

ESMA advises European Commission on equivalence of non-EU clearing and derivatives rules

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C L I F F O R D
C H A N C E



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ESMA advises European Commission on equivalence of non-EU clearing and derivatives rules

ESMA has delivered technical advice to the Commission on the equivalence of non-EU regulatory regimes for the purposes of EMIR:

- On 2 September 2013, covering the US, Japan, Australia, Hong Kong, Singapore, Switzerland;
- On 1 October 2013, covering Canada, India and South Korea with supplemental advice on Australia, Hong Kong, Singapore and Switzerland.

The advice covers the equivalence of the regulatory regimes in those states with respect to:

- **Central counterparties** (Article 25(6) EMIR) – all states;
- **Trade repositories** (Article 75(1) EMIR) – the US, Australia, Hong Kong and Singapore;
- **Duplicative or conflicting rules** on clearing, reporting, non-financial counterparty and risk mitigation (Article 13(2) EMIR) – the US, Japan, Australia, Hong Kong, Switzerland and Canada.

ESMA was not asked to advise whether any non-EU markets are equivalent to a regulated market for the purposes of the definition of OTC derivatives under EMIR.

The following table provides a high level summary of:

- the coverage of the advice delivered;
- the nature of ESMA's findings where it has delivered advice on equivalence.

Next steps

- ESMA has indicated that it has now fulfilled the Commission's mandate. ESMA will need an additional mandate for further advice (e.g. if there are applications to ESMA for recognition by CCPs from jurisdictions not covered by ESMA's advice).
- The Commission is not required to follow ESMA's advice: it will have to determine whether to adopt implementing acts under EMIR determining the equivalence of the relevant non-EU regimes. EMIR does not state a timetable for the adoption of these acts.
- The adoption of implementing acts is a pre-condition to the recognition of non-EU CCPs and trade repositories from these countries and for relief from duplicative and conflicting rules under EMIR when counterparties trade with counterparties from these countries (and the availability of the intra-group exemption).

