.S. is unlikely to cede regulatory authority to, or sovereignty to, the EU, and in that case, are the EU regulators really willing to walk away entirely from any access to U.S. derivatives in the future? Are they willing to give up all access to American markets for swaps and hedges? That looks like that is what is on the table.

Mr. LUKKEN. No, it is exactly what we are trying to portray in that chart is all of these global exchanges require, in order to have the proper liquidity, to serve domestic markets, they need foreign participation. And Eurex is one example where they get a significant amount of their trades from outside of Germany. A lot of it may be coming from the UK, a lot of it is coming from the United States. But again, if any of these proposals end up causing a loss of access to either Europe or the United States, that harms everybody. And that is what we are trying to say is we really need to be sensible about this. Open markets benefit everybody. All boats rise.

Mr. DUNN. It hurts our ability to manage the risk, right?

Mr. LUKKEN. Absolutely, absolutely.

Mr. DUNN. My time is growing short, but I want to say that I—it seems to me like there are no winners in failing to provide equivalence where equivalence is clearly due. I believe that the U.S. should us—and the Congress should use any leverage necessary to ensure that we do not get stuck with a raw deal.

In the meantime, I think Congress should request or even demand that the European regulators come before Congress and explain to us how this is going to work, and why we should allow this regulatory invasion of the United States.

And with that, Mr. Chairman, I yield back.

The CHAIRMAN. Well certainly we appreciate that, and we will move forthrightly on that. I agree with you. As a matter of fact, the Ranking Member and I were just talking about the next steps we need to take. But I assure you, there will be a very strong and adequate response for this. We are not going to put and make our financial service industry be turned into second class citizens on the world financial stage. You can bet that. Thank you, sir.

Now we will hear from Mr. Johnson.

Mr. JOHNSON. Thank you, Mr. Chairman, and I will have some questions for Mr. Lukken.

I think picking up thematically on the lines of questioning from Mr. Marshall and Mr. Dunn, and it seems as I have heard everybody speak today, it seems as though we have a shared understanding of the value of the 2016 equivalence agreement. It seems we have a shared concern about EU efforts to pull back or perhaps complicate that system of regulatory deference. And I am surprised by that, because it seems as though the fundamental landscape is the same as it was in 2016, save for one thing, and that is a pretty substantial member default, and I think a concerning response at a European CCP regulated under the EMIR framework.

My first question for you, Mr. Lukken, FIA has a wide cross section of market participants, including a number in Europe. What were your thoughts or the thoughts of your company when you saw this pretty substantial failure?

Mr. LUKKEN. Well, I think there was significant concern among the entire industry, and a lot of soul searching even among panelists up here on what went wrong during the NASDAQ default. And as you mentioned, they appeared to be EMIR compliant, that entity, and they are owned by the NASDAQ Corporation, the holding company here in the United States. And we did a review of that default and have recommendations. NASDAQ, to its credit, has also done an internal—hired outside consultants to help it identify what went wrong.

Even though you can be in regulatory compliance, that doesn't absolve you from active risk management. I think these clearinghouses can talk about this. Even though on paper you may be compliant, there is an active daily risk management that has to be carefully considered, and for whatever reason, the NASDAQ had, especially as it gained new members, individual members of the clearinghouse, may have let in more risk than was appropriate. It was something concerning to us.

Mr. JOHNSON. And I certainly understand that it is hard to be a perfect safety and soundness regulator, right? I mean, there is risk inherent in the system. But as we said here today talking about a potential pretty substantial shift of that safety and soundness being evaluated in this country to being evaluated in the EU, I have to be left with the question is there any reason to believe they are any good at it? I mean, if they miss the warning signs that led up to this again, a pretty decent sized failure, should we doubt the prudence of the European regulators?

Mr. LUKKEN. I think it is a very good question. Here is ESMA deferring to the national competent authority of the NASDAQ of Sweden in this situation, but not directly regulating that CCP. That is the way the EU law is written, but I think it does raise a question that if you are not regulating your own CCPs, why should you be regulating outside CCPs? That is the way the law is written, but I do think fundamentally, philosophically it raises a good concern and question.

Mr. JOHNSON. Thank goodness we didn't have a serious contagion problem in the wake of that. Were there components or fact sets within this environment that kept the ripple impact to the, I don't want to call it *modest*, but to the non-systemic level that we had?

Mr. LUKKEN. Well, I would say that clearing worked, and one of the reasons that G20 recommended clearing as a safety net for our markets is it has several layers of its waterfall of clearinghouses that ensure that a default does not have contagion risk.

Unfortunately, it got pretty far down into the waterfall, including into the guarantee fund. It took down about  $\frac{2}{3}$  of the guarantee fund. But it quickly recovered and members put more money into the guarantee fund and clearing worked. That doesn't mean we shouldn't use that example, though, to see what the lessons learned might be, and we are in the midst of doing that.

Mr. JOHNSON. My understanding is that it was in the third tier of that waterfall you described. Had the entirety of that default fund been exhausted, is there a fourth level to the waterfall?

