

# A Comparison of US and EU Derivative Market Reforms

How will key Dodd-Frank and EMIR provisions differ in  
substance and timing?

18 September 2012  
[10.00h EDT and 16.00h CET]

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## Introduction

### Hume Brophy

- Management-owned government and regulatory affairs firm with offices in Brussels, London, Paris and Dublin.
- 20-strong team based in Brussels and drawn from law practices, industry, government and national regulators.
- Specialise in agri-business, energy and financial services policy and advise a wide range of clients including asset managers, banks, commodity traders, investment firms, platforms and regulated markets.

## Introduction

### **Delta Strategy Group**

- Boutique US government affairs and strategic consulting firm based in Washington, DC.
- Professionals with over 30 years of government service and strong ties to both political parties.
- Specialize in derivatives policy on a broad range of issues for exchanges, energy and agribusiness companies, global trading firms, pension funds, asset managers, and other Fortune 500 companies.

## A comparison of US and EU derivative market reforms

### Structure of webinar presentation

1. Approach to regulation
2. Scope of clearing mandates / obligations
3. Exemptions from clearing mandates / obligations
4. Treatment of inter-affiliate / intra-group transactions
5. Reporting obligations
6. Extraterritorial application of clearing mandates / obligations
7. Other key issues
8. Question and answer session

## 1. Approach to regulation – US

Derivatives Title of Dodd-Frank is focused on Swap Dealers (“SDs”), Major Swap Participants (“MSPs”).

- SD Determination: qualitative with a *de minimis* exception.
  - SD (i) holds itself out as a dealer in swaps; (ii) makes a market in swaps; (iii) regularly enters into swaps with counterparties as an ordinary course of business for its own account; or (iv) engages in any activity causing it to be commonly known in the trade as a dealer or market maker in swaps. De minimis: entities engaging in less than \$8B in annual aggregated gross notional will not be required to register (excludes hedging and trading)
- Mandatory SD Registration will begin January 1, 2013 (pushed back from October 12, 2012).
- MSP Determination: entirely quantitative; intended to capture those whose positions are large enough that it justifies increased regulation.
- Mandatory MSP Registration begins on October 12, 2012.

## 1. Approach to regulation – EU

EMIR clearing obligations apply primarily to ‘financial counterparties’.

- No SD equivalent in EMIR.
- Article 2(8) EMIR: defines ‘financial counterparty’ with reference to eight Directives in force.
- Definition includes both UCITS funds and management companies.
- Definition includes Alternative Investment Funds (AIFs) but unclear whether AIF subsidiaries or SPVs included.
- Scope of clearing obligations affected by proposed changes to exemptions set out in MiFID 2 proposal.

## 2. Scope of clearing mandates – US

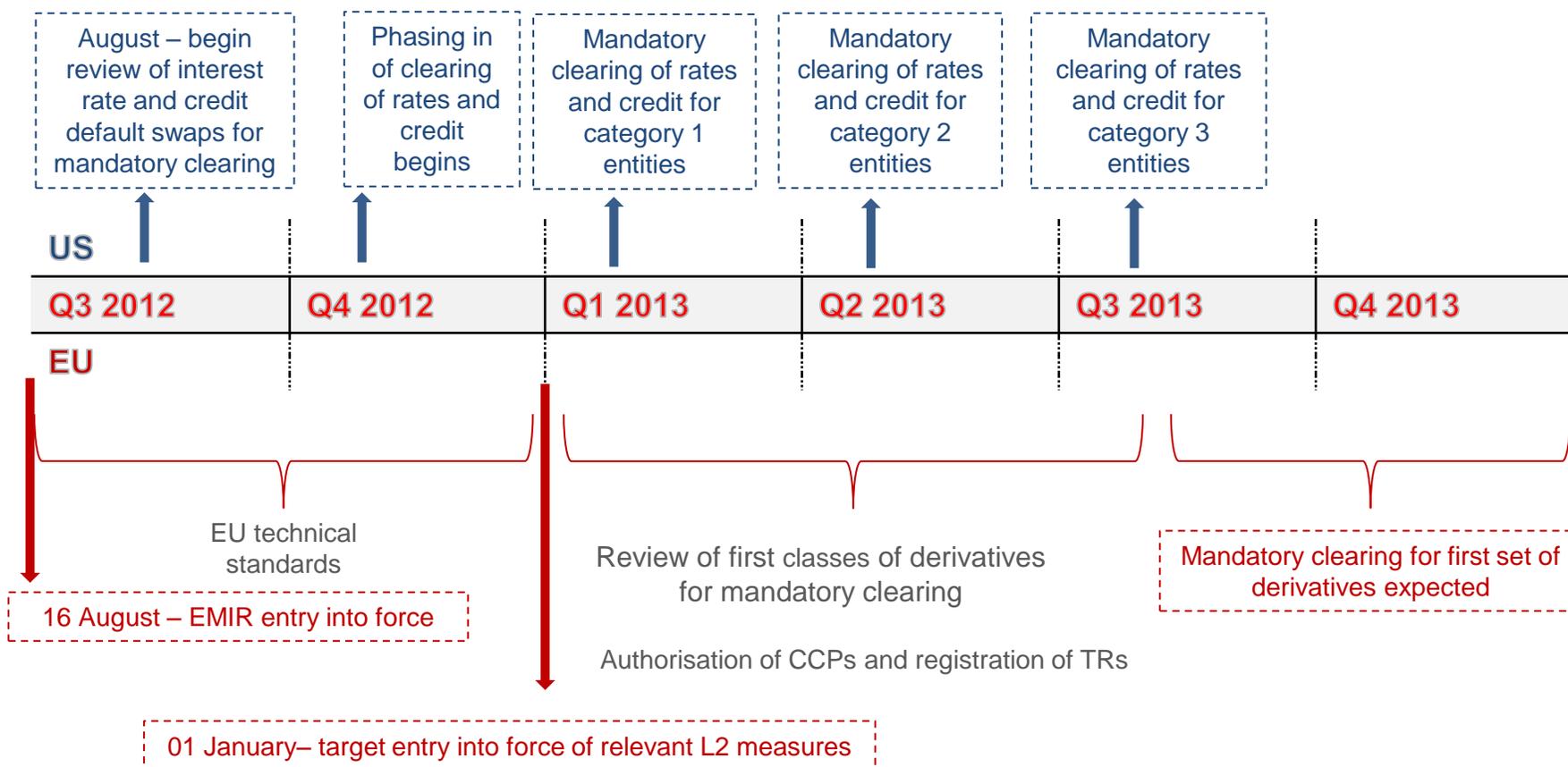
- Clearing obligation applies to all swaps subject to the clearing mandate between parties that are not exempt.
- Determination of swaps subject to clearing will be made by the CFTC by asset class, starting with rates and credit.
- Swaps subject to the clearing mandate must be cleared through a registered DCO.

