

# Derivatives: update on regulatory developments in the EU and the US

**Operations Managers Group**

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# EU: towards the adoption of EMIR

- **5 July 2011:** EP voted on amendments to the Commission's proposal of 15 Sept. 2010 (pending legislative resolution concluding first-reading)
- **Trilogue of 9 February 2012:** political agreement reached between EP and Council on final version of EMIR
- **28-29 March 2012:** planned first-reading vote of EP in Plenary (on a text agreed by Council = planned adoption of EMIR at first reading).
- Entry into force: 20 days after publication (summer 2012)
- **ESMA** published discussion paper on draft Technical Standards on 16 February 2012; open for comments until 19 March 2012

# EU: other relevant regulations

- 20 October 2011: Commission published **review of MiFID (MiFID II)**
  - proposed Directive on markets in financial instruments repealing Directive 2004/39/EC
  - proposed Regulation on markets in financial instruments and amending EMIR, MiFIR
    - All transactions in financial instruments to be reported to competent authorities
    - Trading in derivatives to occur only on eligible platforms: regulated markets, MTFs, OTFs

# EMIR: some issues re. clearing obligation

- **FX derivatives:** no explicit exemption, but:
  - **Recital 12c:** *“In determining the subjection to the clearing obligation of classes of derivatives, due account should be taken of the specific nature of the relevant classes of OTC derivatives. The predominant risk for transactions in some classes of OTC derivatives may relate to settlement risk, which is addressed through separate infrastructure arrangements, and may distinguish certain classes (e.g. foreign exchanges) of OTC derivatives from other classes. CCP clearing specifically addresses counterparty risk, and may not be the optimal solution for dealing with settlement risk. The regime for such contracts should rely notably on preliminary international convergence and mutual recognition of the relevant infrastructure.”*
  - **Article 3 (Clearing obligation):** *“Counterparties shall clear all OTC derivative contracts pertaining to a class of OTC derivatives that has been declared subject to the clearing obligation in accordance with the procedure set out in Article 4 (...).”*

# EMIR: some issues re. clearing obligation

- **Article 4** (Clearing obligation procedure):
  - Competent authority authorises a CCP to clear a class of OTC derivatives; notification to ESMA
  - **ESMA** shall, within 6 months, develop and submit to the Commission **draft regulatory technical standards** determining which class of OTC derivatives should be subject to clearing obligation (*bottom up approach*). Alternatively: *top down approach*.
  - Public consultation and consultation of the ESRB
  - **Criteria** to be taken into account by ESMA:
    - Degree of standardisation;
    - Volume and liquidity;
    - Availability of fair, reliable and generally accepted pricing information.
  - **Deadline** for submission of standards to Commission:

# EMIR: some issues re. clearing obligation

- **OTC derivatives between third country entities**  
(Article 3)
  - Mandatory clearing of contracts concluded “*between third country entities that would be subject to the clearing obligation if they were established in the Union, provided that the contract has a direct, substantial and foreseeable effect within the Union or where such obligation is necessary or appropriate to prevent the evasion of any provisions of this Regulation.”*”
  - Extraterritoriality; mirrors DFA wording
  - Provision added at a late stage of EMIR negotiations
  - ESMA to specify contracts and cases where this provision would apply.
  - Issues raised by overlapping EU and US regulatory jurisdictions

# EMIR: reporting obligation

- **Article 7** (Reporting obligation):
  - Reporting of 'any derivative contract' to trade repository (whether centrally cleared or not);
  - ESMA to draft regulatory technical standards specifying the details and types of reports for the different classes of derivatives.
- **Article 67** (Transparency and data availability):
  - TRs to publish aggregate positions by class of derivatives on the contracts reported to it;
  - TRs to make details of derivatives contracts available to ESMA, ESRB, supervising authorities, ESCB, etc.

# MiFIR: additional clearing and reporting requirements

- **Article 23** (reporting obligation)
  - Investment firms which execute **transactions in financial instruments** shall report details of such transactions to the competent authority as quickly as possible, and no later than the close of the following working day.
  - Transactions traded on a regulated market, an MTF or an OTF shall be reported by the operator of the platform.
- **Article 25** (clearing obligation for non-OTC derivatives)
  - all transactions in derivatives pertaining to a class of derivatives declared subject to the clearing obligation pursuant to Article 4(3) of EMIR that are concluded on a regulated market shall be cleared by a CCP



# Trading requirements (MiFIR)

- **MiFIR** (Articles 24 to 27):
  - trading in certain **eligible OTC derivatives** moved to **regulated market, MTF or OTF**;
  - obligation imposed on both financial and non financial counterparties exceeding the clearing threshold laid down in EMIR;
  - Commission and ESMA have the task of defining the list of derivatives eligible to such obligation, taking into consideration the liquidity of the specific instruments.