Mr. LUKKEN. CCPs have the ability to assess clearing members, again, to replenish the guarantee fund, and certainly, that would

have occurred. This was not a major size clearing organization like the ones here, and I think the clearing members would have done so.

But still, I mean, if you extrapolate that to larger clearinghouses, it is problematic and we want to make sure that whatever problems existed there that we, as an industry, try to address those things.

Mr. JOHNSON. Particularly if you have a couple of problems happen during the same time period, you start to exhaust these management mechanisms pretty quickly.

Thank you very much, Mr. Lukken. Thank you very much, Mr. Chairman. I yield back.

The CHAIRMAN. Now we will hear from the gentleman from Indiana, Mr. Baird, and I might mention, in case any of you don't know, that the Ranking Member and I have decided we will have just a short second round so we can come back and put some final touches on this. If you want to hang around and have a second series, you certainly can.

Mr. Baird, you are recognized.

Mr. BAIRD. Thank you, Mr. Chairman. I certainly appreciate the comments from some of my colleagues about agriculture and the livestock industry, and farmers and ranchers. Mr. Duffy, I really appreciate you recognizing the importance of agriculture in the CME.

But my question, Mr. Edmonds, deals with some background for you. They held a hearing here on the clearinghouse recovery and resolution last year. One thing we learned is that the certainty about the rights and obligations of affected parties and clarity about who is in control is essential to managing the crisis and restoring order. In your testimony, you briefly discussed the challenges of overlapping regulators during a time of crisis. While no one expects a clearinghouse failure, if there was a failure at a non-European Tier 2 CCP that was not extended substitute compliance, is it clear exactly which regulator would be in charge?

Mr. EDMONDS. As we answer the question today, I think it is difficult for us to say with absolute certainty who would be in charge at that point in time. As Mr. Duffy said, if it were CME Group that found itself in that, there would be problems with the U.S. law here. I mean, certainly we have clearinghouse operations around the world that we would also have local and national regulators at the time having that concern at that moment wanting to weigh in.

The one word that keeps coming up, and many of us have touched on it here, really at the epicenter of the issue is whether or not we are creating *certainty*. And the less certainty we have or the more uncertainty we create, that is where you begin to see all of the questions and the waterfall of what you might determine bad things happening. Whether it is inside the clearinghouse, there is a lack of certainty when these things take place. Whether it is in the market, the lack of certainty creates volatility. Sometimes that is good and it means that people are on the right side of that. Other times if it is overwhelming, like we saw in the financial crisis, of the uncertainty, it is really bad for national economic policy or international economic policy at the time.

I can't answer your question with absolute certainty if we would at that time of stress. I think, as Mr. Lukken said, we all want to avoid that. We are all committed to finding ways through that, and if we weren't, we wouldn't be sitting here today and wouldn't be taking the stances we do on the international stage and attempt to drive to that certainty. The worst thing that we can do is wake up and have a customer call us on any one of our venues and say at a given moment in time, what is the answer to this question and not be able to give them a complete answer. And right now, I think as a whole until some of the arms race as Mr. Maguire has articulated settles a bit, we are faced with that issue of having an incomplete answer.

Mr. BAIRD. Thank you. Anyone else care to comment on that question?

Okay. My next question goes to Mr. Maguire. You are registered with the CFTC, and the same as any U.S.-based clearinghouse, and yet you are domiciled in the United Kingdom. Can you describe to me how that relationship between LCH, the CFTC, and the UK regulators works?

Mr. MAGUIRE. Sure. Thank you for the question, Congressman.

I think the way I would describe it is simply it works well. I think the relationships are, you need to think things through, let's say, sunny day scenarios and rainy day scenarios, and the sunny days business as usual, and there are no major defaults or crises, and the rainy days are crises or defaults such as Lehman or MF Global. And over the course of 18 years with those events, and also with the enactment of Dodd-Frank and European regulation and other regulation around the globe, we have always found a way between LCH with the Bank of England, who is a primary regulator in the UK, and the CFTC, who have oversight as well, to navigate through any of those legal or regulatory texts, and always arrived at a sensible outcome.

That has enabled us to be 100 percent compliant with all of the DCO core principles here in the U.S. We are fully compliant with the—and our clients benefit from the client asset protection rules and Part 190 Bankruptcy Code here in the U.S. We hold assets on shore.

It is a way to show that it is possible to navigate where you are systemically important to a jurisdiction, which we clearly are. In this case, it is possible to achieve it.

But, the main point I would say is that the key to that is trust. The key to that is cooperation. The key to that is deference between the regulators and constant communication and transparency.

Mr. BAIRD. Thank you, and I am running out of time, so I yield back, Mr. Chairman.

The CHAIRMAN. Thank you very much.

As I mentioned, the Ranking Member and I have a few more questions, and you may as well, Mr. Baird.

But, let me get to the heart of the matter, and the heart of the matter is, quite honestly, we have a problem here. There is no getting around it. I think in each of your testimonies, you pointed at that.