## 2. Scope of clearing obligations – EU

Clearing obligations *may* apply to any OTC derivative contract per Articles 2(5) and (7) EMIR.

- Clearing obligations will only be mandated after a CCP has been authorised to clear a class of OTC derivatives.
- Authorisations notified to ESMA, which will determine if a clearing obligation ought apply on criteria.
- Article 1 CRI (OTC): lists criteria to be assessed by ESMA.
- N.B. existing clearing “agreement” for European index, single-name CDS.
- No ‘big bang’ date, ESMA’s initial focus likely to be rates, credit.

## 2. Scope of clearing mandates / obligations – timeline



### 3. Exemptions from clearing mandates – US

- Non-financial end users.
  - Must be hedging or mitigating commercial risk.
  - Must notify CFTC as to how they generally intend to meet their financial obligations with regard to those swaps.
- Inter-affiliate swaps.

### 3. Exemptions from clearing obligations - EU

- Non-financial counterparties not exceeding threshold
- Article 10 EMIR: cut-off threshold for clearing for non-financial counterparties
  - EUR €1 billion for credit and equity derivatives
  - EUR € 3 billion for interest rate, FX and ‘commodity derivatives + others’
- Calculation excludes hedging positions
- *‘Breach one, clear all’* approach is highly contentious
- Intra-group transactions
- Pension funds (three year derogation, conditional)

## 4. Treatment of inter-affiliate transactions – US

- Apply to swaps between majority-owned affiliates (includes swaps between a financial affiliate and a counterparty as well as counterparties that are both majority owned by the same third party).
- Exempts the swap from clearing, subject to conditions, including that both parties elect not to clear the swap.
- Does not exempt the swap from variation margin or reporting requirements.

## 4. Treatment of intra-group transactions – EU

- Intra-group transactions by both financial and non-financial counterparties exempted from clearing obligations.
- Exemption subject to Article 3 EMIR conditions, including restrictions on counterparties established outside the EU.
- Exemption from collateralisation subject to positive decision by national competent authorities and other Article 11 EMIR conditions.
- Portfolio reconciliation and compression requirements still apply to all intra-group transactions.
- Unclear if intra-group transactions would count towards threshold.