# Dodd-Frank Act: latest final rules published

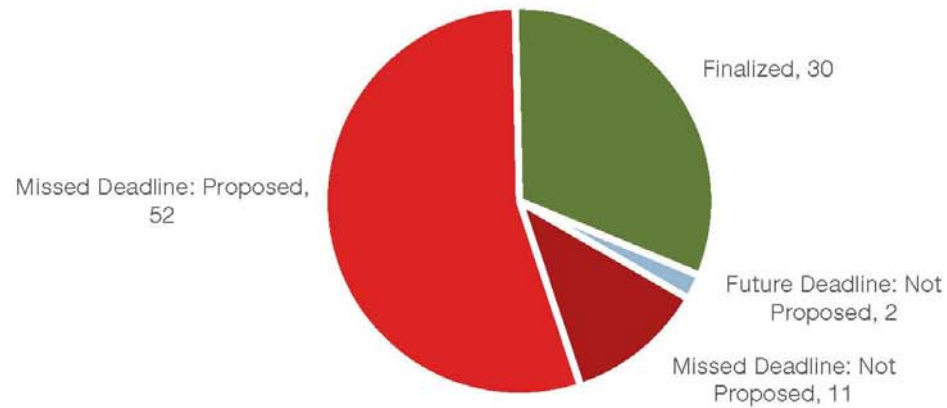
- **9 January 2012: Real-Time Public Reporting of Swap Transaction Data**
  - Not applicable to FX swaps and FX forwards if those are exempted from the definition of swaps
- **13 January 2012: Swap Data Recordkeeping and Reporting Requirements**
- **19 January 2012: Registration of Swap Dealers and Major Swap Participants**
- **7 February 2012: Protection of Cleared Swaps Customer Contracts and Collateral**
- **17 February 2012: Business Conduct Standards for Swap Dealers and Major Swap Participants**

# Dodd-Frank Act: latest final rules published

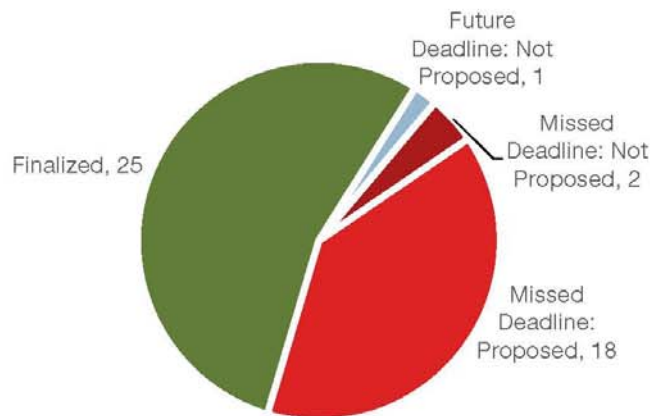
- **Implementation/Compliance date**
  - depends on adoption and effective dates of other regulatory provisions and definitions:  
**16 July 2012** at the latest  
(see CFTC Final Order of 23 December 2011)

## Title VII Progress on Required Rulemakings

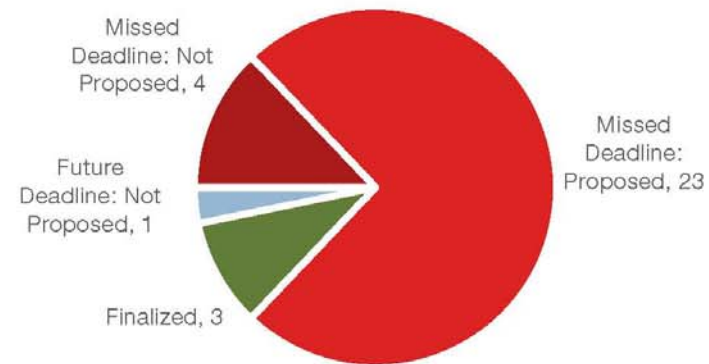
As of February 1, 2012



**CFTC Progress on Required Title VII Rulemakings**



**SEC Progress on Required Title VII Rulemakings**



**Note:** Total pie chart includes requirements from the CFTC, SEC and other regulators with rulemaking requirements under Title VII.

