

OTC derivatives: latest regulatory developments in the US and the EU

Operations Managers Contact Group

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DFA: schedule for mandatory clearing

- Published by CFTC on 30 July 2012 (17 CFR Part 50): **compliance dates for mandatory clearing** are fixed
- Transactions between 2 **cat. I** entities (SD, MSP, active funds): **90 days** after publication of mandatory clearing determination
- Transactions between **cat. I** entity and **cat. II** entity (private funds, persons predominantly engaged in banking business) or 2 **cat. II** entities: **180 days**
- Other combinations of types of counterparties: **270 days**

DFA: classes of assets subject to clearing

- First batch of **asset classes subject to clearing requirement** (CFTC proposal):
 - **2 classes of CDS contracts**: North American Untranchéd CDS Indices Class and European Untranchéd CDS Indices Class
 - **4 classes of IRS**: fixed-to-floating swap, floating-to-floating swap (basis swap), Forward Rate Agreement, overnight indexed swap

DFA: possible timeline for clearing

(source DavisPolk)

Date	Action
August 1, 2012 <i>(July 30, 2012)</i>	CFTC publishes proposed clearing determination for the proposed swaps
October 30, 2012	CFTC publishes final clearing determination for the proposed swaps.
January 28, 2013	Transactions between Category 1 entities in the proposed swaps must be cleared.
April 28, 2013	Transactions between Category 1 and Category 2 entities in the proposed swaps must be cleared.
July 27, 2013	All other transactions in the proposed swaps must be cleared, unless the end-user clearing exemption applies and is elected.

DFA: foreign exchange products

- CFTC/SEC **final rule further defining ‘swap’** became effective on **12 October 2012** (CFR 17 Part I)
- Additional interpretation concerning **FX spot transactions**
- **FX swaps** and **FX forwards** subject to the Treasury’s Secretary’s swap determination (*rule unchanged*):
 - Term ‘swap’ includes FX swaps and forwards, but:
 - FX swaps and forwards no longer swaps if exempted by Treasury’s Secretary
 - Still subject to certain reporting requirements and business conduct standards
 - Timing for adoption of the Secretary's determination?

FX: guidance from CFTC, 12 October 2012

- Pending Treasury's determination
- What about registration as SD/MSP for market participants primarily engaged in FX swaps and forwards dealing activities? (*de minimis* levels of dealing in swaps)
- CFTC: **no relief** on the treatment of FX swaps and forwards as “swaps.”
- **BUT**: if exemption by Treasury before December 31, 2012, FX swaps and forwards may be **excluded retroactively** from the determination of whether an entity is an SD/MSP.

(CFTC Letter No. 12-21)

DFA: schedule for reporting requirements

3 compliance dates (17 CFR Part 45):

- **12 October 2012**: SEFs, DCMs, DCOs, SDs and MSPs to report **credit swaps** and **IRS**
- **10 January 2013**: same categories to report **equity swaps**, **FX swaps** and **other commodity swaps**
- **10 April 2013**: non-SDs/MSPs to report **all swaps**
- Same schedule applies to **historical swaps** (pre-enactment and transition swaps, 17 CFR Part 46)

DFA: legal and confirmation documentation

- SDs and MSPs shall conform with CFTC standards relating to the timely and accurate confirmation, processing, netting, documentation, and valuation of all swaps.
- CFTC final rule, published on 11 September 2012 (17 CFR Part 23)
- **Compliance schedule:**
 - For swap transactions with SDs, MSPs and active funds:
by **1 January 2013**
 - For swap transactions with commodity pools, private fund and persons predominantly engaged in the banking business:
by **1 April 2013**
 - For swap transactions with any other counterparty:
by **1 July 2013**

EU: state of play (EMIR)

- **EMIR** (Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories) **published** in the OJEU on **27 July 2012**
 - Entry into force: 16 August 2012
 - Likely implementation: early 2013 (at the soonest)
- **ESMA**: final report on draft RTS under EMIR, 27 September 2012
- **EBA**: final draft RTS on capital requirements for CCPs, 26 September 2012
- **Commission**: adoption by end 2012

EU: state of play (MiFID II)

- **MiFIR**

(proposed Regulation on markets in financial instruments and amending EMIR)

- Compromise text published by CY **EU Council Presidency** on 9 October 2012
- **European Parliament:** first reading expected on 26 October 2012

EU: clearing obligation under EMIR and MiFIR

- **EMIR:**
 - **All OTC derivative contracts** pertaining to a class of derivative declared subject to the clearing obligation
 - No specific exemption for FX
- **MiFIR:**
 - **All transactions in derivatives** pertaining to a class of derivatives declared subject to the clearing obligation pursuant to EMIR that are **concluded on a regulated market** shall be cleared by a CCP.

EU: reporting obligation under EMIR and MiFiR

- **EMIR:**

- Reporting of **'any derivative contract'**
- Contracts still outstanding on **16 August 2012** and those entered into on or after 16 August 2012
- ESMA: specify details and types of reports, and frequency

- **MiFiR:**

- **transactions in financial instruments** to be reported by investment firms to competent authority
- Transactions traded on a regulated market, an MTF or an OTF: reported by the operator of the platform.

EU: timeline

- **EMIR** entered into force on 16 August 2012, **but:**
- **Clearing obligation not effective yet:**
 - ESMA to conduct a public consultation and consult the ESRB before submitting to the Commission draft technical standards specifying the classes of OTC derivatives subject to clearing and date(s) from which the clearing obligation takes effect.
- **Reporting obligation:**
 - applies as from 16 August 2012 but effectively depends on the adoption of the technical standards by the Commission (specifying how reporting will have to be done)
- **MiFIR:** timeline for adoption uncertain. Sometime in 2013?

Transverse topic

Margin requirements for non-centrally cleared trades

- **BCBS-IOSCO consultative document**, July 2012
 - All non-centrally cleared derivatives should be subject to margining requirements
 - Should **FX swaps and forwards** with a maturity of less than a specific tenor such as one month or one year be exempted from the global margining requirements?
- **ISDA response**, 28 September 2012
 - strongly against universal two-way exchange of initial margin; would lead to a liquidity drain on the market.
 - Exclude FX swaps and forwards; relevant risks already subject to risk mitigation