More information is available on the ESMA website at www.esma.europa.eu

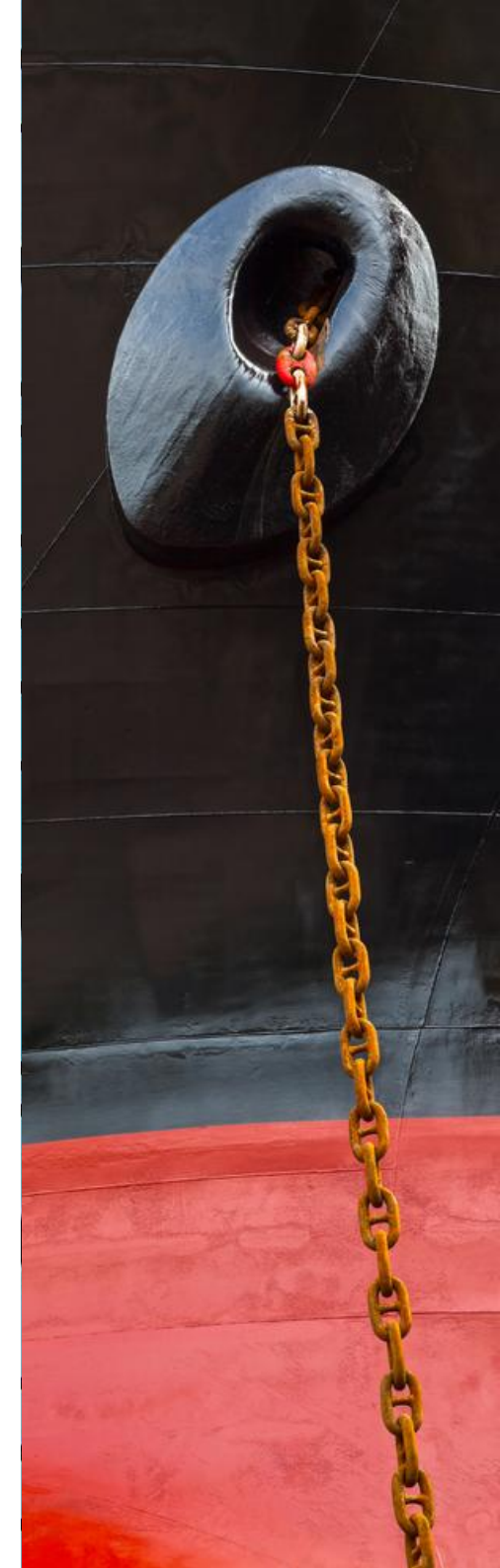
Summary table

	CCPs	Trade repositories	Duplicative or conflicting rules
US	✓ (conditional equivalence but reciprocity issues)	✓ (conditional equivalence)	✓ (partial/conditional equivalence)
Japan	✓ (conditional equivalence)		✓ (partial/conditional equivalence)
Australia	✓ (equivalence except ASX equities clearing)	✓ (equivalence)	✓ (partial/conditional equivalence)
Hong Kong	✓ (conditional equivalence)	✓ (premature to give advice)	✓ (premature to give advice)
Singapore	✓ (conditional equivalence)	✓ (conditional equivalence)	
Switzerland	✓ (equivalence)		✓ (premature to give advice)
Canada			✓ (premature to give advice)
India	✓ (conditional equivalence; but reciprocity issues)		
South Korea	✓ (conditional equivalence; but reciprocity issues)		
Rest of world			

Key:

Advice given:	2 September 2013	1 October 2013	No mandate for advice/more advice
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CCPs

ESMA's advice envisages conditional determinations for all covered countries (other than Australia and Switzerland) because:

- ESMA advises that there are a significant number of areas where there are no local legally binding requirements for CCPs equivalent to those in Title IV EMIR (the CFTC-Commission July 2013 "common path forward" had only identified differences in initial margin coverage for the US).
- ESMA recommends that the Commission considers that CCPs from those countries to be subject to equivalent legally binding requirements if the CCPs adopt internal policies, procedures, etc. incorporating provisions adequately addressing the gaps.
- ESMA would only recognise CCPs that have adopted such internal policies, procedures, etc.
- Internal policies, procedures, etc. would only qualify if they cannot be changed without the approval or non-objection of local regulator and if any departure from or failure to implement those policies, procedures, etc. can give rise to enforcement action.

ESMA concludes that for all covered countries:

- CCPs are subject to effective supervision and enforcement;
- The legal framework provides for an equivalent system for the recognition of third country CCPs, except the US (to the extent that the regime relies on no-action letters and otherwise requires full registration for non-US CCPs), India and (in relation to CCPs clearing instruments other than OTC derivatives) South Korea.

Trade repositories

ESMA's advice:

- For the US and Singapore, envisages conditional determinations on a similar basis as stated above for CCPs (because of areas where there are no local legally binding requirements for trade repositories equivalent to those in EMIR). No similar condition is envisaged for Australia.
- For the US, Australia and Singapore, concludes that there is effective supervision and enforcement and adequate guarantees of professional secrecy.

Even if there is an equivalence assessment, ESMA can only recognise a trade repository where an international agreement (a treaty) is in place with the non-EU state on mutual access to information.

No advice given for Japan because ESMA understands no Japanese trade repository intends to apply for recognition.

Duplicative or conflicting rules

ESMA's advice only covers the equivalence of the clearing obligation in Japan and Australia (because it would be premature to address other rules). The advice for the US covers equivalence for all the EMIR obligations referred to in Article 13 EMIR.

For the US, Australia and Japan, ESMA concludes that the local clearing obligation should be considered equivalent if:

- the product subject to the clearing obligation in the EU is also subject to the clearing obligation in the jurisdiction, and
- the counterparty in the jurisdiction is a non-exempted entity, or if exempted it would benefit from an equivalent exemption if established in the EU.

In line with “stricter-rule-applies” approach in the CFTC-Commission “common path forward” and report of the OTC Derivatives Regulators Group (September 2013).