We want to try to find out what do we do about it? And judging from what I am hearing and what we have heard, I can assure you that we in this Committee, myself and Ranking Member, are prepared to move on some action to very quickly and decisively get a message to the European Union in a proper way. And second, we need to devise a way in which we can use our leverage to respond to this. We are the strongest, most powerful, and fairest economy and financial system in the world, and the European Union is really messing with the wrong tiger here. And we need to get that message out, because if we don't—for example, this whole EMIR situation is wrong in so many ways.

First of all, setting up a way in which you all become or we become what is affectionately called *third countries*. What does all that mean? Why? And then Great Britain is thrown in with that, and between the United States and Great Britain, we are the two largest, most significant financial systems. And they are operating in a very haphazard and dangerous way to themselves. We need to get that out.

We also need to examine how we offer some form of retaliation. Do we pull back our market to them? We have the largest, so we have to think very seriously how we use our leverage. I hope we don't have to go there, but we have to send that message.

What I want to do with this period is to hear from each of you in terms of what specifically you all would recommend that we here in Congress do, and the incubator of this action will be our Subcommittee, because this is our territory. We have an excellent staff. The full bipartisanship of this Committee is ready to spring into action quickly and decisively to do something. What that something is, we need to discuss and come to some decision very quickly on to what it is we need to do to make sure that our financial system, our market participants are not put at a disadvantage on the world stage at this time, or at any time.

That is what I want to try to get to at this point, and may I please start with you, Mr. Duffy, on what it is you think we can do to address this problem with the European Union right now?

Mr. DUFFY. I appreciate that, Mr. Chairman, and as we have been talking about, I think you have already done a lot more than anybody else has done historically, just by holding this hearing and giving the time and attention it so deserves. That is greatly appreciated, and it is has been so bipartisan, as I said earlier, that it is a very powerful message when the United States Congress gets involved, not just the regulators. I am very much appreciative of that, and I know the industry is as well.

I want to go back to what one of your colleagues said earlier, that the UK is the bully. I don't believe the UK is the bully, nor is Mr. Maguire. I think Mr. Maguire and the UK are in the same situation as the U.S. is right now. The EU is trying to show their dominance throughout this process on the Brexit, and that is part of what this hearing is about, and they are using the U.S. as part of their leverage against the UK. I don't believe they are the bully. As you said earlier, I think they are a very powerful economy and they are going to maintain that.

What Mr. Lukken said earlier is critically important, and I hope to remind everybody of the statistics he gave: 70 percent of the

German bond is traded outside of Germany, and if you really want to get to the heart of the matter, you get the German authorities in here and ask them what they think they are doing with their European counterparts in order to drive this regulation. Because if you take the liquidity out of the German bond, that will cripple their economy to a degree, and if that liquidity going into that bond is coming out of the UK and the U.S., which I believe a good chunk is coming out of the U.S., and you limit that, that would be a very powerful statement to limit that type of activity.

Now is that a good thing? Absolutely not, but if they are going to go down this path, we have to also understand that we can just as well by going through the Part 30 process.

The CHAIRMAN. Thank you very much.

Mr. Edmonds?

Mr. EDMONDS. I think you have a multitude of options and probably know, certainly better than I do, and maybe better than the rest of us on the panel, of all the levers you have to pull. I am going to talk to you a little bit about when you pull those levers, whatever, how they are perceived on the other side.

You have heard us all talk about certainty and anything that you can do to increase certainty, I think, is an absolute must, and you should find great favor in it when you are drafting whatever response you deem is appropriate and proportionate to make sure that it is promoting certainty.

I think you should promote equivalence. We have taken a lead on this as a country. I don't know on the regulatory side; I am not exactly sure of the benefit of us going in a different direction than the leadership we have shown to date—

The CHAIRMAN. You did say *equivalence*?

Mr. EDMONDS. Right. That is correct.

If we are providing a framework and supporting other frameworks that provide that level of deference through the equivalence process, and we are providing certainty along the way, I think what you are doing is to the benefit for the marketplace as a whole to be able to operate within a set of rules in order to manage the businesses they have, no matter where they are, from a hedge fund down to a farmer, and everyone in between, that you want to get to that have a crucial function to play within our market system as a whole.

The CHAIRMAN. Yes.

Mr. EDMONDS. And then if you don't get what you are looking for there, you have to be prepared to act. And those are the levers that you are going to know better than we are exactly what is best. This is not a binary decision that you are going to make, whichever one. There are going to be other actions and reactions to whatever you decide to do, and I think you have to look at that holistically and you have a much better point of view or vision of that than we are going to be able to see. Because we are going to take your action and we are going to have to react to it, whatever that is. And we are going to have change parts of our business, whether it is in London, whether it is in Chicago, or anywhere else here in the United States, in order to continue to provide for our customers. That is our job at the end of the day is to get through all of it at the end of the day and give them some level that they can continue

to manage their business within the confines of that regulatory framework.

Just to reiterate, the more that you can promote equivalence, the more you can promote certainty from that equivalence, and being that leader by example, I think we get to a better place at the end of the day.

The CHAIRMAN. All right.

