I'M OK, EUR OK; AT LONG LAST, U.S.-EU CCP RECOGNITION IS MUTUAL

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On February 10, the U.S. Commodity Futures Trading Commission ("CFTC") and the European Commission ("EC") announced a much-anticipated transatlantic agreement to harmonize European Union ("EU") and U.S. regulations concerning central clearing counterparties ("CCPs"). The CFTC-EC agreement comes as financial regulatory authorities attempt harmonization of certain financial regulations across jurisdictions. As the CFTC continues implementation of rules required under the Dodd-Frank Wall Street Reform and Consumer Protection Act, CFTC Chairman Timothy Massad has reiterated a focus on harmonizing a host of the CFTC's derivatives rules with international standards. Further, Chairman Massad has signaled a commitment to continue collaboration with the EC, the European Securities Markets Authority ("ESMA"), and the Financial Conduct Authority to work to narrow differences between cross-border regulatory regimes.

LONG-AWAITED AGREEMENT

This CFTC-EC agreement is part of the larger movement, set forth by G20 leaders in 2009, to clear as many standardized over-the-counter ("OTC") derivative contracts as possible. Since 2009, G20 jurisdictions have promulgated rules requiring a large majority of derivative contracts to be cleared. G20 jurisdictions — the United States and Europe key among them — have been working together, sometimes in fits and starts, to increase harmonization among clearing requirements to facilitate global trading in the derivatives markets.

The increased use of clearinghouses has been favored by European regulators who prefer "prudential"-style regulation as opposed to the traditional U.S. disclosure-based regulation. This dynamic is also visible in the agreement, with the EU equivalence decision, which is based on a number of "prudential" conditions to be met by CFTC-registered U.S. CCPs seeking recognition in the EU. Importantly, ESMA has been consulting recently on the possibility of instituting an alternative client-margining standard, which is closer to the U.S. standard. The joint statement notes that it is necessary to proceed rapidly with the adoption of the relevant standard.

CFTC-EC AGREEMENT

CFTC Substituted Compliance. The agreement provides that the CFTC staff will also propose for adoption a determination of comparability concerning EU requirements, which will permit EU CCPs to provide their services in the U.S. while complying primarily with requirements under the European Market Infrastructure Regulation ("EMIR"). Moving forward, the EC and the CFTC, which represent the largest markets for derivatives globally, have committed to further collaboration to ensure that the agreement is applied consistently and regulatory

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arbitrage is prevented. Pursuant to the agreement, the CFTC staff will also propose to streamline the registration process for EU CCPs. The CFTC's substituted compliance is expected to be completed on the same timetable as the EU equivalence.

EU Equivalence. The agreement provides that the EC will propose for adoption shortly an equivalence decision regarding CFTC requirements for CCPs, so that the ESMA will be able to recognize U.S. CCPs seeking to provide services in EU markets. After recognition by the ESMA, U.S. CCPs will be allowed to provide services in the EU while complying primarily with U.S. requirements. Furthermore, such a CCP will be deemed a "qualifying" CCP for purposes of the EU Capital Requirements Regulation, thus reducing costs for EU financial institutions. Without the agreement, OTC derivatives cleared via non-qualifying CCPs would have been subject to the proposed initial and variation margin requirements for non-cleared OTC contracts. Under the agreement, the proposed determination for EU equivalence is based on the requirement that CFTC-registered U.S. CCPs pursuing recognition in the EU confirm that their internal rules and procedures provide the following:

- The collection of initial margin for clearing members' proprietary positions in exchange-traded derivatives, which takes into account a two-day liquidation period;
- Initial margin models that mitigate the risk of "procyclicality"; and
- Maintenance of "cover 2" default resources.

The agreement provides an exemption from these requirements for U.S. agricultural commodity derivatives traded and cleared in the United States. Importantly, the EC is expected to propose the adoption of a decision under the EMIR to establish an equivalency between U.S. trading venues and regulated EU markets.

Member state authorities will be required to vote in the European Securities Committee before an equivalence decision can be adopted by the EU. Such an adoption would trigger the ESMA recognition process for U.S. CCPs, during which CFTC-registered U.S. CCPs will continue to benefit from any extensions or other relief provided under the EU Capital Requirements Regulation.

OTHER HARMONIZATION EFFORTS

As the Committee on Payments and Market Infrastructures ("CPMI") and the International Organization of Securities Commissions ("IOSCO") continue their review of issues related to clearinghouse resilience, the EU and CFTC have identified this review as a potential opening to assess the quality of standards contained in the Principles for Financial Market Infrastructure regarding initial margin methodologies. The U.S. and Europe have participated in the CPMI-IOSCO review, and a report on clearinghouse strength and stability is expected to be released by mid-2016.

Notably, Chairman Massad is expected to soon request the CFTC to adopt a staff recommendation on the cross-border application of its margin for uncleared swaps rules. The CFTC has also announced the approval of the registration of Eurex Clearing, one of the largest clearinghouses in Europe, to further bolster the CFTC's efforts to achieve the international clearing and harmonization of derivatives regulations. Additionally, the CFTC is also expected to continue to be actively engaged in international efforts related to data harmonization.

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CONCLUSION

As regulators continue their work to achieve greater convergence of financial regulations, there will likely be opportunities for impacted financial firms and other stakeholders to play an essential role in influencing outcomes by advocating for sound policy solutions that could result in more certainty and stability for the marketplace. The U.S.-EC agreement represents a substantial step forward for U.S.-EU harmonization of financial regulation. However, many issues are still being debated — and face the risk of moving in conflicting directions — that will have far-reaching and tangible impacts for financial firms on both sides of the Atlantic.

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