

Derivatives Alert

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Derivatives Regulators Reach Agreement on Cross-Border Harmonization for Central Clearing Counterparties

Recent regulatory actions by the U.S. Commodity Futures Trading Commission (CFTC) and the European Commission (EC) are bringing an end to years of negotiation on how to regulate central clearing counterparties (CCPs) operating in both the U.S. and the European Union. These actions implement a much-anticipated cross-border harmonization agreement for CCPs announced last month by CFTC Chairman Timothy Massad and Jonathan Hill, the European commissioner for Financial Stability, Financial Services and Capital Markets Union.

Under the agreement, the U.S. and EC agreed to a common approach on regulating CCPs operating in both the U.S. and the EU, which is expected to avert the market and liquidity fragmentation that had been threatening the increasingly global derivatives marketplace.¹ To implement the agreement, the EC determined on March 15, 2016, that CFTC regulatory requirements for CCPs are equivalent to EU requirements applicable to CCPs.² On March 16, 2016, the CFTC approved a substituted compliance framework for dually registered CCPs³ located in the EU and determined that certain EU rules applicable to CCPs are comparable to CFTC regulations.⁴

Significance of EC Determination

The EC's equivalence determination will allow the European Securities and Markets Authority (ESMA) to recognize U.S. CCPs.⁵ Once recognized by ESMA, a U.S. CCP will be able to provide services in the EU while complying with CFTC requirements. Additionally, market participants will be able to comply with the European clearing requirement by clearing trades through a U.S. CCP recognized by ESMA.⁶

¹ See "The U.S. Commodity Futures Trading Commission and the European Commission: Common Approach for Transatlantic CCPs" (Feb. 10, 2016).

² See European Commission press release IP/16/807, "European Commission Adopts Equivalence Decision for CCPs in USA" (March 15, 2016).

³ A dually registered CCP is a CCP that is both registered with the CFTC as a derivatives clearing organization and authorized in the EU pursuant to the European Market Infrastructure Regulation.

⁴ See "Comparability Determination for the European Union: Dually-Registered Derivatives Clearing Organizations and Central Counterparties," 81 Fed. Reg. 15260 (Mar. 22, 2016).

⁵ The CFTC is working with U.S. CCPs seeking recognition by ESMA to ensure ESMA has all the necessary information to review the CCPs' applications in a timely manner.

⁶ Article 4(1) of the European Market Infrastructure Regulation obligates certain counterparties to clear certain over-the-counter derivative contracts through a CCP. The first phase of the European clearing requirement, which will apply to certain categories of interest rate derivatives, is scheduled to begin in June 2016. See European Commission Delegated Regulation of 6 August 2015.

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The EC's equivalence determination also is significant because of its impact on European bank capital requirements. A U.S. CCP that has been recognized by ESMA will obtain qualifying CCP status across the EU; as a result, when calculating a bank's regulatory capital under the EU Capital Requirements Regulation, an EU bank's exposures to a qualifying CCP will be subject to a lower risk weight than the bank's exposures to a CCP that is not qualified.

Significance of CFTC Determination

As a result of the CFTC's determination, a CCP that is authorized in the EU and registered with the CFTC as a derivatives clearing organization (DCO) will be able to comply with certain CFTC requirements by complying with corresponding requirements under the European Market Infrastructure Regulation (EMIR) framework.⁷ Furthermore, the CFTC plans to provide a streamlined approach for EU CCPs that may wish to register with the

⁷ The CFTC requirements for which corresponding EMIR requirements can be substituted concern financial resources, risk management, settlement procedures and default rules.

CFTC in the future. On March 16, 2016, the CFTC staff also issued a no-action letter to provide limited relief from the application of CFTC regulations to discrete aspects of the non-U.S. clearing activities of an EU-based CCP that is registered with the CFTC as a DCO and authorized to operate in the EU.⁸

Additional Harmonization on the Horizon

CFTC Chairman Massad stated that the agreement "is a significant milestone in harmonizing regulation of our derivatives markets."⁹ The CFTC and EC's joint announcement also foreshadowed a determination expected shortly from the EC that U.S. trading venues are equivalent to regulated markets in the EU. We will monitor developments as regulators continue to recognize the importance of cross-border harmonization in an increasingly global marketplace.

⁸ See CFTC Letter No. 16-26 (Mar. 16, 2016).

⁹ See "[Statement of Chairman Massad Regarding Common Approach for Transatlantic CCPs](#)" (Feb. 10, 2016).