INVESTMENT COMPANY INSTITUTE

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CFTC and European Commission Agree on a Common Approach for Regulating CCP

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TO:

DERIVATIVES MARKETS ADVISORY COMMITTEE No. 5-16
ICI GLOBAL TRADING & MARKETS COMMITTEE No. 6-16
SECURITIES OPERATIONS ADVISORY COMMITTEE

RE:

CFTC AND EUROPEAN COMMISSION AGREE ON A COMMON APPROACH FOR REGULATING CCPs

The U.S. Commodity Futures Trading Commission ("CFTC") and the European Commission ("EC") recently announced a common approach to the regulation and supervision of central counterparties ("CCPs"). [1] This approach will allow CFTC-registered U.S. CCPs to operate in the EU and to satisfy certain EU requirements by complying with comparable U.S. rules. Similarly, EU CCPs will be permitted to operate in the U.S. while complying with EU regulations that are comparable to U.S. law. [2] The common approach to CCP regulation is designed to ensure that U.S. counterparties can continue to trade with EU counterparties once EU requirements for clearing interest rate swaps take effect on June 21, 2016. [3] The EC and CFTC expect that CFTC-registered U.S. CCPs will be in a position to be recognized by this date.

The CFTC and European regulators must take a number of actions before they can implement the common approach. From the European perspective, the EC intends to adopt shortly an equivalence decision with respect to CFTC requirements for U.S. CCPs. This decision will allow the European Securities and Markets Authority ("ESMA") to recognize U.S. CCPs as soon as practicable. To receive recognition by ESMA, U.S. CCPs will be required to confirm that their internal rules and procedures ensure:

- The collection of sufficient initial margin to cover a two-day liquidation period for

clearing members’ proprietary positions;
- That initial margin models include measures to mitigate the risk of procyclicality; and
- The maintenance of default resources sufficient to cover the simultaneous default of their two largest clearing members. [4]

ESMA also will execute a cooperation arrangement with the CFTC, providing for the ongoing sharing of information with respect to CFTC-registered U.S. CCPs recognized in the EU. [5]

The CFTC’s process for implementing the common regulatory approach calls for the CFTC staff to propose a determination of comparability for EU CCPs, which would permit these CCPs to operate in the U.S. while still complying with certain requirements set forth in the European Market Infrastructure Regulation (“EMIR”). The CFTC staff also will propose a streamlined registration process for EU CCPs wishing to register with the CFTC. The CFTC will need to adopt these staff recommendations to implement the common approach to CCP regulation.

The CFTC and EC have agreed to act as quickly as practicable to take the steps needed to implement their agreement. The CFTC staff and the European Commission Services intend to work to ensure that changes are implemented in a coordinated manner, to monitor the impacts resulting from the agreement, and to assess whether any further actions must be taken to ensure financial stability or prevent regulatory arbitrage. [6]

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endnotes

[1] See The United States Commodity Futures Trading Commission and the European Commission: Common approach for transatlantic CCPs (February 10, 2016), available at http://www.cftc.gov/PressRoom/PressReleases/cftc_euapproach021016

[2] EU CCPs would have to be registered with the CFTC but would be permitted to satisfy certain CFTC requirements by complying with EU regulations under substituted compliance.

[3] See ICI Memorandum No. 29522 (December 3, 2015), available at https://www.iciglobal.org/iciglobal/pubs/memos/memo29522.

[4] These conditions do not apply with respect to U.S. agricultural commodity derivatives traded and cleared within the U.S.

[5] In anticipation of the cross-border effects of EU trading requirements, the EC also intends to propose the adoption of an equivalence decision to determine that U.S. trading venues are equivalent to regulated markets in the EU, leveling the playing field between U.S. and EU execution venues.

[6] The regulators note that the potential for regulatory arbitrage arises in connection with

the current margin rules for financial instruments other than over-the-counter derivatives in client accounts. U.S. law requires CCPs to use a one-day minimum liquidation period for these instruments, applied on a gross basis, while EMIR Regulatory Technical Standards currently provide for a two-day minimum liquidation period, applied on a net basis. ESMA recently consulted on the possibility of allowing CCPs to apply a margin standard that would be more similar to U.S. rules. ESMA believes that its proposal would reduce opportunities for regulatory arbitrage. See ICI Memorandum No. 29671, available at, https://www.iciglobal.org/iciglobal/pubs/memos/memo29559.