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Comparison of US and EU Regulation of the Swaps Market

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I. Introduction

At the height of the 2008 global financial crisis, international regulators met at the G-20 Summit in Pittsburgh to discuss appropriate measures to address the crisis and to prevent similar crises in the future. The regulators agreed to a number of resolutions on derivatives in the areas of trading, clearing, reporting, and risk mitigation:

> **All standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end-2012 at the latest. OTC derivative contracts should be reported to trade repositories. Non-centrally cleared contracts should be subject to higher capital requirements ....[1]**

Regulators in the US and the European Union (EU), the two largest derivatives markets, have been in the forefront of efforts to meet the goals of the G-20. In July 2010, the US Congress passed the Dodd-Frank Act (DFA),[2] which, among other things, amended the Commodity Exchange Act (CEA). The DFA provided the Commodity Futures Trading Commission (Commission or CFTC) and the Securities and Exchange Commission (SEC) with oversight of different segments of the over-the-counter (OTC) swaps market, and mandated the execution, clearing, and reporting of these derivative instruments. In general, the Commission regulates interest-rate swaps, certain foreign exchange swaps, and credit default swaps (CDS) on broad-based indices (as well as futures and options on futures). The SEC regulates, among other things, single-name CDS, and CDS on narrow-based indices.[3]

In the EU,[4] the European Parliament has approved legislation consistent with the G-20 goals, including: (1) the European Market Infrastructure Regulation (EMIR),[5] which came into force in August 2012, and addresses clearing, reporting, and risk mitigation; and (2) the Markets in Financial Instruments Directive (and Regulation) (MiFID II / MiFIR), which came into force in July 2014, and focuses on trade execution.[6] In the EU, the European Commission (EC) is the chief regulator of the derivative markets by deciding legislation, with the advice and ongoing consultation of the European Securities and Markets Authority (ESMA), which generally drafts the implementing

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regulations. As of this writing, in both the US and EU, the drafting and implementation of regulations is well advanced.

Although the regulatory efforts in the US and the EU grew out of the same G-20 commitments and share many similarities, there are also important distinctions between the two. A comparison of how these two jurisdictions address the areas highlighted at the Pittsburgh G-20 – clearing, trading, reporting, and risk mitigation for uncleared swaps – follows. We also discuss their differing approaches to the extraterritorial scope of their regulation, a critical issue not addressed by the G-20 accords.

II. Clearing

A. Mandatory Clearing

The CFTC and the ESMA have drafted similar regulatory provisions for mandatory clearing. The CFTC has: (1) set mandatory clearing criteria; (2) established the initial contracts that are subject to mandatory clearing; (3) defined the registration process for central counterparties (CCPs) (Derivatives Clearing Organizations or DCOs); and (4) registered several DCOs. And, as of this writing, the CFTC staff is reportedly drafting proposed regulations that would allow certain non-US DCOs to be exempt from DCO registration. In the EU, the EC has approved final rules for the mandatory clearing criteria, the registration of CCPs, and the recognition of non-EU CCPs. The EC also has proposed, but not finalized, the list of initial contracts that are subject to mandatory clearing.

1. Mandatory Clearing Criteria

US law mandates that the Commission consider a number of factors in determining if a contract should be subject to the mandatory clearing regime, including: (1) the volume and liquidity of the contract; (2) the operational readiness of the clearing organization to handle its clearing; and (3) the effect of clearing on the market, both in terms of competition and systemic risk.[7]

In determining whether a product must be subject to mandatory clearing, EU law includes a similar review of factors that address volume and liquidity, market impact and CCP capacity; namely:

(1) "[T]he degree of standardisation of the contractual terms and operational processes of the relevant class of OTC derivatives";

(2) "[T]he volume and liquidity of the relevant class of OTC derivatives"; and

(3) "[T]he availability of fair, reliable and generally accepted pricing information in the relevant class of OTC derivatives."[8]

2. Products

To date, the CFTC has determined that certain classes of interest rate swaps (IRS) and certain credit default swap indices (CDS) are subject to mandatory clearing. For interest rate swaps, these categories include:

(a) Fixed-to-Floating Interest Rate Swaps (USD, EURO, GBP, JPY);

(b) Forward Rate Swaps (USD, EURO, GBP, JPY);

(c) Basis Swaps (USD, EURO, GBP, JPY); and

(d) Overnight Index Swaps (USD, EURO, GBP).[9]

And the credit default index swaps required to be cleared include:

(a) North American Untranched; and

(b) European Untranched.[10]

EU regulation is moving toward a similar mandatory clearing determination. As of this writing, ESMA has proposed the mandatory clearing of IRS and CDS.[11] The proposed IRS products are:

(a) Fixed-to-float interest rate swaps;

(b) Forward rate agreements;

(c) Basis swaps; and

(d) Overnight index swaps.

And for CDS, ESMA's draft regulatory technical standards propose the mandatory clearing of European untranched index CDS.

3. Mandatory Clearing Review Process

In regard to the mandatory clearing review process, under US law a DCO is "presumed eligible" to clear swaps that it already clears, and therefore such swaps do not have to be submitted to the Commission for a mandatory clearing determination.[12] Regarding swaps that were not already being cleared at the time of rulemaking however, a DCO must submit them to the CFTC for a mandatory clearing review, before offering them for clearing.[13] Also, the CFTC will conduct independent reviews of swaps and groups of swaps to determine if they must be cleared.[14]

Similarly, under EU law, within six months of ESMA receiving a notification that a competent authority has authorized an EU CCP (or a CCP located outside of the EEA (i.e., third country entity (3rdCE) has been recognized),[15] ESMA will submit draft technical standards to the EC identifying which swaps, if any, should be subject to mandatory clearing.[16] Furthermore, ESMA is authorized to identify classes of swaps that should be cleared but no CCP is clearing, and request proposals for clearing.[17]

4. Entities

US and EU law are broadly similar in their application of mandatory clearing criteria to entities. Both sets of law broadly require that financial companies, except for affiliates, clear swaps that are subject to mandatory clearing, while allowing non-financial firms to avoid the mandatory clearing obligation.

Exemption for Non-Financial Entities

US

Under CFTC regulation, swaps that have been made subject to mandatory clearing must be cleared, absent an exception to the clearing requirement.[18] One of the key exceptions to this obligation is the End-User Exception (the "Exception"), which is available to an entity that is not a "financial entity," where the financial entity definition includes:

(1) a Swap Dealer (SD);

(2) a Major Swap Participant (MSP);

(3) a Commodity Pool;

(4) a Private Fund;

(5) an Employee Benefit Plan; or

(6) a Person predominantly engaged in the "business of banking" or "activities that are financial in nature" (per Bank Holding Act).[19]

Moreover, in order to use the Exception, the non-financial company must be using the swaps to "hedge or mitigate commercial risk."[20] Thus, under CFTC regulation, a non-financial company that is using a swap, subject to mandatory clearing, for speculation, absent its eligibility for other exemptions, must clear that swap.[21]

EU

Similarly, under EU law, a swap that is subject to a mandatory clearing determination must be cleared if no exemption exists, and it is between financial parties. Unlike US law, EU law divides non-financial companies into two segments, depending on whether or not they are above (NFC+) or below (NFC-) a certain notional threshold. NFC+s are subject to mandatory clearing, while NFC-s are not.[22]

As indicated, if a non-financial entity's swap activity falls below certain thresholds (which differ based on asset class),[23] it is exempted from the mandatory clearing determination, regardless of whether or not the swap is being used for hedging.[24] However, in calculating its position in relation to the threshold, the NFC can exclude hedging transactions, referred to in the statute as transaction that are "objectively measurable as reducing risks directly relating to the commercial activity or treasury financing activity of the non-financial counterparty or of that group."[25]

