GLOBAL FINANCIAL REGULATION
The Puzzle of EMIR and Dodd-Frank

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AGENDA

- The EMIR and DFA LEGAL Frameworks
- Implementation Timeline
- Central Clearing
- Mandatory Trading
- Reporting / Registration
- Risk Mitigation (Portfolio Reconciliation and compression, DR, …)
- Position Limits
- Extraterritoriality
THE EMIR AND DFA LEGAL FRAMEWORKS

EMIR

  - Commission Implementing Regulations supplementing EMIR
  - Commission Delegated Regulations supplementing EMIR
- Implementing technical standards (a direct responsibility of the European Securities and Markets Authority (ESMA))

DFA

- OTC Derivatives Reforms in Title VII of DFA
- Required 398 rulemakings and studies by various federal financial regulators (CFTC, SEC, FDIC, Federal Reserve Board, Treasury, OCC)
IMPLEMENTATION TIMELINE

**EMIR**

- General Legislative key dates
  - Aug. 2012: EMIR enters into force
  - Dec. 2013: EU Commission adopts TS
- CCPs and central clearing obligation
  - Sept. 2013: Previously existing EU CCPs authorization application deadline [A + 6 months]
  - March 2014: First EU CCP authorized [B]
  - March 2014: First notification for the clearing obligation
  - Sept. 14: ESMA to submit draft Regulatory Technical Standards (RTS) on the clearing obligation [B + 6 months]
- Trade Repositories (TRs)
  - Nov. 2013: Adoption of the registration decision of the first TRs [C]
  - Feb. 2014: Reporting start date for all asset classes [C + 5 working days + 90 calendar days]

**DFA**

- Set forth deadlines for rulemakings in specific areas (CFTC established 30 rulemaking teams):
  - Definitions/registration rules for swaps dealers and major swaps participants
  - Definitions swaps, security-based swaps, mixed swaps
  - Mandatory clearing and derivatives clearing organizations
  - Mandatory trade execution and trading platforms (SEFS)
  - Reporting swaps data to swap data repositories (SDRs)
  - Internal/External Business Conduct Standards
  - Capital, Margin, and Segregation and Bankruptcy rules
  - New Enforcement authorities
  - Position Limits
EMIR

- Emir imposes a central clearing requirement for standardized derivative contracts to be cleared through central counterparties
- Article 4(1) of EMIR requires certain OTC derivatives as determined by ESMA which entered into between parties who are EU authorised counterparties, relevant non-financial counterparties and certain non EU entities to be subject to mandatory clearing.

DFA

- DF Section 723 resulted in amendment to the CEA, new section 2(h)(1)(A) to require that a swap must be cleared through a DCO if the Commission determines that the swap, or group category, type or class of swap is required to be cleared.
- DCO Rules, 76 FR 44776 (7/27/11), new framework for certification and approval for new products, including swaps
- Process for Review of Swaps for Mandatory Clearing, 76 FR 44464 (7/25/11), procedures for determining whether DCO can clear swaps, submission of swaps by DCO to CFTC for a mandatory clearing determination, Commission-initiated review, and stay of clearing determination
- Clearing Requirement, 77 FR 74284 (12/13/12), CFTC adopted first clearing requirement determination for 4 classes of IR swaps and 2 classes of CDSs
- Clearing Exemption for Inter-Affiliate Swaps (Part 50), 78 FR 21749 (4/11/13)
- End-User Exception (Part 50) 17 FR 42560 (7/19/12)
- Systemically Important DCO Rules 78 FR 72476 (12/2/13) (FSOC designates financial market utilities (including 2 DCOs) as SIDCOs (CME, ICE); DCMs, SDRs, SEFs excluded from definition of “financial market utility”
- MAT Rule, 78 FR 33606, (6/4/13) , CFTC issued final rule on process for DCM or SEF to make a swap “available to trade”
MANDATORY TRADING

EMIR

- There is an exchange trading mandate in MiFID
- Under MiFIR, ESMA determines which classes of derivatives subject to the clearing obligation will be subject to mandatory trading.

DFA

- DF amended CEA, new sections 2(h)(7-8), Section (8) provides that all swaps subject to clearing requirement must be executed on a DCM/SEF/ except where no DCM/SEF makes it “available to trade” or where there is a 2(h)(7) exception
- Final rule (6/4/13) sets forth procedures for MAT-ting a swap
- Trade execution requirement compliance is the later of clearing requirement date under Reg. 50.25 (clearing requirement compliance schedule) or 30 days after MAT determination is deemed approved under Reg. 40.5 or deemed certified under Reg. 40.6
- SEF Registration Requirements and CPs, 78 FR 33476 (6/4/13), SEFs are multiple to multiple systems; includes registration procedures (including temporary/provisional registration); explains minimum trading functionalities/ order book requirements; deliniates between required and permitted transactions (e.g., required, execution method is either 1( order book, RFQ in conjunction with OB; permitted, any method, but must offer OB consistent with minimum trade functionality requirement); compliance date – 10/2/13
EMIR

- All OTC and exchange-traded derivative transactions (whether cleared or not cleared), where one party is a NFC and the other a FC are subject to trade reporting requirements to a TR(Article 9 of EMIR).

- Reporting may be delegated but liability remains on counterparties.

- A reporting requirement applies to all derivative contracts that are entered into before the date of entry into force of EMIR and are outstanding on that date.