# CFTC tentative timetable for final rules

- **January to March 2012:**
  - **Still missing** (among others):
    - Client Clearing Documentation
    - Product Definitions
    - DCMs
- **April 2012 and after:**
  - Capital and margin
  - Extraterritoriality
  - Governance and conflict of interest
  - Process for making a swap available to trade
  - Segregation for uncleared swaps
  - Etc.

# Dodd-Frank Act: status re. FX swaps

- **Treasury Secretary's Proposed Determination of Foreign Exchange Swaps and Foreign Exchange Forwards under the Commodity Exchange Act is not final yet:**
    - proposal made on 29 April 2011: FX swaps and FX forwards should not be regulated as 'swaps' under the Commodity Exchange Act
      - => no mandatory central clearing, no exchange trading
    - Justification: FX swaps and forwards:
      - have fixed payment obligations;
      - are physically settled;
      - are predominantly short-term instruments.
- Focus on settlement risk (vs. counterparty credit risk).

# Dodd-Frank Act: status re. FX swaps

- Exclusion of FX swaps and FX forwards effective upon the Secretary's submission of the determination to the appropriate Congressional Committees.
- Only once the CFTC/SEC have adopted final rules with respect to the definition of 'swap', 'swap dealer' and 'major swap participant'?  
(expected by March 2012)
- Even if proposed determination is adopted, FX swaps and FX forwards will remain subject to:
  - trade reporting requirements;
  - anti-evasion rules;
  - strengthened business conduct standards for swap dealers and major swap participants.

# Dodd-Frank Act: Volcker rule

- **Section 619 DFA** added a new section 13 to the Bank Holding Company Act of 1956 that generally **prohibits any banking entity from engaging in proprietary trading** or from acquiring or retaining an ownership interest in, sponsoring, or having certain relationships with a hedge fund or private equity fund.
- **FED and several other agencies** (SEC, FDIC, CFTC, etc.) have proposed rules to implement the Volcker rule
- Concerns expressed by many foreign governments on the implication of the rule for **non-US sovereign debt**
- **21 February 2012**: letter sent by Danish Presidency to the Chairman of the Board of Governors of the FED expressing some **concerns about the implication in the EU** of the implementation of the Volcker rule



## Implementation of G20 commitment in other jurisdictions: some examples

- **Japan:** Amendment to the Financial Instruments and Exchange Act passed in May 2010; gives the Japanese financial regulator (JFSA) the authority to regulate OTC derivatives; implementing measures to be finalized by November 2012.
- **Hong-Kong:** the HK Monetary Authority and the HK Securities and Futures Commission released a consultation paper on their proposed OTC regulatory regime in October 2011. Public consultation planned for beginning of 2012. Adoption of final regulations foreseen by end 2012.
- **Canada:** Canadian Securities Administrators (CSA) released a consultation paper on OTC Derivatives Regulation in Canada in November 2010. Specific regulatory proposals have been and will be subsequently

# FSB progress report of October 2011

- 11 October 2011: **Financial Stability Board** published its **2<sup>nd</sup> progress report** on the implementation of the OTC derivatives markets reform
- The report concluded that *'jurisdictions should aggressively push forward to meet the end-2012 deadline in as many reform areas as possible.'*
- Some jurisdictions indicated that they are **waiting for the US and EU regulatory frameworks to be finalised before acting**. Consistency in implementation across jurisdictions is critical.
- While rules on clearing and reporting obligations are quite on track, those on exchange and electronic platform trading are behind schedule.

# Conclusion

- **EU:** EMIR on schedule for meeting G20 commitment by end 2012, BUT (i) implementation still depends on timely adoption of the technical standards developed by ESMA; and (ii) MiFID II not there yet.
- **DFA:** CFTC/SEC able to meet the 16 July 2012 deadline?
- Other G20 jurisdictions are generally behind schedule
- Timing issue + substantial inconsistencies among jurisdictions in the implementation of G20 commitment:
  - Conflicts due to extraterritoriality
  - Room for regulatory arbitrage