

**TESTIMONY
OF
TERRENCE A. DUFFY
CHAIRMAN AND CEO
CME GROUP INC.
BEFORE THE
House Agriculture Committee
Subcommittee on Commodity Exchanges, Energy & Credit
Hearing to Review U.S. CCP Equivalence in the E.U.
June 26, 2019**

Chairman Scott, Ranking Member Scott, and Members of the Subcommittee, I am Terry Duffy, Chairman and CEO of CME Group Inc. (“CME Group”).¹ Thank you for the opportunity to testify today regarding U.S. central counterparty (“CCP”) equivalence in the European Union (“E.U.”) and the potential implications for the U.S. futures markets. We appreciate your interest in addressing the E.U.’s recent legislation on non-E.U. 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 E.U. to move towards an approach of regulatory deference before the full package of revised legal and regulatory requirements for non-E.U. CCPs is finalized by the E.U. We expand on our views on how Congress can reduce the likelihood of E.U. overreach in our concluding remarks and believe that active congressional engagement is a prerequisite to a positive result.

Background on E.U. CCP Equivalence

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

¹ 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>.

² 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>.

On June 23, 2016, the United Kingdom (“U.K.”) voted to depart from the E.U. To ensure ongoing oversight of the Euro currency and financial markets denominated in Euros, the European Commission proposed new legislation in June of 2017 (hereafter, “EMIR 2.2”).³ But rather than focus on Euro denominated products and E.U. risks⁴, this legislation instead proposed a broad test to determine whether non-E.U. CCPs are of systemic importance to the E.U. As drafted, the legislation may have captured non-E.U. CCPs with an extremely limited nexus to the Euro and/or limited exposures to E.U. financial institutions. As expanded upon below, this approach potentially captures U.S. DCOs such as CME, which have limited exposures to the Euro and E.U. clearing members. Consequently, under these very broad standards, U.S. DCOs that are found to be of systemic importance to the E.U. would be subject to direct E.U. regulation and supervision, contrary to the original equivalence agreement reached in March of 2016.

Despite efforts by the CFTC to encourage E.U. 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-E.U. CCP have a nexus to the E.U.⁵ Thus, U.S. DCOs such as CME could be designated systemically important in the E.U., despite CME’s limited exposures in E.U. denominated products and to E.U. 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”).⁶ The ESMA Consultations propose text for regulations that are required to be adopted by the European Commission to implement EMIR 2.2.

³ 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.

⁴ *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 Union²². 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)’.”).

⁵ 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>.

⁶ 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; 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; 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.

Although EMIR 2.2 provides a mechanism based on comparable regulation that could potentially avoid the application of E.U. 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 E.U. must comply with the majority of laws and regulations adopted for E.U. 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.⁷ 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, U.S. DCOs would be subjected to recently developed E.U. laws and regulations on risk management and governance which were drafted with E.U. financial markets in mind. It is notable that ESMA does not, and will not under EMIR 2.2 or the ESMA Consultations, supervise any E.U. CCPs. In fact, the E.U. policy-makers specifically considered giving ESMA supervisory powers over E.U. CCPs as part of the legislative process and decided to continue to defer to the local regulators in the E.U. 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 E.U.

CME does not pose a systemic risk to the E.U. 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 E.U. 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 E.U. 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, E.U. domiciled entities clear less than 2% of the risks that CME manages. The de minimis nature of CME's exposures to E.U. domiciled clearing members is consistent with the limited products that CME clears denominated in E.U.

⁷ 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.

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 E.U. 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 E.U.'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.⁸ 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 E.U. 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 E.U. 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 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 E.U. 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

⁸ 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>.

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 E.U.

Thank you. I look forward to answering your questions.