ESMA's conclusions on the US rules corresponding to the following EMIR rules are as follows:

- **Reporting:** not equivalent.
- **Timely confirmation:** equivalent if EU counterparty transacts with CFTC regulated swap dealer (SD) or major swap participant (MSP) (but the EU reporting obligation would not be disapplied).
- **Portfolio reconciliation:** equivalent if:
 - EU financial counterparty or non-financial counterparty over the clearing threshold (NFC+) transacts with a CFTC regulated SD/MSP and the SD/MSP applies rules for timely confirmation applicable to transactions between SDs/MSPs and
 - Other EU non-financial counterparty (NFC-) transacts with SD/MSP and the SD/MSP applies the US rules applicable to transactions with other counterparties.
- **Portfolio compression:** equivalent if EU counterparty transacts with CFTC regulated SD/MSP.
- **Dispute resolution:** not equivalent.
- **Margin and capital:** cannot be assessed (EU rules not yet adopted).
- **Non-financial counterparties:** Assessment should follow the relevant rule.

ESMA's advice does not reach a specific conclusion as to whether there is an adequate guarantee of professional secrecy or whether the regime is applied in a equitable and non-distortive way for the purposes of Article 13 EMIR.

General

EMIR does not specifically envisage the possibility that the Commission can make a conditional determination of equivalence in relation to the recognition of CCPs and trade repositories (and it may be difficult for non-EU CCPs to meet the conditions specified by ESMA).

In relation to Article 13 (duplicative or conflicting rules):

- EMIR does not specifically envisage that the Commission can make an equivalence determination with respect to some of the relevant rules and not others.
- Nor does it specifically envisage that the Commission can make a conditional determination of equivalence.
- However, it may be possible to interpret Article 13(3) so that it only disapplies the relevant EMIR rule where an equivalent duplicative or conflicting rule applies to a counterparty or the transaction (to avoid the creation of loopholes).
- It is unclear whether a partial or conditional determination under Article 13(2) would allow a counterparty to rely on the exemption for intra-group transactions from the clearing or margining obligation under EMIR.
 - But ESMA advises that the Commission should allow transactions between EU and US members of a group to benefit from the exemption in relation to the clearing and (probably subject to the adoption of equivalent margining rules) the margin obligation under EMIR.
 - No similar comment is made in relation to the application of the intra-group exemption for Japan or Australia.

In a number of cases, the country in question is still developing or finalising its relevant regime and therefore ESMA concluded that it was premature to reach a conclusive analysis or deliver technical advice.

EMIR framework for equivalence assessments

CCPs	Article 25(6) EMIR	<p>The Commission may adopt an implementing act determining:</p> <ul style="list-style-type: none"> ▪ that the legal and supervisory arrangements of a third country ensure that CCPs authorised in that third country comply with legally binding requirements which are equivalent to the requirements laid down in Title IV of EMIR, ▪ that those CCPs are subject to effective supervision and enforcement in that third country on an ongoing basis; and ▪ that the legal framework of that third country provides for an effective equivalent system for the recognition of CCPs authorised under third-country legal regimes
Trade repositories	Article 75(1) EMIR	<p>The Commission may adopt an implementing act determining that the legal and supervisory arrangements of the relevant third country ensure that:</p> <ul style="list-style-type: none"> ▪ trade repositories authorised in that third country comply with legally binding requirements which are equivalent to those laid down in EMIR; ▪ effective supervision and enforcement of trade repositories takes place in that third country on an ongoing basis; and ▪ guarantees of professional secrecy exist, including the protection of business secrets shared with third parties by the authorities, and they are at least equivalent to those set out in EMIR.
Duplicative and conflicting rules	Article 13(2) EMIR	<p>The Commission may adopt an implementing act declaring that the legal, supervisory and enforcement arrangements of a third country:</p> <ul style="list-style-type: none"> ▪ Are equivalent to the requirements laid down under Articles 4, 9, 10 and 11 EMIR; ▪ Ensure protection of professional secrecy that is equivalent to that set out in EMIR; and ▪ Are being effectively applied and enforced in an equitable and non-distortive manner so as to ensure effective supervision and enforcement in that third country.