Thus, the exception for non-financial entities in EU law can be considered both broader and narrower than the US exception. It is broader in that, up to the base threshold, the EU "end user" does not have to be hedging to use the exception. However, the EU exception also can be seen as narrower since it establishes an upper threshold at all, as US law has no threshold requirement for non-financial end users that are hedging. *See* summary of differential treatment in the table below:

Entities Eligible for Exemption from Mandatory Clearing	**US**	**EU**
NFC- That is Hedging	Yes	Yes
NFC- That is Not Hedging	No	Yes
NFC+ That is Hedging	Yes	No[26]
NFC+ That is Not Hedging	No	No
Financial Entity Whether or Not Hedging	No	No

Inter-Affiliate Exemption

Both the US and EU approach swaps between affiliates in a similar manner. US law provides that certain swaps between majority-owned parents and their subsidiaries, or two subsidiaries (that are majority-owned by the same parent), do not have to be cleared. To use this exemption, market participants must meet several criteria, including that the subsidiaries must be on the consolidated financials of their parent company, must have a risk management program, and must report the swaps to a trade repository (Swap Data Repository or SDR).[27] Similar to the US inter-affiliate exemption, EU law also allows for an exemption for intragroup swaps.[28]

III. Trade Execution

The US and EU have largely similar approaches to trade execution, though there are some key distinctions, such as their differing processes through which contracts are chosen for mandatory trade execution.

A. Trading Venues

US

CFTC regulation and guidance provides that swaps, including those subject to mandatory clearing, can be executed on a number of venues: (1) Designated Contract Markets (DCMs), which traditionally have listed futures, but, under DFA, are now also permitted to list swaps for trading; (2) Swap Execution Facilities (SEFs), which are required to register for the first time under DFA and are only permitted to list swaps for trading; (3) Foreign Boards of Trade (FBOTs), which are non-US exchanges that are required by regulation to register with the CFTC in order to offer US persons direct access to their electronic trading system to trade futures and swaps; and (4) Qualifying Multilateral Trading Facilities (QMTFs), which are non-US exchanges that, pursuant to no-action relief, are permitted to allow US persons to trade thereon without registration as a SEF.

First, swaps can be traded on DCMs, provided that the DCM submits to the Commission a description of how it intends to meets its statutory, regulatory, and self-regulatory obligations in regard to swaps trading.[29] All transactions on a DCM, including swaps, must be cleared.[30]

Second, any trading system which is not a DCM, and in which multiple participants may accept bids and offers for swaps made by other participants, must register as a SEF.[31] A SEF, among other things:

(1) Must be limited to Eligible Contract Participants (ECP)s;[32]

(2) Must have an Order Book;[33]

(3) Can have a Request-For-Quote system (RFQ);[34] and

(4) Can permit multiple means of communication – e.g., voice.[35]

Non-US exchanges can apply for registration as DCMs or SEFs, and, as of this writing, there is one non-US venue that is temporarily registered as a SEF.[36]

EU

In regard to EU regulation, MiFID II provides that swaps can be traded on several EU trading venues, including: (1) Regulated Markets (RMs); (2) Multilateral Trading Facilities (MTFs); and (3) Organised Trading Facilities (OTFs).

A RM is a highly regulated organized exchange,[37] which must meet a number of requirements, including those pertaining to governance,[38] organization,[39] and trade practice.[40] In addition, all derivative transactions executed on a RM must be cleared by a CCP.[41] RMs must also have "transparent and non-discretionary rules and procedures that provide for fair and orderly trading and establish objective criteria for the efficient execution of orders."[42] Furthermore, RMs cannot allow market operators to execute client orders against proprietary capital, or to engage in matched principal trading on any of the regulated markets that they operate.[43]

MTFs are akin to Automated Trading Facilities in the U.S. and are defined as: (1) a multilateral system, (2) operated by an investment firm or a market operator, (3) which facilitates trading of multiple third party entities.[44] Like RMs, MTFs must have non-discretionary rules for the execution of orders in the system.[45] Also, MTFs cannot execute orders against proprietary capital or engage in matched principal trading,[46] and they must have rules establishing non-discriminatory access.[47]

OTFs, which are akin to SEFs, among other things:

(1) Are not a RM or MTF;

(2) Facilitate trading of multiple third party entities; and

(3) Are permitted to list for trading bonds, structured finance products, emission allowances and derivatives.[48]

OTFs differ from RMs and MTFs in that: (1) OTFs must execute orders on a discretionary basis;[49] (2) OTFs can only trade derivatives, bonds, structured finance products, and emission allowances; and (3) investment firms operating OTFs may engage in limited matched principal trading in derivatives that are not subject to a mandatory clearing obligation.[50] Under law, they are given access discretion – the operator can determine types of counterparties. Like SEFs, OTFs can also use multiple trading mechanisms, including RFQ, order book, or voice as means to execute transactions.[51] OTFs are also required to make current bids and offers public.[52] Third country trading venues that are equivalent may also list for trading products under this recognition category.[53]

B. Trade Execution Mandate

In regard to trade execution, the CEA requires that all swaps subject to mandatory clearing must be executed on DCM or SEF, unless none "makes the swap available to trade" (MAT).[54] The Commission has established a process in which DCMs and SEFs that wish to make a swap available to trade must submit a MAT determination to the CFTC for its approval through a rule change process.[55] The CEA and CFTC rules require that as a preliminary matter, the swap must be: (1) subject to mandatory clearing; and (2) listed on the SEF or DCM.[56] Furthermore, in their analysis of the appropriateness of the MAT determination, the SEF/DCM must demonstrate consideration of at least one of the following factors for the contract:

(1) whether there are ready and willing buyers and sellers;

(2) the frequency or size of transactions;

(3) the trading volume;

(4) the number and types of market participants;

(5) the bid/ask spread; or

(6) the usual number of resting firm or indicative bids and offers.[57]

EU rules similarly mandate that all swaps subject to mandatory clearing must be executed on a (1) RM; (2) MTF; or (3) OTF.[58] EU regulation also mandates that derivatives that are subject to the execution mandate must be eligible to be traded on the aforementioned venues on a "non-exclusive and non-discriminatory basis."[59]

EU law, however, provides for a different process by which contracts are to be considered for mandatory trade execution – ESMA, not the trading venues, determines which contracts are considered for mandatory trade execution. Pursuant to those rules, in order for a contract subject to the clearing obligation to be subject to the trading obligation, it must be: (1) admitted to trading or traded on at least one trading venue; and (2) it must be sufficiently liquid.[60] Further, to assess liquidity, ESMA must use the following criteria:

(1) "the average frequency and size of trades over a range of market conditions, having regard to the nature and lifecycle of products within the class of derivatives";

(2) "the number and type of active market participants including the ratio of market participants to products/contracts traded in a given product market"; and

(3) "the average size of the spreads."[61]

Furthermore, RMs, MTFs and OTFs, like US facilities, must ensure that contracts that are cleared are submitted and accepted for clearing "as quickly as technologically practicable using automated systems."[62]

IV. Reporting

A. Who Must Report

The two jurisdictions differ in the requirements regarding who must report swap data. In the US, there is a hierarchy for determining which counterparty is the reporting party:

(1) If only one of the parties is a dealer, the reporting party is the dealer.

(2) If one party is a MSP and other party is not a dealer, the reporting party is the MSP.

(3) If one party is a financial entity and the other is not a dealer or MSP, the reporting party is the financial entity.

(4) If both parties are either dealer, or MSPs; or both parties are not dealers MSPs, the reporting party is the party agreed to by the parties.