Mr. Maguire, yes?

Mr. MAGUIRE. Thank you, Chairman. I want to make two remarks to your request.

In the first, I just point to the long established and well working relationship between both the U.S. and the UK financial systems markets, and I would hold those up as the epitome of something that works and works well, and it works well into, repeating what I said earlier, sunny days and rainy days, good times and bad times. I think it is important to lean on that when we talk about how equivalence and deference can work around the globe from financial markets. We have a model in place between the UK authorities and the U.S. authorities for overseeing the firm that I lead. It works well, and I think that should be held up as a model and I think it should be used as an artifact in explaining how things could and should work, and do work.

I think the second remark I would make is that when we talk around Tier 2, which has been referred to, slight technical point in EMIR 2.2, right now things are in, let's say, an ambiguous state. There is a full range of tools available to the European authorities in the bucket of Tier 2, and it is really expected to be a continuum of either Tier 2 heavy oversight *versus* Tier 2 light oversight. But what is lacking and what makes us all nervous and gives us that lack of certainty and clarity that Mr. Edmonds refers to is there is no definition or precision around that.

The sooner there is more precision and definition of what *Tier 2* means, what it means for each firm, what kind of oversight that that could potentially mean, I think that could very much help bring the temperature down here on how things are looked at from the third countries.

But right now, absent that clarity and certainty, it is difficult, and a key point being that that determination of level 2 tiering is likely to commence towards the back end of this year and into Q1 2020. The time, I would say, is opportune to request that level of specificity and definition.

The CHAIRMAN. Okay, thank you.

Mr. Lukken?

Mr. LUKKEN. Thank you, Mr. Chairman.

I think the most powerful tool that this Committee has at the moment is its oversight function; this hearing being a part of that. There is an open comment period right now in Europe on EMIR 2.2. I would be sending a letter to the ESMA agency and with the record of this hearing as part of that comment period, so they understand what the view of Congress is and the view of the United States might be on this topic. You certainly have the ability through your oversight to make sure that it is clear that there will be collateral damage as a result of this EMIR 2.2 if the United States is not recognized as part of that regulation.



I do want to make clear though on one of the issues that the Europeans have raised with us when we see them is that the CFTC over time, and this dates back to Dodd-Frank, has laws and regulations in place that regulate and require the registration of foreign CCPs.

Now, the current Chairman has said he wants to walk that back and he wants to propose something very soon that would put in place a recognition regime like we are talking about. Because of the transition to the new Chairman, that has not occurred yet. But I would give this new Chairman some room, some breathing room to try to negotiate with the Europeans to get them to make the right choice.

It reminds me of my parents. They would tell me you have two choices, choice one and the right choice. This Committee can be very effective at making sure that they are making the right choice on this and allowing the new Chairman to come in and help us to get us to that place.

The CHAIRMAN. Now, you said a letter. What would be the most emphatic points that we need to make within that letter, and I think you also mentioned that we would send them this hearing in and of itself.

Mr. LUKKEN. This is part of the public record, this hearing here, and our testimony is part of the public record. They are in the midst of a consultation, and just like any public record, this is an important factor that should be a part of their determination.

Whatever cover letter you would like to summarize the hearing here, and your views that includes the entire record of this hearing, I think, would be important.

The CHAIRMAN. And you are saying within the European Union, who specifically, you mentioned the—

Mr. LUKKEN. ESMA is the agency that has an open consultation period right now for this regulation.

The CHAIRMAN. All right. Good. Thank you.

Yes, Mr. Berger?

Mr. BERGER. Thank you.

The U.S. has a robust framework for the regulation and supervision of our clearinghouses, and that is what helps make the U.S. markets the most deep liquid and efficient markets in the world. And as market participants who are active on all the clearinghouses that are represented here, MFA members don't trust that blindly. We remain vigilant. We care about the governance and risk management practices of all CCPs that we participate on, and sometimes comment on those to even enhance them further.

To pick up on the points that Mr. Lukken just made, where we stand right now in the European process is they are evaluating how they approach two decisions. One is how they evaluate which foreign or non-EU CCPs they deem to be systemically important, and then if they make that decision that they are systemically important or Tier 2 CCP, then the next step is how do they evaluate whether the framework in that other jurisdiction is comparable. They call it comparable compliance.

I suspect everyone up here will be weighing in with advice on how they take those next steps in the process. EMIR 2.2 is now a piece of legislation, but the implementing rules are still under de-

velopment. I still think there is ample opportunity for our voices to be heard, and your leadership and bringing attention to these important points will, I think, help amplify the voices that are providing advice to ESMA as they consider the next steps here.

The CHAIRMAN. Thank you, and now we will recognize and hear from the Ranking Member, Mr. Scott.

Mr. AUSTIN SCOTT of Georgia. Thank you, Mr. Chairman.

I want to go back again to some of the statements I made earlier.

We share common interests and common values, and we need each other. And while we need each other now for economic growth, we will need each other more in the case of a financial crisis in any one of the countries or regions that we are talking about.