Note:

Article 2(7) EMIR defines an “OTC derivative” as a derivative contract the execution of which does not take place on a regulated market within the meaning of Article 4(1)(14) of MiFID or on a third country market considered equivalent to a regulated market in accordance with Article 19(6) of MiFID. Under Article 19(6) of MiFID a third country market will be considered as equivalent to a regulated market if it complies with equivalent requirements to those established under Title III of MiFID (requirements for regulated markets in the EU).

The Commission is required to publish a list of those markets that are considered equivalent but has not done so. ESMA’s Q&A indicate that as a result no non-EU markets are currently considered equivalent for the purposes of EMIR. The Commission has not published a mandate to ESMA seeking advice for this purpose.

Application of equivalence assessments

<p>CCPs Article 25(2) EMIR</p>	<p>Article 25(2) EMIR</p>	<p>Market participants may only use a third country CCP to satisfy their clearing obligation under EMIR where it has been recognised by ESMA.</p> <p>ESMA may recognise a third country CCP for the purposes of EMIR where the following conditions are met:</p> <ul style="list-style-type: none"> ▪ The Commission has adopted an implementing act on equivalence assessment under Article 25(6); ▪ The CCP is authorised in the relevant third country, and is subject to effective supervision and enforcement ensuring full compliance with the prudential requirements applicable in that third country; ▪ Cooperation arrangements have been established between ESMA and the relevant competent authorities of the third country; ▪ The CCP is established or authorised in a third country that is considered as having equivalent systems for anti-money laundering and combating the financing of terrorism to those of the EU in accordance with the criteria set out in the common understanding between Member States on third-country equivalence under Directive 2005/60/EC of the European Parliament and of the Council of 26 October 2005 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing.
<p>Trade repositories Article 75(1) EMIR</p>	<p>Article 75(1) EMIR</p>	<p>Market participants may only use a third country trade repository to satisfy their reporting obligation under EMIR where it has been recognised by ESMA.</p> <p>ESMA may recognise a third country trade repository where the following conditions are met:</p> <ul style="list-style-type: none"> ▪ The Commission has adopted an implementing act on equivalence under Article 75(1); ▪ The third country has entered into an international agreement with the EU under Article 75(2) (regarding mutual access to, and exchange of information on, derivative contracts held in trade repositories which are established in that third country, so that EU authorities have immediate and continuous access to all the information needed for the exercise of their duties); ▪ The third country has entered into cooperation arrangements under Article 75(3) to ensure that EU authorities (including ESMA) have immediate and continuous access to all the necessary information .
<p>Duplicative and conflicting rules</p>	<p>Article 13(3) EMIR</p>	<p>Where the Commission has adopted an implementing act on equivalence under Article 13(2) in relation to a third country, counterparties entering into a transaction subject to EMIR shall be deemed to have fulfilled the obligations contained in Articles 4, 9, 10 and 11 where at least one of the counterparties is established in that third country.</p>
<p>Intra-group transactions</p>	<p>Article 3(1) and (2) EMIR</p>	<p>Intra-group transactions between an EU counterparty and a counterparty in a third country are only exempt from the clearing and margin obligations if the Commission has adopted an implementing act on equivalence under Article 13(2) on that third country and certain other conditions are fulfilled under Articles 3, 4 and 11.</p>

- **CCP:** central counterparty
- **Clearing threshold:** the threshold size of derivatives positions specified for the purposes of determining whether a non-financial counterparty is subject to the clearing requirement under EMIR
- **Commission:** the European Commission
- **Derivative:** as defined in EMIR, i.e. a financial instrument as set out in points (4) to (10) Section C, Annex 1, MiFID, as implemented by the MiFID implementing regulation
- **EMIR:** the EU regulation on OTC derivatives, central counterparties and trade repositories
- **ESMA:** European Securities and Markets Authority
- **Financial counterparty:** as defined in EMIR, i.e. an investment firm, credit institution, insurance/reinsurance undertaking, UCITS, pension scheme and alternative investment fund managed by an alternative investment manager, in each case where authorised or registered in accordance with the relevant EU directive
- **MiFID:** the EU markets in financial instruments directive
- **Non-financial counterparty:** as defined in EMIR, i.e. an undertaking established in the EU which is not a financial counterparty
- **Third country:** a non-EU state
- **EU:** European Union

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