(5) If the parties are a US person and a non-US person, where neither party is a dealer or MSP, the reporting party is the US person.[63]

In the EU, however, the rules do not provide that only one party act as the reporting counterparty; rather, both parties have the obligation to report.[64] The reporting obligation, however, can be delegated.[65] Delegation can take several forms: (1) One party can make the entire report; (2) the parties can submit different parts of the report; or (3) both can delegate reporting to a 3rd party (e.g., a CCP). The rules require, however, that there be no duplication in reporting; the parties must agree on reporting, prior to submission. 3rdCEs are not expected to report.[66] Moreover, while a party can delegate its reporting function, it maintains ultimate responsibility for that data.

B. What Must Be Reported

Both US and EU law generally provide that the primary economic terms at contract initiation must be reported, as well as subsequent modifications, though EU law requires more information. In the US, two kinds of information must be reported: creation data and continuation data. Creation data generally consists of the initial primary economic terms of the contract, such as price, quantity and contract type.[67] Creation data also includes information about the counterparties including whether a counterparty is a dealer, MSP, financial entity, or US person. Continuation data consists of any changes to the initial data.[68] Continuation data includes valuation data; however, valuation data must only be reported by the DCO for each cleared swap, and for each uncleared swap, it must be reported if one of the counterparties is a MSP or dealer.[69]

The two categories under EU law that must be reported are: common data and counterparty data.[70] Common data includes data regarding primary economic data (including, as applicable, type, maturity date, notional amount, price and settlement date). Counterparty data includes the information about the identity of the counterparties, such as their name, domicile, whether or not they are a financial entity, whether they are domiciled outside of EEA, and whether the contract is for the NFC's commercial activity or treasury financing (in accordance with the hedging exemption for counting contracts toward the clearing threshold).[71] Unlike US regulation, pursuant to EMIR, counterparty data must also include information on valuation including the mark to market value of the contract, and the date, time and type of valuation. Counterparty data also includes information on any collateralization, including the value of the collateral. However, for cleared swaps, valuation data must only be reported by the CCP.[72] Moreover, NFC-s do not have to report on collateralization or valuation.[73]

EU reporting requirements differ from those in US law in key aspects. First, EU counterparties are required to include a "reporting log," which is a log of all modifications, including which entity requested it, rationale for modification, date and time of modification, and a clear description of all changes.[74] And though both EU and US law require counterparty data, the EU requirements are more extensive, for instance requiring whether there is a beneficiary of contract (if different than the counterparty), and the amount of collateralization.[75]

The differences in US and EU requirements were highlighted in ESMA's equivalency review. ESMA determined that US reporting requirements are not equivalent to the EU requirements in the following areas:

(i) US reporting requirements are less detailed than EU requirements, namely, there is an absence of daily data on the valuation of all contracts for all counterparties and on collateral on a trade level or portfolio basis (e.g., US requirements only mandate an indication of whether or not the contract is collateralized);[76]

(ii) Unlike US rules, EU Rules require a log of modifications to data registered in a trade repository, including identification of the person or persons that requested the modification;[77]

(iii) Unlike EU requirements, US law does not require that SDRs maintain operational separation between any ancillary services they provide and their data collection and maintenance operations;[78]

(iv) EU Rules require reporting the beneficiary of the rights and obligations arising from a derivative contract, if different from the counterparty, while CFTC Rules and SEC rules do not;[79] and

(v) There are statutory restrictions on the access to SDR data by foreign regulators because of an indemnification requirement.[80]

Because of these differences, ESMA recommended that, before determining that US SDRs comply with legally binding requirements that are equivalent to EMIR's requirements, the EC should require that they adopt and maintain legally binding policies and procedures in the areas of divergence that are "equivalent" to those required under EMIR. [81]

V. Risk Mitigation for Uncleared Swaps

In the US, only dealers and MSPs are required to engage in risk mitigation practices including: (1) establishing relationship documentation; (2) providing trade confirmation; (3) providing portfolio reconciliation, if appropriate; (4) establishing rules for portfolio compression; (5) engaging in daily valuation; and (6) allowing for dispute resolution.[82] In regard to trade valuation, dealers and MSPs must, among other things, provide daily mid-market valuation, and disclose methodology and assumptions underlying valuation.[83] In regard to portfolio compression, dealers and MSPs must have written policies and procedures for conducting portfolio compression as follows: (1) if a counterparty is another dealer or MSP, when it is appropriate; or (2) if a counterparty is not a dealer or MSP, when the counterparty requests it.[84] And for portfolio reconciliation, among other things, swap dealers and MSPs must have written policies requiring portfolio reconciliation, including methods to resolve valuation discrepancies.[85] Moreover, proposed rules would subject SDs to capital[86] and margin requirements in regard to their swap trading activities.[87]

Under EU regulation, not just dealers and MSPs, but all counterparties that enter into any uncleared OTC contracts must, ensure that there are appropriate procedures regarding timely confirmation, portfolio reconciliation, dispute resolution, and valuation of contracts.[88] Also, contracts between FCs and NFC+s, as well as NFC-s must be confirmed in a timely manner (however, the required time frame to make the confirmations is generally shorter (per asset class) for the former.)[89] Also, all counterparties must agree to portfolio reconciliation procedures prior to the start of the contract, though the reconciliation must be conducted more frequently for trades entered into by NFC+ and FCs.[90] And in regard to portfolio compression, FCs and NFCs with 500 or more uncleared swaps with a single counterparty must have procedures to review the possibility of portfolio compression.[91] Furthermore, FCs and NFCs+, but not NFC-s, must conduct daily mark-to-market valuations for all OTC contracts,[92] and have risk management procedures that require the exchange of collateral.[93] Last, only FCs must maintain appropriate capital.[94]

VI. Extraterritoriality

Both the US and EU have addressed the extraterritorial reach of their requirements—the CFTC through guidance, and the EC through rules.[95] Although there are differences, they also share common themes.

A. US

Statutory Provision

Regarding US law, Section 2(i) of the CEA states that swap rules only apply to non-US transactions that "have a direct and significant connection with activities in, or effect on, commerce of the United States." Also, the CEA does not apply to swaps transactions outside the United States unless the transaction evades provisions of CEA, included under DFA.[96]

Person Definition

The Commission and staff have issued several interpretations on different aspects of the Commission's extraterritorial reach. First, in the cross-border guidance,[97] the Commission noted that, for purposes of section 2(i) of the CEA, a US person includes the following:

(i) Natural person who is a U.S. resident;

(ii) Estate of a decedent who was a U.S. resident;

(iii) An enterprise (e.g., corporation, partnership, limited liability company) that is organized or incorporated in the U.S., or has its principal place of business in the US;

(iv) A pension plan of employees of an enterprise described in (iii);

(v) A U.S. trust;

(vi) A collective investment vehicle that is majority-owned by US persons;

(vii) A legal entity that is majority-owned by US persons, and bears unlimited responsibility;

(viii) An account with US beneficial owner; and

(ix) A foreign branch of a US person.[98]

Further, according to the guidance, the following are not considered US persons but still trigger some regulatory obligations: (1) "Guaranteed Affiliates" (GAs); and (2) "Affiliate Conduits" (ACs). First, a GA is a non-US affiliate of a US person; that has its swap dealing obligations with non-US counterparties guaranteed by a US person.[99] An AC is a non-US person that is majority-owned by a US person that: (1) regularly enters into swaps with one or more of its US affiliates of its US person owner; and (2) the financial results of such non-US person are included in the consolidated financial statements of its US person owner.[100]

US Located Persons

Moreover, in the US, there have been a number of interpretations promulgated by CFTC staff regarding the activities of "US Located Persons." Footnote 513 of the Cross Border Guidance states that US branches of non-US SDs are subject to transaction-level requirements without substituted compliance but does not mention affiliates.[101] The Division of Swap Dealer and Intermediary Oversight (DSIO) clarified the meaning of this footnote by publishing Advisory 13-69,[102] which stated that a non-US SD (including an affiliate of a US SD), regularly using personnel or agents located in the US to arrange, negotiate, or execute a swap with a non-US person, must comply with Transaction-Level requirements even if trades are booked in a non-US branch of the non-US SD.