The best path forward to me is very clear, to take a couple of steps back. Let's take a look at what Commissioner Giancarlo or the new Commissioner of the CFTC would put out, and hopefully, no additional steps would be necessary from this Committee to achieve global harmonization.

But with that said, while I prefer to take a couple of steps back and end up with that harmonization from the regulatory agencies, if necessary, I stand prepared to move forward with my colleague, Chairman Scott, as I believe the full Agriculture Committee would be, if necessary, to make sure that we achieve that global harmonization. But again, I do believe the best path forward is to take a—everybody take a couple steps back and recognize that we need each other.

We have talked about, and this gets to my question, we have talked about the transactions, if you will, but one of the things we haven't talked about much is the technology. And this question is for you, Mr. Lukken, because you mentioned it specifically with regard to FinTech and the R&D capabilities. You talked about the emergence of the importance of the emerging financial technology. You talked a little bit about legislation that this Committee, including myself, has been working on.

Can you speak to why it is so important that U.S. regulators, and quite honestly, global regulators are able to stay abreast of the latest financial technologies and keep up with the capabilities, both for the U.S. and for foreign regulators?

Mr. LUKKEN. FIA as a trade association oftentimes have conferences, and we have oftentimes new innovators—we call it Innovators Pavilion—where we ask for the latest technology being developed. Oftentimes, it is on the private-sector trading side, but oftentimes it is on the reg tech side. It is giving us technology on how you surveil the markets, making sure that traders aren't trading ahead or doing illegal activity, or if risk is building up in the system. All these CCPs around this table have private companies that are helping them to manage the risk of their exchanges.

You have shown some leadership on this and have introduced some legislation that would allow the CFTC to partner with private-sector financial firms to allow them to utilize some of this technology in a fair way, in a transparent way, currently, the CFTC is not allowed because this would be an *in-private inurement* to the CFTC, and governments can't receive gifts. This would be an exception.

Right now, the Defense Department allows this sort of partnership arrangement. A lot of the EU and the UK allows this type of partnership arrangement. As a former Commissioner and Chairman of the CFTC, having access to that kind of technology would be tremendous in a way that will better the markets, further the public interest.

We as an agency, or we as the FIA, certainly support this initiative that you put forward.

Mr. AUSTIN SCOTT of Georgia. And let me say as one of the authors of the legislation, we recognize the word *gift* can be misconstrued. If there is a way to change that definition to relieve any concerns that some individual is actually receiving something of monetary value, because that is clearly not the intention of the legislation, then we are happy to work to find the definitions that resolve any of those questions. But the goal is simply to allow our regulators to see and work within that technology so that they understand what is actually happening in the technological side of the market and the trades.

Thank you for your comments. Mr. Chairman, thank you for your leadership on this. As I said, I think the best path forward is a step back, but if necessary, I am perfectly willing to work with you to push ahead with legislation.

With that, I yield the remainder of my time.

The CHAIRMAN. Thank you very much, Ranking Member. Oh, yes, sir, Mr. Duffy.

Mr. DUFFY. I am so sorry, but may I make a comment?

The CHAIRMAN. Sure.

Mr. DUFFY. I would be remiss if I walked out of here without making this comment, because I really feel passionate about this.

I understand what the Ranking Member said about taking a step back, and I understand what Mr. Lukken said about giving the new Chairman an opportunity to deal with this issue. The new Chairman has a lot on his plate, other than just dealing with equivalence by running this government agency. I think having the confidence of the United States Congress working with him is a very powerful tool that he would embrace, and I don't think he would shun it away.

I also want to talk a little bit about the timing. As you know, the EMIR 2.2 has already been agreed upon by the European Union. Also, I think it would be critically important for this Congress to send a very strong message that you do not move forward any further until our answers have been addressed and our concerns have been recognized. Because I think when Mr. Maguire referenced here, too, under EMIR 2.0, I don't know if everybody realizes what that means. They are talking about having the ability to set margins on products here in the United States. You tell me what they know about the livestock market that your colleagues talked about. You tell me what they know about the risk management of these products and they are going to set the margins that won't put the U.S. at risk.

They are also going to charge fees, as we discussed earlier, to fund their own agencies. They are also going to have the ability to fine CCPs up to 30 percent of their revenue unilaterally, whatever they want to do. They also get to decide the governance of these

entities, which is in direct conflict with Delaware law, as public companies. And as far as it goes with the regulation by the U.S. on the EU or on the UK, we do not regulate their base futures and options business. What Mr. Lukken was referring to is swaps. We have a very light touch on anything that relates to futures and options. They want to regulate our entire business, not just what our government is doing with them right now on the swap side.

There are some major differences here, and I applaud you again, Mr. Chairman and this Committee, for taking this up. Thank you for allowing me the time.

The CHAIRMAN. Thank you so very much.