DFAs

- SDR Registration Standards and CPs, 76 FR 54538 (9/1/11)

- Real Time Reporting
  - 77 FR 1182 (1/9/12), framework for RT public reporting of swaps transaction and pricing data for all swaps
  - 78 FR 32866 (5/31/13), block trades, criteria for grouping blocks of swaps in categories; methodologies for setting minimum blocks for each

- Data Recordkeeping and Reporting
  - 77 FR 2136 (1/13/12), general requirements
  - 77 FR 35200 (6/12/12), pre-enactment and transition swaps

- Large Swaps Trader Reporting, 76 FR 43851 (7/22/11)
EMIR

To facilitate risk mitigation include:

• Provision & segregation of collateral
• Proportionate holding of capital (FCs)
• Daily marking-to-market/model (FCs & NFC+s)
• Timely confirmation of trades (where possible by electronic means) is also required:
  • Cut-off date for timely confirmation of trades will vary by reference to factors such as whether party is a financial institution, the date on which trades are concluded and the type of trades.

DFA

• Capital and Margin for Uncleared Swaps – comment period concluded, international margin report produced in 8/13, finals rules inchoate
• Segregation and Bankruptcy,
  • 77 FR 6336 (2/7/12), for cleared swaps, use LSOC
  • 78 FR 66621 11/6/13), requirements on SDs/MSPs as to treatment of collateral posted by CPs to margin, guarantee or secure uncleared swaps
• Internal Business Conduct Standards (First “Cluster”), 77 FR 20128 (4/3/12), recordkeeping, reporting, daily trading records; risk management; conflicts of interest; CCO
• International Business Conduct Standards (Second “Cluster”, 77 FR 55904 (9/11/12) confirmation, portfolio reconciliation and compression, documentation
• External Business Conduct Standards, 77 FR 9734 (2/17/12) prohibits abusive practices, requires certain disclosures to CPs and requires SDs/MSPs due diligence; exemptions for SEF/DCM transactions when SD/MSP does not know identity of CP prior to execution
EMIR

- No applicable provisions in EMIR, although the European Parliament in its draft report currently provide for the imposition of position limits by trading venue operators in respect of commodity derivatives.

DFAs

- Reproposed by CFTC 12/12/13
- Comment period closed July 3, 2014
- Final Rule Pending
EMIR

The obligation to clear OTC derivative transactions applies where one or both of the counterparties are non-EU entities which would be subject to the clearing obligation if they were established in the EU, and the contract has a “direct, substantial and foreseeable effect” within the EU or “where the obligation is necessary or appropriate to prevent the evasion of any provisions of EMIR” (Article 4(2)).

Applies to transactions by counterparties authorized or established in the EU (Article 5).

DFAs

Section 2(i) of the CEA provides that DF shall not apply unless swap activities have a “direct and significant connection with activities in, or effect on, commerce of the United States; or contravene such rules or regulations as the Commission may prescribe or promulgate as are necessary or appropriate to prevent the evasion of any provision of this Act that was enacted by the Wall Street Transparency and Accountability Act of 2010.”

CFTC also instituted a “substituted compliance” process, to determine whether a foreign jurisdiction’s requirements are comparable and comprehensive as compared to the CEA/CFTC regs entity and transaction level requirements.
CFTC Issues proposed “guidance” in July 2012

- Broad definition of US person
- Several unprecedented, negative comments received from various non-US governmental agencies
- GMAC meeting in November 2012, responses almost uniformly negative
- In brief, the proposal was intended to be a general policy on how section 2(i) applies to cross border swap transactions
- It instructed market participants to determine whether or not they were a “US Person” or dealing with a “US Person” for purposes of application of DF statutes and rules.
- This in turn would require registration as a swap dealer (or MSP) if the US person definition was triggered
The CFTC’s “guidance” created significant cross-border issues for entities doing business with US persons and firms.

There was no Part 30-type exemption for swaps.

There was no concept of working through omnibus accounts generally.

So, if the non-US firm has to register in the US, then all of the DF rules listed above will apply (with few exceptions).

Result was that the CFTC issued an exemptive order in December 2012, to be effective through July 2013—this allowed people to (at least) keep doing business under the definition of US person that was included in the in previous guidance.

On July 11, 2013, the US and the EU issued a “Path Forward,” that was to signal a general harmonizing and a way to move toward regularizing definitions and allowing business to continue to conduct business.

CFTC issued final guidance on July 12, 2013, with a continued restricted definition of US Person.
EXTRATERRITORIALITY (CON’T)

- The final guidance, as issued in July 2013, focused on the “normal activities” of the firm or person.

- The final guidance did include some needed amendments, it was less expansive than the proposed version, but still needed some modifications, e.g.:
  - Issues related to affiliates and conduits
  - Aggregation Issues

- ISDA, SIFMA and IIB sued the CFTC regarding its issuance of the guidance, in essence alleging that it was violating the APA.

- The Final guidance included language that confused people regarding “conduits” and “affiliates”—people were not sure which was which, and which involved making an entity and US person.
Then, November 14, 2013, the staff of the CFTC issued an advisory including a “locational requirement”—something that had purposefully NOT been included in the final guidance.

The focus was on “fn 513”, and created major market confusion and disruption.

In brief, the staff’s focus on fn 513 added this “locality test” (NOT included in the July 2013 final guidance):

- Where a swap is between two non-US persons, but arranged, negotiated or executed using personnel located in the US, then DF requirements apply
- This created significant legal uncertainty in the global swaps markets
The result was that the CFTC issued a “Request for Comment on Application of Commission Regulations to Swaps Between Non-US Swap Dealers and NON-US Counterparties Involving Personnel or Agents of the Non-US Swap Dealers Located in the United States” on January 3, 2014, requesting comment on the November 14, 2014 staff advisory.

This calmed the waters somewhat, but the issue remains murky.
Path forward:


- Acknowledged simultaneous application of EMIR/Title VII could lead to conflicts of law, inconsistencies and uncertainty

- Sets out high level agreement between EU Commission and CFTC as to how to resolve certain issues
FOR MORE INFORMATION

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