Subsequently, staff from three divisions[103] of the Commission issued No-Action Letter 14-01[104]—which provided relief to non-US SDs using personnel in the US to arrange, negotiate, or execute swaps with non-US counterparties that are not guaranteed or conduit affiliates. That relief provided that such entities are not required to adhere to transaction level requirements. The relief is time-limited, and stipulated that if a counterparty is a non-US SD, it must nevertheless adhere to portfolio compression and relationship documentation requirements. In response to questions from market participants, the CFTC then published a Request for Comment on the Advisory.[105] Among the questions raised in the advisory were:

(1) Should the CFTC adopt the advisory?

(2) If so, should it only apply to Guaranteed Affiliates or Affiliate Conduits? and

(3) Should the Staff offer substituted compliance?

Finally, the advisory posed the additional questions of, "What is the appropriate meaning of "regularly," "arranging, negotiating, or executing," and "core front-office activity"? The Staff then followed with a roundtable discussion. As of this writing, these issues remain outstanding.[106]

Trade Execution

CFTC regulations require non-US exchanges to register as FBOTs in order to permit US persons to directly access their markets to trade futures contracts and options thereon.[107] By regulation, registered FBOTs can also list for trading swaps, including those that are subject to mandatory clearing, subject to certain conditions.[108] However, many FBOTs currently are operating under Division of Market Oversight (DMO) no-action relief which do not address the trading of swaps. DMO staff in 2013 issued additional no-action relief permitting these exchanges (Grandfathered FBOTs) to list for trading swaps while waiting for decisions on their applications for FBOT registration.[109]

Also, on November 15, 2013, DMO issued guidance stating that it expects that the following will register as a SEF (or DCM): a non-US multilateral swaps trading platform that provides the ability to trade swaps (directly or indirectly) to: (1) US Persons; or (2) "US-located persons" (i.e., located in US, including personnel and agents of non-US persons located in US).[110] DMO and the DSIO have also issued letters providing relief to non-US trading facilities that meet the conditions provided in the letter from the requirement to register as SEFs, by becoming QMTFs.[111]

Clearing

Under CFTC regulation, non-US CCPs may register as DCOs, and several foreign CCPs are already registered as such.[112] Further, the CEA provides that the Commission may draft regulations to allow non-US CCPs to be exempted from the DCO requirement.[113] Staff of the Division of Clearing and Risk (DCR) has stated that they are drafting a proposal for the Commission's consideration to exempt non-US DCOs that are comprehensively and comparably regulated. One significant aspect of the staff's consideration is that they would recommend to the Commission that any exemption only apply "to members that engage in proprietary clearing, not clearing for customers.[114] During the interim period, DCR has provided no action relief to at least one non-US CCP that intends to apply for exempt DCO status, once the applicable CFTC rules are proposed and finalized, permitting them, subject to certain conditions, to clear for US persons in the interim.[115]

B. EU

Statutory Provision

Under EMIR, the clearing obligation exists if both counterparties are 3rdCE and (1) contract has a "direct, substantial and foreseeable effect" within the EU; or (2) clearing obligation is "necessary or appropriate to prevent the evasion of any provisions of EMIR."[116] There is also a clearing obligation if swap is between FC, NFC+ or 3rdCE, and the 3rdCE would be subject to the clearing obligation if it was established in the EU.[117] Pursuant to EMIR regulatory technical standards,[118] a contract between two 3rdCEs is considered to have a "direct, substantial and foreseeable effect of contracts within the Union" if: (1) part or all of the liability resulting from the contract is guaranteed by a counterparty established in the EU; or (2) both of the 3rdCEs use their branches in the EU to enter into the transaction, and both would qualify as FCs if they were established in the EU.[119]

Person Definition

Similar to US law, EU law notes that EU persons' guaranteed affiliates and foreign branches are subject to the EC's authority. Under the EMIR technical standards however, the guaranteed affiliate prong has a de minimis exception; the notional amount of the contracts that are so guaranteed must equal or surpass 8B Euro; and be at least 5% of the EU guarantor's total OTC derivative exposure.[120]

Trading and Clearing

EU rules permit swaps subject to mandatory clearing to be executed on a 3rdCE trading venue which the EC determines is: (1) subject to equivalent regulation, and (2) is in a jurisdiction that reciprocally recognizes EU venues. [121] A derivative that is subject to the trading obligation of a non-EU jurisdiction may also be subject to the trading obligation in the EEA if it would have been subject to the clearing obligation if it was established in the EU.[122]

In terms of EU regulation, regarding recognizing non-EU clearing organizations, EU law states that non-EU CCPs cannot clear contracts for EU members, unless authorized by an EU Member state.[123] This means that these non-EU CCPs also cannot clear for foreign branches of EU Firms, though they can clear for foreign *subsidiaries* of EU firms.[124] In this way, EU law differs from US law which permits the Commission to draft regulations exempting non-US CCPs that are comprehensively and comparably regulated to be exempted from the DCO requirement. All non-EU CCPs clearing for EU members, at the time of passage, were required to apply for registration by September 15, 2013.[125] Pursuant to EMIR, a non-EU CCP can be permitted to clear if it has been "recognised" by the EC. As of this writing, 38 non-EEA CCPs have applied for recognition, including eight US CCPs.[126] The requirements for recognizing non-EU CCPs include:

(1) The CCP must be authorized in a jurisdiction where it is subject to "effective supervision and enforcement";

(2) The EU and the applicable jurisdiction have cooperation arrangements in place;

(3) The applicable jurisdiction has equivalent anti-money laundering and anti-terrorism financing regulation; and

(4) The EC has adopted an "implementing act," regarding the jurisdiction, after it has determined that:

   (a) The legal and supervisory arrangements of a the jurisdiction ensure that its CCPs authorised comply with legally binding requirements that are "equivalent" to EMIR's requirements;

   (b) The CCPs are subject to "effective supervision and enforcement" on an ongoing basis; and

   (c) The jurisdiction has an equivalent system for recognizing CCPs outside of its jurisdiction.[127]

In summary, in order for the EC to recognize a non-EU CCP, the EC must determine that the non-EU CCP is in full compliance with the regulation of a regime with regulations that are equivalent to EMIR.

To aid the EC in deciding whether to adopt an implementing act for the US, ESMA performed an equivalence determination and found US rules were not comparable in several areas, including the following requirements for CCPs': governance, business continuity, margin, default, financial resources, liquidity risk, investment policy, and testing of models.[128] Because of these gaps, ESMA recommended that EC consider US DCOs equivalent only if, among other things, they adopt and maintain legally binding policies and procedures that are "equivalent" to those required under EMIR.[129]

In regard to trading, 3rdCE execution venues that are deemed equivalent may also trade products, subject to mandatory trade execution.[130]

VII. Conclusion

In keeping with the G-20 commitments, the US and EU have enacted and are in the process of implementing broadly similar rules. For instance, both jurisdictions have a mandatory clearing regime, similar requirements for clearing organizations, criteria for mandatory trade execution, and extraterritorial provisions. However, as detailed above, there are significant regulatory differences between the two regimes. It will remain to be seen whether the regulatory authorities are able to harmonize these differences going forward or whether, once both regulatory regimes are fully implemented, these differences will become a source of regulatory arbitrage.