And as we conclude, let me just say this. I feel very strongly about this, and we are going to take the results of this hearing and all of our remarks and concerns. We are going to take it to the full Committee Chairman and Ranking Member, Chairman Peterson and as well as Ranking Member Conaway, and I am going to be pushing very hard to hopefully convince them that we need to take a step. We need to send a message to the European Union. I think the least we can do is follow your recommendation, Mr. Lukken, that they make sure—we love C-SPAN. It would be wonderful if they were watching this now there, but we can work with C-SPAN to make sure they get the full hearing.

It is not just me. It is not just our Committee, our Subcommittee here. It is you. It is you all who are the ones that have to make it work. You all are the ones that are being put at a disadvantage. And when you are being put at a disadvantage, the American people are being put at a disadvantage. I am telling you, I feel it very insulting that this EMIR 2.2 coming at this time, and they are going to take away the regulation of our financial services industry from us to them, and then charge you a fee for regulating them. This is insulting. It is wrong, and we need to respond to it.

It is important that we respond as a full, bipartisan Congress, so you can rest assured that your testimonies and the results of this will be discussed and we will meet with the full Committee. We will take it from that point. We will also speak with the leadership of the full Congress, Speaker Pelosi, as well as the Minority Leader, Mr. McCarthy, on that side, and move forward.

This is an insult to the American people. It is an insult to us. We are going to respond. We have an excellent staff that has been taking copious notes, and we have the recording. We will let you know that this meeting has not been in vain. The ESMA will hear this voice that we spoke this morning. I can assure you that certainly will be the first step.

And now with that, I want to thank everybody for coming—

Mr. AUSTIN SCOTT of Georgia. Mr. Chairman, just in my closing remark, I want to address what Mr. Duffy said and make it clear. When I say the best path forward is to take a step back, a step forward on EMIR 2.2 triggers what others have been referring to as the arms race.

The CHAIRMAN. Yes.

Certainly, and Ranking Member, I want to thank you as well. I mean, we have been fighting so many battles together. This is just another one. We had to fight to get the emergency funding down

to our farmers. He and I have been at it, and now we are fighting to protect our financial system on the world's stage.

With that, thank you all very much, and I may say, under the Rules of the Committee, the record of today's hearing will remain open for 10 calendar days to receive additional material and supplementary written responses from the witnesses to any questions posed by a Member.

This hearing of the Subcommittee on Commodity Exchanges, Energy, and Credit is adjourned.

[Whereupon, at 12:13 p.m., the Subcommittee was adjourned.]

[Material submitted for inclusion in the record follows:]



## APPENDIX

The listed material is being submitted as attachments to the Committee on Agriculture of the United States House of Representatives Consultation submission of ESMA's EMIR 2.2 proposal. The documents are also retained in Committee file.

1. **Duffy Ref. No. 01:** *Minutes of the Financial Stability Oversight Council*, July 18, 2012, <https://www.treasury.gov/initiatives/fsoc/Documents/July%2018%20FSOC%20Meeting%20Minutes.pdf>.
2. **Duffy Ref. No. 02:** *Commission Implementing Decision (EU) 2016/377 of 15 March 2016 on the equivalence of the regulatory framework of the United States of America for central counterparties that are authorised and supervised by the Commodity Futures Trading Commission to the requirements of Regulation (EU) No 648/2012 of the European Parliament and of the Council*, March 15, 2016, <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016D0377&from=EN>.
3. **Duffy Ref. No. 03:** *COM(2017) 331 final—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*, June 13, 2017, [https://eur-lex.europa.eu/resource.html?uri=cellar:80b1cafa-50fe-11e7-a5ca-01aa75ed71a1.0001.02/DOC\\_1&format=PDF](https://eur-lex.europa.eu/resource.html?uri=cellar:80b1cafa-50fe-11e7-a5ca-01aa75ed71a1.0001.02/DOC_1&format=PDF).
4. **Duffy Ref. No. 04:** 7621/19—*Interinstitutional File: 2017/0136 (COD), COM(2017) 331 final, Regulation of the European Parliament and of the Council 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—Confirmation of the final compromise text with a view to agreement*, March 19, 2019, <https://data.consilium.europa.eu/doc/document/ST-7621-2019-ADD-1/en/pdf>.
5. **Duffy Ref. No. 05:** ESMA, Consultation Paper, ESMA 70-151-2138, *Draft technical advice on criteria for tiering under Article 25(2a) of EMIR 2.2*, May 28, 2019, [https://www.esma.europa.eu/sites/default/files/library/esma70-151-2138\\_cp\\_ta\\_on\\_tiering\\_criteria.pdf](https://www.esma.europa.eu/sites/default/files/library/esma70-151-2138_cp_ta_on_tiering_criteria.pdf).
6. **Duffy Ref. No. 06:** ESMA, Consultation Paper, ESMA 70-151-2179, *Technical Advice on Comparable Compliance under article 25a of EMIR*, May 28, 2019, [https://www.esma.europa.eu/sites/default/files/library/esma70-151-2179\\_cp\\_ta\\_on\\_comparable\\_compliance.pdf](https://www.esma.europa.eu/sites/default/files/library/esma70-151-2179_cp_ta_on_comparable_compliance.pdf).
7. **Duffy Ref. No. 07:** ESMA, Consultation Paper, ESMA 70-151-1663, *ESMA fees for Third-Country CCPs under EMIR 2.2*, May 28, 2019, [https://www.esma.europa.eu/sites/default/files/library/esma70-151-1663\\_cp\\_on\\_emir\\_2\\_2\\_ccp\\_fees.pdf](https://www.esma.europa.eu/sites/default/files/library/esma70-151-1663_cp_on_emir_2_2_ccp_fees.pdf).
8. **Duffy Ref. No. 08:** *COM(2018) 796 final—Communication from the Commission to the European Parliament, the European Council (Euro Summit), the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions, Towards a stronger international role of the euro*, May 12, 2018, <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52018DC0796&from=en>.
9. **Edmonds Ref. No. 01:** PR7342–16, *CFTC Approves Substituted Compliance Framework in Follow-up to the Recent Equivalence Agreement between the US and the EU*, March 16, 2016, <https://www.cftc.gov/PressRoom/PressReleases/pr7342-16>.
  - *Attachment 9a: Comparability Determination for the European Union: Dually-Registered Derivatives Clearing Organizations and Central Counterparties*, FEDERAL REGISTER, March 22, 2016 pp. 15260–15272, <https://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2016-06261a.pdf>.
  - *Attachment 9b: Staff Letter, 16–26, No-Action Relief for EU-Based Registered Derivatives Clearing Organizations that are Authorized to Operate in the European Union, from Certain Requirements under Part 22 and Part 39 of Commission Regulations*, March 16, 2016, <https://www.cftc.gov/idc/groups/public/@lrlattergeneral/documents/letter/16-26.pdf>.
  - *Attachment 9c: Statement of CFTC Chairman Timothy Massad regarding Substituted Compliance Determination for the European Union*, March 16,

