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CFTC and European Commission Take Steps to Implement the Common Approach for Regulating CCPs

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TO: DERIVATIVES MARKETS ADVISORY COMMITTEE No. 7-16
ICI GLOBAL TRADING & MARKETS COMMITTEE No. 9-16
SECURITIES OPERATIONS ADVISORY COMMITTEE RE: CFTC AND EUROPEAN COMMISSION TAKE STEPS TO IMPLEMENT THE COMMON APPROACH FOR REGULATING CCPS

In February, the U.S. Commodity Futures Trading Commission ("CFTC") and the European Commission ("EC") agreed on a common approach to the regulation and supervision of central counterparties ("CCPs"), known as derivatives clearing organizations ("DCOs") in the U.S. [1] The common approach calls for the authorities to determine that their regimes for regulating CCPs are generally equivalent. This approach will facilitate the EU's recognition of U.S. DCOs and the registration of EU CCPs by the CFTC and permit EU and U.S. counterparties to comply with their clearing obligations in their respective jurisdictions. Both authorities have recently taken important steps to implement their agreement.

On March 15, the EC adopted an equivalence decision with respect to CFTC requirements for U.S. CCPs. [2] Under this equivalence decision, the CFTC's legal and supervisory arrangements over U.S. CCPs will be considered equivalent, in most respects, to the framework for CCP regulation described in the European Market Infrastructure Regulation ("EMIR"). As a practical matter, the EC's equivalence decision permits the European Securities and Markets Authority ("ESMA") to recognize U.S. CCPs to operate and provide clearing services in the EU and to satisfy certain EU requirements by complying with comparable U.S. rules. The EC's equivalence determination takes effect on April 5, 2016.

To receive recognition from ESMA, U.S. CCPs will be required to include in their rules specific risk management measures ensuring that initial margin is calculated and collected according to the following parameters:

- The CCP's rules must provide for the collection of sufficient initial margin to cover a two-day liquidation period, calculated on a net basis, for clearing members' proprietary positions;
- The CCP's initial margin models must include measures to mitigate the risk of

procyclicality; [3] and
- The CCP must maintain default resources sufficient to cover the simultaneous default of its two largest clearing members. [4]

On March 16, the CFTC adopted a comparability determination for EU CCPs, which permits these CCPs to register as DCOs and to comply with certain CFTC requirements by meeting similar requirements set forth in EMIR. [5] Specifically, the Commission's determination provides for substituted compliance with respect to most requirements for DCO financial resources, risk management, settlement procedures, and default rules and procedures. To further streamline the registration process, the CFTC staff issued limited no-action relief that excuses EU CCPs from complying with certain CFTC rules with respect to the non-U.S. clearing activities of these CCPs. [6] The CFTC's comparability determination and staff no-action relief take effect when the Federal Register publishes the comparability determination, which is expected to happen soon.

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endnotes

[1] See ICI Memorandum No. 29708 (February 17, 2016), available at https://www.iciglobal.org/iciglobal/pubs/memos/memo29708.

[2] European Commission, Commission Implementing Decision (EU) 2016/377 of 15 March 2016 on the equivalence of the regulatory framework of the United States of America for central counterparties that are authorised and supervised by the Commodity Futures Trading Commission to the requirements of Regulation (EU) No 648/2012 of the European Parliament and of the Council, available at http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016D0377&from=EN.

[3] The measures designed to limit procyclicality must be equivalent to at least one of the following: (i) measures applying a margin buffer at least equal to 25% of the calculated margin which the central counterparty allows to be temporarily exhausted in periods where calculated margin requirements are rising significantly; (ii) measures assigning at least 25% weight to stressed observations in the look-back period; and (iii) measures ensuring that margin requirements are not lower than those that would be calculated using volatility estimated over a 10 year historical look-back period.

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

[5] Commodity Futures Trading Commission, Comparability Determination for the European Union: Dually-Registered Derivatives Clearing Organizations and Central Counterparties (March 16, 2016), available at http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/federalregister031616.pdf.

[6] See Letter from Jeffrey M Bandman, Acting Director, Division of Clearing and Risk, CFTC

dated March 16, 2016, available at
http://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/16-26.pdf.