The chart below provides a summary of US and EU requirements:

A. US – Regulatory Overview

SD	Clearing Obligation (Inter-Affiliate Exception). Reporting Obligation. Risk Mitigation. Registration.
MSP	Clearing Obligation (Inter-Affiliate Exception). Reporting Obligation. Risk Mitigation (except scenario analysis, institutional suitability). Registration.
FE	Clearing Obligation (Inter-Affiliate Exception). Reporting Obligation.
End User	Reporting Obligation (Inter-Affiliate Exception).
3rd CE	If it meets applicable extraterritorial standard: Possible Clearing Obligation. Possible Reporting Obligation (Large Trader Reporting). Possible Risk Mitigation (substituted compliance). Possible Registration.

B. EU – Regulatory Overview

FC	Clearing Obligation (Intragroup Exemption). Reporting Obligation. Risk Mitigation (timely confirmation, portfolio compression / reconciliation, dispute resolution, daily valuation, margining, capital) (Intragroup Exemption from margin).
NFC+	Clearing Obligation. Reporting Obligation. Risk Mitigation (all except capital).
NFC-	Reporting Obligation. Risk Mitigation (timely confirmation, portfolio reconciliation / compression, dispute resolution).
3rd CE	Clearing Obligation (if hypothetical FC / NFC+). Risk Mitigation I (timely confirmation, portfolio reconciliation / compression, dispute resolution) if 2 hypothetical FCs/NFCs trade and it meets extraterritorial standard. Risk Mitigation II (all above and daily variation, margining) if 2 hypothetical FCs/NFCs+ trade and it meets extraterritorial standard.

NOTES

1. *See* "Leaders' Statement – The Pittsburgh Summit," at 9, (September 24-25, 2009), *available at* https://www.g20.org/about_g20/past_summits/2009_pittsburgh.
2. Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111–203, 124 Stat. 1376 (2010).
3. *See* section 3(a)(68) of the Exchange Act, and CEA 1a(44), respectively. Unless otherwise specified, this article focuses on the CFTC's regulation, not the SEC's.
4. Several of the EC's laws apply to the European Economic Area (EEA), which includes all but one of the states in the EU as well as three member states that are not part of the EU, but are part of the European Free Trade Association (Iceland, Liechtenstein, and Norway).
5. EMIR came into force on August 16, 2012.
6. MiFID and MiFIR were published in the EU Official Journal on June 12, 2014. EC regulations (such as MiFIR) have binding legal force throughout every Member State as soon as they are passed (like national laws), while directives (such as MiFID) are addressed to national authorities, who must then take action to make them part of national law. *See* "Application of EU Law," *available at* http://ec.europa.eu/eu_law/introduction/what_regulation_en.htm.
7. Specifically, in determining whether a product must be subject to mandatory clearing, US law requires that the CFTC consider five criteria:

   (1) "The existence of significant outstanding notional exposures, trading liquidity, and adequate pricing data";

   (2) "The availability of rule framework, capacity, operational expertise and resources, and credit support infrastructure to clear the contract on terms that are consistent with the material terms and trading conventions on which the contract is then traded";

   (3) "The effect on the mitigation of systemic risk, taking into account the size of the market for such contract and the resources of the derivatives clearing organization available to clear the contract";

   (4) "The effect on competition, including appropriate fees and charges applied to clearing"; and

   (5) "The existence of reasonable legal certainty in the event of the insolvency of the relevant derivatives clearing organization or 1 or more of its clearing members with regard to the treatment of customer and swap counterparty positions, funds, and property."

   CEA 2(h)(2)(D).
8. EMIR, Title II, Article 5(4). The technical standards further specify the criteria stating:

   In relation to the degree of standardisation of the contractual terms and operational processes of the relevant class of OTC derivative contracts, ESMA shall take into consideration:

   (a) whether the contractual terms of the relevant class of OTC derivative contracts incorporate common legal documentation, including master netting agreements, definitions, standard terms and confirmations which set out contract specifications commonly used by counterparties;

   (b) whether the operational processes of that relevant class of OTC derivative contracts are subject to automated post-trade processing and lifecycle events that are managed in a common manner to a timetable which is widely agreed among counterparties.

   2. In relation to the volume and liquidity of the relevant class of OTC derivative contracts, ESMA shall take into consideration:

   (a) whether the margins or financial requirements of the CCP would be proportionate to the risk that the clearing obligation intends to mitigate;

   (b) the stability of the market size and depth in respect of the product over time;

   (c) the likelihood that market dispersion would remain sufficient in the event of the default of a clearing member;

   (d) the number and the value of the transactions.

   3. In relation to the availability of fair, reliable and generally accepted pricing information in the relevant class of OTC derivative contracts, ESMA shall take into consideration whether the information needed to accurately price the contracts within the relevant class of OTC derivative contracts is easily accessible to market participants on a reasonable commercial basis and whether it would continue to be easily accessible if the relevant class of OTC derivative contracts became subject to the clearing obligation.

   See "Commission Delegated Regulation (EU) No 149/2013 of 19 December 2012 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on indirect clearing arrangements, the clearing obligation, the public register, access to a trading venue, non-financial counterparties, and risk mitigation techniques for OTC derivatives contracts not cleared by a CCP," ("Clearing Obligation RTS"), Chapter IV, Article 7.

9. "Clearing Requirement Determination Under Section 2(h) of the CEA; Final Rule," 77 *Fed. Reg*. 74284 (Dec. 13, 2012). Specifically, interest rate swaps required to be cleared include:
   (a) Fixed-to-Floating Interest Rate Swaps with a tenor of 28 days and 50 years (in Dollar, Euro, Yen, British Pound);
   (b) Forward Rate Swaps with a tenor of 3 days to 3 years (in Dollar, Euro, Yen, British Pound);
   (c) Basis Swaps with a tenor of 28 days to 50 years (in Dollar, Euro, Yen, British Pound); and
   (d) Overnight Index Swaps with a tenor of 7 days to 2 years (in Dollar, Euro, British Pound).
10. *Id*. Specifically, the credit default index swaps required to be cleared include:
   (a) North American Untranched (CDX.NA.IG and CDX.NA.HY); and
   (b) European Untranched (iTraxx Europe, iTraxx Europe Crossover, and iTraxx Europe HiVol).

   Only a subset of these swaps is currently subject to the mandatory trade execution requirement.

   The US mandatory clearing requirement does not apply, to foreign exchange swaps and forwards. *See* "Determination of Foreign Exchange Swaps and Foreign Exchange Forwards under the Commodity Exchange Act; Final Determination," 77 *Fed. Reg.* 69694 (Nov. 20, 2012). *See also* CFTC Rule 1.3(xxx)(3). US law, unlike EU law, also makes a distinction between swaps and security-based swaps, one regulated by the CFTC and the other by the SEC. *See* CEA 1a(47)(B)(x).
11. *See* "Consultation Paper: Clearing Obligation under EMIR (no. 1)," available at http://www.esma.europa.eu/consultation/Consultation-paper-Clearing-Obligation-no1-IRS; *see also* "Consultation Paper: Clearing Obligation under EMIR (no. 2)," available at http://www.esma.europa.eu/consultation/Consultation-paper-Clearing-Obligation-no2-CDS. *See* also "Discussion Paper: The Clearing Obligation under EMIR," at 6, *available at* http://www.esma.europa.eu/consultation/Discussion-Paper-Clearing-Obligation-under-EMIR. *See* press release on "ESMA defines central clearing of interest rate and credit default swaps," *available at* http://www.esma.europa.eu/news/Press-release-ESMA-defines-central-clearing-interest-rate-and-credit-default-swaps?t=326&o=home.
12. CFTC Rule 39.5(a).
13. CFTC Rule 39.5(b).
14. CFTC Rule 39.5(c).
15. Pursuant to EMIR, Title III, Chapter 1, Articles 14, 15; and Title III, Chapter 4, Article25.
16. EMIR, Title II, Article 5(2).
17. EMIR, Title II, Article 5(3).
18. CEA 2(h)(1). Specifically, interest rate swaps required to be cleared include:
   (a) Fixed-to-Floating Interest Rate Swaps with a tenor of 28 days and 50 years (in Dollar, Euro, Yen, British Pound);
   (b) Forward Rate Swaps with a tenor of 3 days to 3 years (in Dollar, Euro, Yen, British Pound);
   (c) Basis Swaps with a tenor of 28 days to 50 years (in Dollar, Euro, Yen, British Pound); and
   (d) Overnight Index Swaps with a tenor of 7 days to 2 years (in Dollar, Euro, British Pound).