- 2016, <https://www.cftc.gov/PressRoom/SpeechesTestimony/massadstatement031616>.
- *Attachment 9d: Statement of CFTC Commissioner J. Christopher Giancarlo Comparability Determination for the European Union: Dually-Registered Derivatives Clearing Organizations and Central Counterparties*, March 16, 2016, <https://www.cftc.gov/PressRoom/SpeechesTestimony/giancarlostatement031616>.
10. **Edmonds Ref. No. 02:** PR7817-18, *Chairman Giancarlo Releases Cross-Border White Paper*, October 1, 2018, <https://www.cftc.gov/PressRoom/PressReleases/7817-18>.
    - *Attachment 10a: Cross-Border Swaps Regulation Version 2.0: A Risk-Based Approach with Deference to Comparable Non-U.S. Regulation*.
  11. **Maguire Ref. No. 01:** European Commission, *Brexit: European Commission implements “no-deal” Contingency Action Plan in specific sectors*, December 19, 2018, [http://europa.eu/rapid/press-release\\_IP-18-6851\\_en.htm](http://europa.eu/rapid/press-release_IP-18-6851_en.htm).
  12. **Maguire Ref. No. 02:** European Securities and Markets Authority, ESMA–71–99–1114—ESMA to recognise three UK CCPs in the event of a no-deal Brexit, February 18, 2019, <https://www.esma.europa.eu/press-news/esma-news/esma-recognise-three-UK-ccps-in-event-no-deal-brexit>.
  13. **Maguire Ref. No. 03:** LCH Member Update, *Brexit Update: LCH Limited Article 25 Recognition by ESMA under an Article 50 extension*, April 5, 2019, <https://www.lch.com/membership/ltd-membership/ltd-member-updates/brexit-update-lch-limited-article-25-recognition-0>.
  14. **Maguire Ref. No. 04:** International Organization of Securities Commissions, FR07/2019, *Market Fragmentation & Cross-border Regulation*, June 2019, <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD629.pdf>.
  15. **Maguire Ref. No. 05:** Financial Stability Board, *Implementation and Effects of the G20 Financial Regulatory Reforms*, 4th Annual Report, November 28, 2018, <https://www.fsb.org/2018/11/implementation-and-effects-of-the-g20-financial-regulatory-reforms-fourth-annual-report/>.
  16. **Maguire Ref. No. 06:** European Commission, *European Commission adopts equivalence decision for CCPs in USA*, March 15, 2016, [http://europa.eu/rapid/press-release\\_IP-16-807\\_en.htm](http://europa.eu/rapid/press-release_IP-16-807_en.htm).
  17. **Maguire Ref. No. 07:** Remarks by Jerome H. Powell, Member, Board of Governors of the Federal Reserve System at The Federal Reserve Bank of Chicago Symposium on Central Clearing, Chicago, Illinois, Central Clearing and Liquidity, June 23, 2017, <https://www.federalreserve.gov/newsevents/speech/powell20170623a.htm>.
  18. **Maguire Ref. No. 08:** Lewis, Rebecca, John McPartland, Federal Reserve Bank of Chicago, PDP-2017-02, *Non-default loss allocation at CCPs*, April 2017, <https://www.chicagofed.org/~media/publications/policy-discussion-papers/2017/pdp-2017-02-pdf.pdf>
  19. **Maguire Ref. No. 09:** International Swaps and Derivatives Association, *The Case for CCP Supervisory Cooperation*, April 2018, <https://www.isda.org/2018/04/18/the-case-for-ccp-supervisory-cooperation/>.
  20. **Maguire Ref. No. 10:** Futures Industry Association, *FIA Global: CCP Risk Position Paper*, April 2015, [https://fia.org/sites/default/files/content\\_attachments/FIAGLOBAL\\_CCP\\_RISK\\_POSITION\\_PAPER.pdf](https://fia.org/sites/default/files/content_attachments/FIAGLOBAL_CCP_RISK_POSITION_PAPER.pdf).
  21. **Maguire Ref. No. 11:** Keynote Remarks of Chairman Timothy Massad at SEFCON VII, January 18, 2017, <https://www.cftc.gov/PressRoom/SpeechesTestimony/opamassad-55>.