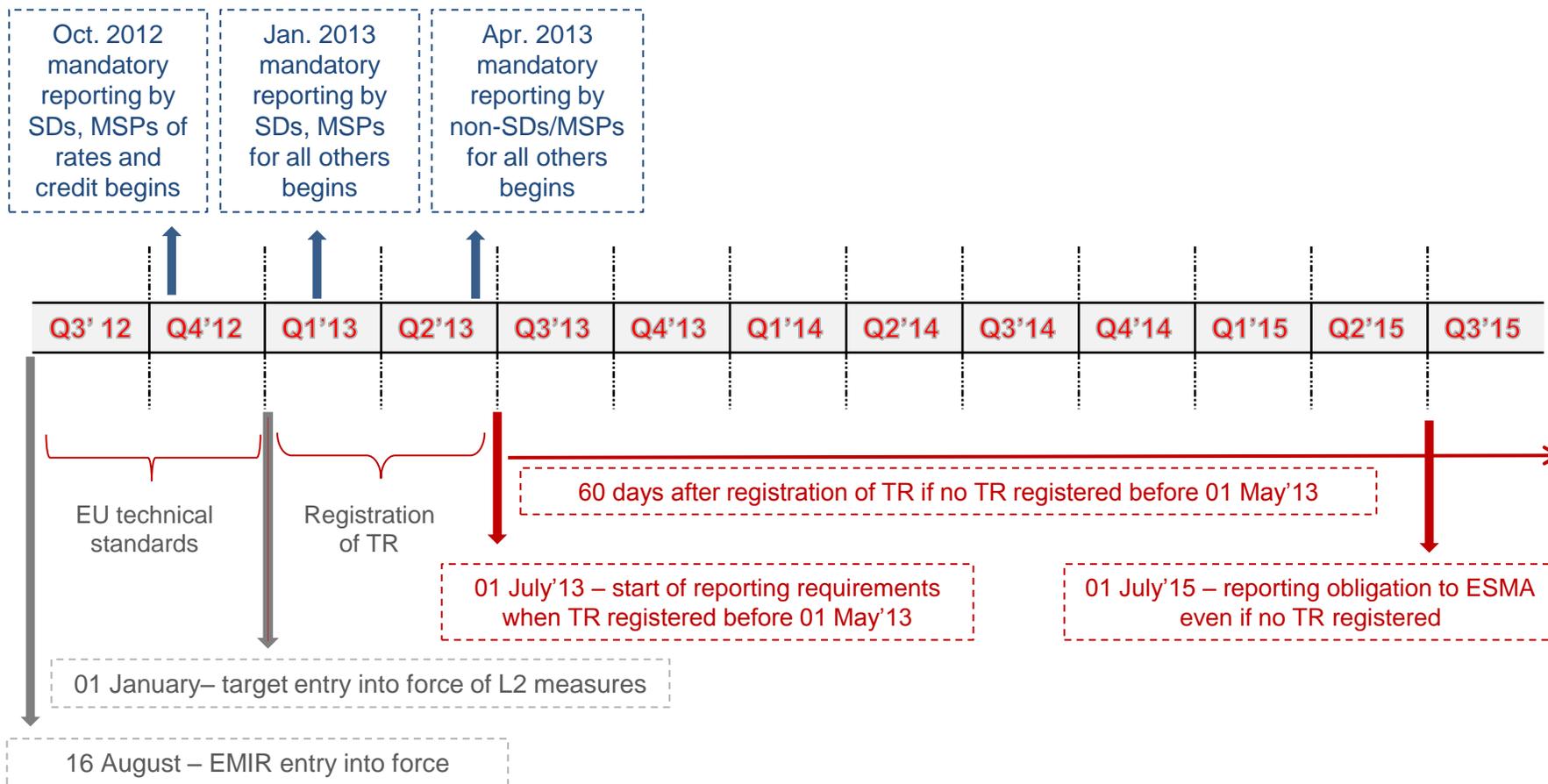
## 5. Reporting obligations – US

- Complicated phasing by type of market participant and asset class
- Reporting hierarchy
  - DCOs → SEFs/DCMs → SDs/MSPs → Non-SD/MSPs
- Asset class
  - Interest rates and credit
  - FX, equity, other asset classes
- Real-time public reporting for certain data fields; all other is reported to SDRs and not made public.

## 5. Reporting obligations – EU

- Article 9 EMIR: obligation to report details of transaction to a TR applies respectively to counterparties and CCPs.
- Obligation is delegable to a third entity.
- Report must identify the beneficiary of the contract if not a counterparty.
- Report must detail the exchange of collateral with different provisions if exchanged on individual contract or portfolio basis.
- Specific requirements set out in Annex 1 of the draft RTS.
- Timing: expected first-stage requirement from 01 July 2013 for all contracts open on or agreed after 16 August 2012.

## 5. Reporting obligations – timeline



## 6. Extraterritorial application of clearing mandates – US

- CFTC issued “Proposed Interpretive Guidance” for comment on July 12, 2012 regarding the cross-border impacts of Dodd-Frank rules.
- Applicable to swap contracts entered into by 3rd country entities transacting with a “U.S. Person” as defined in the guidance, regardless of domicile.
- Applicable to swap contracts entered into by US Swap Dealers regardless of the domicile of the counterparty.
- Applicability to other swap contracts will be dependent upon either party’s relation to a US parent/person and “substituted compliance” (comparable regulation) in another country.

## 6. Extraterritorial application of clearing obligations – EU

- Article 4(1)(a)(iv)-(v) extend the clearing obligation to transactions entered into by certain third country entities.
- Three key conditions: (1) subject to obligation if EU-established, (2) direct, substantial and foreseeable effect, and/or (3) prevent evasion.
- Article 4(4) EMIR: tasks ESMA with developing draft RTS to assess/define latter two conditions.
- No draft RTS published on 25 June, speculation on reasons for delay.
- Hope amongst some European market participants that delay may facilitate negotiations with US to avert ‘competitive application’.

## 7. Other key issues

- Margin requirements
- Collateral
- Straight through processing
- Position limits
- Trading mandate / requirement

## Questions and comments

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