   Credit default index swaps required to be cleared include:
   (a) North American Untranched (CDX.NA.IG (investment grade) and CDX.NA.HY (high yield)); and
   (b) European Untranched (iTraxx Europe, iTraxx Europe Crossover, and iTraxx Europe HiVol).
19. CEA 2(h)(7)(C). These are entities that are not, themselves, eligible for the End-User Exception; however if their counterparty is eligible for the Exception and elects to use it, the swap transaction does not have to be cleared. CEA 2(h)(7)(A).
20. *Id*.
21. CEA 2(h)(7)(C). The Exception also has a notification requirement; the entity must notify the Commission of use of the Exception, and inform the Commission of how it will meet its financial obligations regarding the swap(s). CEA 2(h)(7)(A)(iii). Also eligible for the End-User Exception, among others, subject to certain conditions, are small banks (less than $10 Millon), captive finance companies, and affiliates of non-financial companies. *Id*.; *see also* CFTC Rule 39.6(d).
22. Specifically, the following are subject to the mandatory clearing requirements:
   (1) Two "Financial Companies" (FCs);
   (2) Two "Non-Financial Companies" for whom the notional value of their swap transactions surpasses a certain threshold (NFC+s);
   (3) A FC and a NFC+;
   (4) A FC or NFC+ and a 3rdCE that would be subject to the clearing obligation if it were established in the EU (e.g., the 3rdCE would be considered a FC or NFC+);
   (5) Two 3rdCEs that 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 such obligation is "necessary or appropriate" to prevent the evasion of EMIR.

EMIR, Title II, Article 4(1)(a). The FC category includes:
(1) Banks;
(2) Insurance/assurance/reinsurance undertakings;
(3) Alternative investment funds;
(4) Investment firms;
(5) Undertakings for Collective Investment in Transferable Securities (UCIT); and
(6) Occupational pension schemes.

EMIR, Title I, Article 2(8).

23. EMIR, Title I, Article 2(9). The thresholds are that NFC's average position over 30 days of non-hedging (including intragroup) contracts exceeds:
(1) EUR $1 B - credit and equity derivatives; and
(2) EUR $3 B - interest rate, forex, commodity, others. And third, if Third Country Entities (3rdCE) meet the definition of FC, or NFC+, they can be subject to certain mandatory clearing (and risk mitigation) requirements.
See Clearing Obligation RTS, Chapter 7, Article 11.

24. EMIR, Title II, Article 4(1)(a), and Article 10(1).

25. EMIR, Title II, Article 10(3). In the Clearing Obligation RTS (Chapter VII, Article 10), the standard for determining whether a transaction meets this hedging definition include:

> (1) "it covers the risks arising from the potential change in the value of assets, services, inputs, products, commodities or liabilities that the non-financial counterparty or its group owns, produces, manufactures, processes, provides, purchases, merchandises, leases, sells or incurs or reasonably anticipates owning, producing, manufacturing, processing, providing, purchasing, merchandising, leasing, selling or incurring in the normal course of its business;"
>
> (2) "it covers the risks arising from the potential indirect impact on the value of assets, services, inputs, products, commodities or liabilities referred to in point (a), resulting from fluctuation of interest rates, inflation rates, foreign exchange rates or credit risk;" and
>
> (3) "it qualifies as a hedging contract pursuant to International Financial Reporting Standards (IFRS)."

26. However, hedging activity would not be included in the swaps counted towards determining if an NFC surpasses the threshold.

27. *See* "Clearing Exemption for Swaps Between Certain Affiliated Entities; Final Rule," 78 *Fed. Reg*. 21750 (April 11, 2013).

28. EMIR, Title II, Article 4(2). Parties to intragroup transactions may also able to avoid risk mitigation requirements. For instance, parties in the same Member state can avoid risk mitigation requirements if there are no legal or practical impediments to the prompt transfer of funds or repayment of liabilities between them. EMIR, Title II, Article 11(5) and (6).

29. CFTC Rule 38.8.

30. CFTC Rule 38.601.

31. CFTC Rule 37.3(a)(1). The rule states:

> Any person operating a facility that offers a trading system or platform in which more than one market participant has the ability to execute or trade swaps with more than one other market participant on the system or platform shall register the facility as a swap execution facility under this part or as a designated contract market under part 38 of this chapter.

32. CFTC Rule 37.202(a).

33. CFTC Rule 37.9(a)(2).

34. CFTC Rule 37.9(a)(2)(i)(B).

35. CFTC Rule 37.9(a)(2)(ii).

36. The non-US venue that is temporarily registered as a SEF is ICAP Global Derivatives Limited, which is based in London, England. *See* "Trading Organizations - Swap Execution Facilities (SEF)," *available at* http://sirt.cftc.gov/SIRT/SIRT.aspx?Topic=SwapExecutionFacilities. Also, as of this writing, Australian-based Yieldbroker Pty Limited, has applied for registration as a SEF, and has received no action relief during the pendency of its application to operate as a SEF, subject to certain conditions including that it cannot list swaps subject to a mandatory trade execution. *See* CFTC Press Release 6976-14, available at http://www.cftc.gov/PressRoom/PressReleases/pr6976-14.

37. Article 4(21) states:

> regulated market' means a multilateral system operated and/or managed by a market operator, which brings together or facilitates the bringing together of multiple third-party buying and selling interests in financial instruments—in the system and in accordance with its non-discretionary rules—in a way that results in a contract, in respect of the financial instruments admitted to trading under its rules and/or systems, and which is authorised and functions regularly and in accordance with Title III of this Directive;

38. MiFID II, Title III, Articles 45 and 46.

39. MiFID II, Title III, Article 47.

40. *See* MiFID II, Title III, Article 52.
41. MiFIR, Title V, Article 29(1).
42. MiFID II, Title III, Article 47(1)(d).
43. MiFID II, Title III, Article 47(2).
44. MiFID II, Title I, Article 4(1)(22) states:

    'multilateral trading facility' or 'MTF' means a multilateral system, operated by an investment firm or a market operator, which brings together multiple third-party buying and selling interests in financial instruments—in the system and in accordance with non-discretionary rules—in a way that results in a contract in accordance with Title II of this Directive;

45. MiFID II, Title II, Article 19(1).
46. MiFID II, Title II, Article 19(5).
47. MiFID II, Title II, Article 18(3). .
48. "Regulation of the European Parliament and of the Council on markets in financial instruments and amending Regulation (EU) No 648/2012" ("MiFIR"), Article 2(1)(15); MiFID II, Article 4(1)(23) states:

    'organised trading facility' or 'OTF' means a multilateral system which is not a regulated market or an MTF and in which multiple third-party buying and selling interests in bonds, structured finance products, emission allowances or derivatives are able to interact in the system in a way that results in a contract in accordance with Title II of this Directive;

49. MiFID II, Chapter 1, Article 20(6) states:

    Member States shall require that the execution of orders on an OTF is carried out on a discretionary basis. An investment firm or market operator operating an OTF shall exercise discretion only in either or both of the following circumstances:

    (a) when deciding to place or retract an order on the OTF they operate;
    (b) when deciding not to match a specific client order with other orders available in the systems at a given time, provided it is in compliance with specific instructions received from a client and with its obligations in accordance with Article 27.