    - *Attachment 21a: Accomplishments of the Commodity Futures Trading Commission*, June 2014–January 2017, January 18, 2017, [https://www.cftc.gov/idc/groups/public/@newsroom/documents/file/massadaccomplishments0614\\_1216.pdf](https://www.cftc.gov/idc/groups/public/@newsroom/documents/file/massadaccomplishments0614_1216.pdf).
  22. **Maguire Ref. No. 12:** U.S. Department of the Treasury, *A Financial System That Creates Economic Opportunities Capital Markets–Capital Markets*, October 2017, <https://www.treasury.gov/press-center/press-releases/documents/a-financial-system-capital-markets-final-final.pdf>.
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24. **Lukken Ref. No. 02:**<sup>1</sup> Futures Industry Association, *Mitigating the Risk of Market Fragmentation*, March 2019, [https://fia.org/sites/default/files/FIA\\_WP\\_Mitigating%20Risk.pdf](https://fia.org/sites/default/files/FIA_WP_Mitigating%20Risk.pdf).
  25. **Lukken Ref. No. 03:** Financial Stability Board, *FSB Report on Market Fragmentation*, June 4, 2019, <https://www.fsb.org/wp-content/uploads/P040619-2.pdf>.
  26. **Lukken Ref. No. 04:**<sup>2</sup> *Testimony of Chairman J. Christopher Giancarlo Before the House Committee on Agriculture Subcommittee on Commodity Exchanges, Energy and Credit, Washington, D.C.*, May 1, 2019, <https://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo70>.
  27. **Berger Ref. No. 01:** Committee on Economic and Monetary Affairs, *A8-0190/2018, Authorisation of CCPs and recognition of third-country CCPs, Amendments By the European Parliament to the Commission proposal Regulation (EU) 2019/ . . . of the European Parliament and of the Council of . . .*, April 10, 2019, [http://www.europarl.europa.eu/doceo/document/A-8-2018-0190-AM-002-002\\_EN.pdf](http://www.europarl.europa.eu/doceo/document/A-8-2018-0190-AM-002-002_EN.pdf).
  28. **Berger Ref. No. 02:** Comment Letter: May 10, 2019, Laura Harper Powell, Associate General Counsel, Managed Funds Association, *Re: Global Markets Advisory Committee*, <https://www.managedfunds.org/wp-content/uploads/2019/05/MFA-Letter-on-CFTC-GMAC-Meeting-on-April-15-2019-Final.pdf>.
  29. **Berger Ref. No. 03:** Comment Letter: March 15, 2019, Laura Harper Powell, Associate General Counsel, Managed Funds Association, *Re: Swap Execution Facilities and the Trade Execution Requirement (RIN Number 3038-AE25)*, <https://www.managedfunds.org/wp-content/uploads/2019/03/MFA-Comment-Letter-on-CFTC-SEF-Proposed-Rule-Final.pdf>.
  30. **Berger Ref. No. 04:** Bank for International Settlements, *BCBS/IOSCO statement on the final implementation phases of the Margin requirements for non-centrally cleared derivatives*, March 5, 2019, <https://www.bis.org/press/p190305a.htm>.
  31. **Berger Ref. No. 05:** Comment Letter: November 15, 2018, Richard H. Baker, President and CEO; and Jennifer W. Han, Associate General Counsel, *Re: A Proposal for a Harmonized Primary Regulator Approach to SEC and CFTC Regulation of Dual Registrants*, [https://www.managedfunds.org/wp-content/uploads/2018/11/MFA-Proposal-for-Dual-Registrants.final\\_11.15.18.pdf](https://www.managedfunds.org/wp-content/uploads/2018/11/MFA-Proposal-for-Dual-Registrants.final_11.15.18.pdf).



<sup>1</sup>Note: this report is attached following the prepared statement of Mr. Lukken, see p. 29.

<sup>2</sup>This is the press release issued by the CFTC posting Chairman Giancarlo's prepared statement. In the case of this submission, attached is the actual hearing: *The State of the Commodity Futures Trading Commission*, held on May 1, 2019 by the Commodity Exchanges, Energy, and Credit Subcommittee.