50. MiFID II, Chapter 1, , Article 20(2).
51. *See e.g.*, MiFIR, Chapter 2, Article 8(2).
52. MiFIR, Title II, Chapter 2, Article 8 reads:

    1. Market operators and investment firms operating a trading venue shall make public current bid and offer prices and the depth of trading interests at those prices which are advertised through their systems for bonds, and structured finance products, emission allowances and derivatives traded on a trading venue. That requirement shall also apply to actionable indication of interests. Market operators and investment firms operating a trading venue shall make that information available to the public on a continuous basis during normal trading hours. That publication obligation does not apply to those derivative transactions of non-financial counterparties which are objectively measurable as reducing risks directly relating to the commercial activity or treasury financing activity of the non-financial counterparty or of that group.

    2. The transparency requirements referred to in paragraph 1 shall be calibrated for different types of trading systems, including order-book, quote-driven, hybrid, periodic auction trading and voice trading systems.

53. MiFID II, Title II, Chapter 2, Section 2, Article 25(4)(a).
54. CEA 2(h)(8).
55. CFTC Rule 37.10(a)(1) and CFTC Rule 38.12(a)(1).
56. CEA 2(h)(8); CFTC Rules 37.10(a)(1) and 38.12(a)(1)
57. CFTC Rule 37.10(b) and CFTC Rule 38.12(b).
58. MiFIR, Title V, Article 28(1).
59. MiFIR, Title V, Article 28(3).
60. MiFIR, Title V, Article 32(2).
61. MiFIR, Title V, Article 32(3).
62. MiFIR, Title V, Article 29(2).
63. CFTC Rule 45.8. For exchange-traded swaps, the Exchange usually reports creation data, and the DCO reports confirmation data.
64. EMIR, Article 9(1).
65. *Id*.
66. *Id*.
67. CFTC Rule 45.3; Appendix 1 to Part 45.
68. CFTC Rule 45.1 ("Required swap continuation data means all of the data elements that must be reported during the existence of a swap to ensure that all data concerning the swap in the swap data repository remains current and accurate, and includes all changes to the primary economic terms of the swap occurring during the existence of the swap. For this purpose, required swap continuation data includes: (1) All life cycle event data for the swap if the swap is reported using the life cycle reporting method, or all state data for the swap if the swap is reported using the snapshot reporting method; and (2) All valuation data for the swap.")
69. CFTC Rule 45.4(b)(2) ("Valuation data for the swap must be reported as follows: (i) By the derivatives clearing organization, daily; and (ii) If the reporting counterparty is a swap dealer or major swap participant, by the reporting coun-

terparty, daily. Non-SD/MSP reporting counterparties are not required to report valuation data for cleared swaps.")

70. *See* "Commission Delegated Regulation (EU) No 148/2013 of 19 December 2012 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories with regard to regulatory technical standards on the minimum details of the data to be reported to trade repositories" ("Trading Obligation RTS"), Article 1(1).
71. Trading Obligation RTS, Annex, Table 1.
72. Trading Obligation RTS, Article 3(5).
73. Trading Obligation RTS, Article 3(4).
74. Trading Obligation RTS, Article 4
75. Trading Obligation RTS, Annex, Table 1.
76. ESMA Equivalence Assessment, at 22-5.
77. *Id*. at 177.
78. *Id*. at 22-25
79. *Id*. at 175-6.
80. ESMA Equivalence Assessment, at 22-5. CEA section 21(d) mandates that before an SDR may share the requested swap data or information with foreign regulators, the regulators must agree in writing to abide by confidentiality requirements established in the CEA and to indemnify the SDR and the Commission for any expenses arising from litigation relating to the information provided by the SDR. On October 22, 2012, the Commission issued an Interpretive Statement, to, under certain circumstances, exempt foreign regulators from these indemnification and confidentiality provisions. *See* "Swap Data Repositories: Interpretative Statement Regarding the Confidentiality and Indemnification Provisions of Section 21(d) of the Commodity Exchange Act," 77 Fed. Reg. 65177 (Oct. 25, 2012).
81. *Id*. at 25.
82. "Confirmation, Portfolio Reconciliation, Portfolio Compression, and Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants," 77 *Fed. Reg*. 55904 (September 11, 2012).
83. CFTC Rule 23.431.
84. CFTC Rule 23.503.
85. CFTC Rule 23.502. There is a de minimis provision for resolving discrepancies. CFTC Rule 23.502(a)(5) and (b)(4). Also, dealers and MSPs have 5-day turnaround requirement to resolve any disputes with counterparties that are not dealers or MSPs. CFTC Rule 23.502(c)(2).
86. *See* "Capital Requirements of Swap Dealers and Major Swap Participants," 76 Fed. Reg. 27802 (May 12, 2011).
87. *See* "Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants," 76 Fed. Reg. 23732 (May 11, 2011). For margin, there is a proposed exemption for non-financial End-Users from margin. *Id*. at 23734.
88. EMIR, Title II, Article 11(1); Clearing Obligation RTS, Chapter VIII, Articles 12, 13, 14 and 15.
89. Clearing Obligation RTS, Title VIII, Article 12.
90. *Id*., Article 13.
91. *Id*., Article 14.
92. EMIR, Title II, Article 11(2). FCs and NFCs+ can mark to model in an inactive market. *Id*.
93. *Id*., Article 11(3).
94. *Id*., Article 11(4).
95. The SEC has also adopted rules about its extraterritorial reach. "Application of 'Security-Based Swap Dealer' and 'Major Security-Based Swap Participant' Definitions to Cross-Border Security-Based Swap Activities; Republication," 79 *Fed. Reg.* 47278 (Aug. 12, 2014).
96. CEA 2(i)(2); *see also* CFTC Rule 1.6(a).
97. *See* "Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations," 78 Fed. Reg. 45292, 45316 (July 26, 2013) ("Cross-Border Guidance").
98. *See* "Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations," 78 Fed. Reg. 45292, 45316 (July 26, 2013) ("Cross-Border Guidance").
99. Cross-Border Guidance at 45318-9.
100. *Id*.
101. Cross-Border Guidance at 45350.
102. Nov 14, 2013.
103. DSIO, DMO, and DCR.
104. CFTC Letter No. 14-01, No Action, Jan. 3, 2014, available at http://www.cftc.com/ucm/groups/public/@lrlettergeneral/documents/letter/14-01/pdf.
105. CFTC Solicits Comments Regarding Cross-Border Applicability Rules for Non-U.S. Swap Dealers and Non-U.S. Counterparties (Fed. Reg.) (January 8, 2014) (The CFTC published a request for comments regarding the Staff Advisory issued on November 14, 2013, in the Federal Register.)
106. September 15, 2014.
107. CFTC Rule 48.4(b); CFTC Rule 48.7(c)(iii) and (d).
108. CFTC Rule 48.7(c)(i).
109. CFTC Rule 48.6(c). CFTC Letter No. 13-46 (July 11, 2013).
110. "Division of Market Oversight Guidance on Application of Certain Commission Regulations to Swap Execution Facilities," at 2 (Nov. 15, 2013).
111. CFTC Letter No. 14-46 (April 9, 2014). The guidance does provide an exception for registered FBOTs.
112. These include: (1) ICE Clear Europe Limited, LCH, Clearnet SA, Natural Gas Exchange Inc., and Singapore Exchange Derivatives Clearing Limited. *See* "Derivatives Clearing Organiza-

tions," *available at* http://sirt.cftc.gov/sirt/sirt.aspx?Topic=ClearingOrganizations.

113. CEA 5b(h) ("The Commission may exempt, conditionally or unconditionally, a derivatives clearing organization from registration under this section for the clearing of swaps if the Commission determines that the derivatives clearing organization is subject to comparable, comprehensive supervision and regulation by the … appropriate government authorities in the home country of the organization.").

114. *See* Transcript of Global Markets Advisory Committee Meeting on May 21, 2014, at 18-9 (remarks by Phyllis Dietz).

[T]here will be no customer clearing. … [C]learing members can clear for themselves and for affiliates …. A non-US Clearing member can clear for a US affiliate. … [A] registered FCM, as long as it is clearing proprietary positions only, could also be included …. [E]ven if an affiliate were a "customer" in the foreign jurisdiction, as long as it is within our definition of proprietary, it is proprietary.

115. *See e.g.*, CFTC Letter 14-68 (May 7, 2014) (granting no-action relief to OTC Clearing Hong Kong Limited and certain of its clearing members, until Commission approves its application to be an exempt DCO); CFTC Letter No. 14-07 (Feb. 6, 2014) (providing relief to ASX Clear (Futures) Pty Limited ("ASXCLF") (which intended to apply for an exemption from DCO registration, for failure to register as a DCO until Commission exempts it from DCO registration); CFTC Letter No. 14-87 (June 26, 2014) (providing relief to Korea Exchange, Inc. for failure to register as a DCO until Commission exempts it from DCO registration).

116. EMIR, Title II, Article 4(1)(a)(v).

117. EMIR, Title II, Article 4(1)(a)(iv).

118. On 13 February 2014, the European Commission has adopted regulatory technical standards specifying the contracts that are considered to have a direct, substantial and foreseeable effect within the Union or to prevent the evasion of rules and obligations. *Available online* at http://eurlex.europa.eu/LexUrlServ/LexUrlServ.do?url=OJ:L:2014:085:0001:0003:EN:PDF.

119. "Commission Delegated Regulation (EU) No 285/2014 of 13 February 2014 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on direct, substantial and foreseeable effect of contracts within the Union and to prevent the evasion of rules and obligations" ("Extra-Territorial RTS") Article 2 and Article 3.

120. *Id.*, Article 2.

121. MiFIR, Title V, Article 28(4). The criteria to determine equivalence include:

(1) trading venues in that third country are subject to authorisation and to effective supervision and enforcement on an ongoing basis;

(2) trading venues have clear and transparent rules regarding admission of financial instruments to trading so that such financial instruments are capable of being traded in a fair, orderly and efficient manner, and are freely negotiable;

(3) issuers of financial instruments are subject to periodic and ongoing information requirements ensuring a high level of investor protection;

(4) it ensures market transparency and integrity via rules addressing market abuse in the form of insider dealing and market manipulation ….

122. MiFIR, Title V, Article 28(2).

123. EMIR, Title III, Chapter 4, Article 25 ("A CCP established in a third country may provide clearing services to clearing members or trading venues established in the Union only where that CCP is recognised by ESMA.").

124. *See* "EMIR: Frequently Asked Questions," Question #III(3), *available at* http://ec.europa.eu/internal_market/financial-markets/derivatives/index_en.htm, which states:

[Question:] Do third country's CCPs providing services outside of the EU need to be recognized under EMIR to provide services to EU branches located in that third country?

[Answer:] …Third-country branches of EU clearing members are considered to be established in the EU. Therefore, the relevant third country CCPs need to be recognized under EMIR in order to provide services to those branches. On the contrary, third country CCPs do not need to be recognized under EMIR to provide services to subsidiaries of EU firms incorporated in such third-country.

125. *See* "EMIR Timeline," *available at* http://www.esma.europa.eu/page/post-trading.

126. The eight US CCPs are: Chicago Mercantile Exchange Inc , Fixed Income Clearing Corporation, ICE Clear Credit LLC, ICE Clear U.S. Inc., LCH, Clearnet LLC, Minneapolis Grain Exchange Inc. , National Securities Clearing Corporation, and The Options Clearing Corporation. *See* full list at "List of applicant central counterparties (CCPs) established in non-EEA countries," *available at* http://www.esma.europa.eu/content/List-applicant-central-counterparties-CCPs-established-non-EEA-countries.

127. EMIR, Title III, Chapter 4, Article 25.

128. *See* "Final report: Technical Advice on Third Country Regulatory Equivalence under EMIR – US," at 19, *available at* http://www.esma.europa.eu/page/Third-non-EU-countries. One of the examples of gaps found by ESMA is in regard to the minimum liquidation times used to calculate initial margin. ESMA noted that the CFTC requires 1 day for futures/options/swaps on agricultural commodities, energy commodities, and metals, and 5 days for all other swaps. EMIR, on the other hand, requires 5 days for OTC derivatives and 2 days for other financial instruments and OTC derivatives that have the same risk characteristics as derivatives executed on regulated market or equivalent 3rdCE. *Id*., at 115. ESMA also identified a gap in the business continuity provisions, as EMIR requires that CCPs have a secondary processing site with a different geographical risk profile than the primary site, while the CFTC only requires backup facilities. *Id*., at 91-2. Another example of a gap that ESMA identified was in regard to other financial resources. EMIR requires that the financial resources are sufficient to cover the default of the two clearing members to which it has the largest exposure. CFTC rules require that the DCO have enough financial resources to cover the default of the largest clearing member (and a year's operating costs). *Id*., at 122-3.

129. *Id*., at 20-1. On June 27, Michel Barnier, European Commissioner for Internal Market and Services, announced that he would propose that the EC adopt equivalence decisions to allow clearinghouses from Japan, Singapore, Australia, Hong Kong and India to clear for EU members, but not from the US. In Mr. Barnier's statement, he suggested that the reason that the EC did not find the US CCPs equivalent is because the US had not provided a means to exempt non-US CCPs, in which the US deferred to the other jurisdictions' regulation over the non-US CCP; he stated: "If the CFTC also gives effective equivalence to third country CCPs, deferring to strong and rigorous rules in jurisdictions such as the EU, we will be able to adopt equivalence decisions very soon." *See* "Statement by Commissioner Barnier on Global Derivatives Regulation" (June 27, 2014):

> I intend to propose shortly that the European Commission adopt 'equivalence' decisions that will allow CCPs from five countries outside the EU – Japan, Singapore, Australia, Hong Kong and India - to clear EU derivatives trades. This will be done in full deference to the rules and supervisory systems of those countries. This is the right way and the only way to regulate this global market. Decisions for other countries should follow shortly afterwards. I am confident that this will also include the USA whose CCPs are truly global market infrastructures. Our technical talks with the CFTC are progressing well and I am confident that we can agree on outcomes-based assessments of our rules and on aligning key aspects of margin requirements to avoid arbitrage opportunities. If the CFTC also gives effective equivalence to third country CCPs, deferring to strong and rigorous rules in jurisdictions such as the EU, we will be able to adopt equivalence decisions very soon. I look forward to continuing my discussions with US partners as a priority matter.

See also David Bailey (FCA) comments at the GMAC meeting regarding CFTC staff proposal for exempt DCOs, at 33:

> A critical element of an overseas regime is having a reciprocal arrangement in place between the relevant regulators. Indeed, from a European perspective that is enshrined within the EMIR legislative text, and that's why I'm very pleased we'll have the opportunity to discuss the scope of the exempt DCO proposal that Phyllis has outlined today. From our perspective, a regime that applies only to member and not client trades would not be reciprocal, and it wouldn't resolve the issues I've outlined.

130. MiFID II, Title II, Chapter 2, Section 2, Article 25(4)(a).