

# COMMITTEE ON CAPITAL MARKETS REGULATION

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RE: European Union and United States Need to Resolve Differences Between Their  
Clearinghouse Requirements

Dear Messrs. Buenaventura, Gensler, and Pearson:

The Committee's staff has compared the proposed regulation of the E.U. over-the-counter derivatives market via the European Market Infrastructure Regulation ("EMIR") and the European Securities and Markets Authority ("ESMA") final technical standards ("E.U. regime") against the corresponding U.S. regulatory regime, chiefly comprising Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") and certain U.S. Commodity Futures Trading Commission ("CFTC") rules implementing Title VII ("U.S. regime"). The comparison revealed significant differences between the clearinghouse requirements of the two jurisdictions, as set forth in detail in the Appendix hereto. (For purposes of this memorandum, "clearinghouse" refers to "U.S. Derivatives Clearing Organizations" ("DCOs") or "E.U. Central Clearinghouse Counterparties" ("CCPs"), as the case may be).

The CFTC proposed guidance interprets Section 722 of Dodd-Frank<sup>1</sup> to require cross-border swaps between a U.S. person and a foreign person to be cleared by a CFTC-recognized clearinghouse.<sup>2</sup> Similarly, EMIR requires cross-border swaps between an E.U. person and a foreign person to be cleared by an ESMA-recognized clearinghouse.<sup>3</sup> Thus, the CFTC would require a swap between a U.S. and an E.U. bank to be cleared by a CFTC-

<sup>1</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act § 722, Pub. L. No. 111-203 (2010) [hereinafter "Dodd-Frank Act"].

<sup>2</sup> Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act, 77 Fed. Reg. 41,214, 41,218 (July 12, 2012) [hereinafter "Cross-Border Regulation"].

<sup>3</sup> Council & Parliament Regulation 648/2012, OTC Derivatives, Central Counterparties and Trade Repositories, 2012 O.J. (L201) 17 (EU) [hereinafter "OTC Regulation"].

recognized clearinghouse, while EMIR would simultaneously require such a swap to be cleared by an ESMA-recognized clearinghouse.

The CFTC proposed guidance has defined a “U.S person” broadly to include certain entities located in the E.U, for example, an E.U. branch or agency of a U.S. bank.<sup>4</sup> Because the European Commission has not yet implemented EMIR, the CFTC has issued exemptive orders that narrow the definition of “U.S. person” to exclude foreign branches until July 12, 2013. Chairman Gensler has indicated that this narrow definition is only temporary, and once the relevant orders expire, jurisdictional overlap between the CFTC proposed guidance and EMIR will once again be a concern.

Due to this jurisdictional overlap, E.U. and U.S. persons will only be able to clear E.U.-U.S. cross-border swaps in clearinghouses recognized by both the CFTC and the European Commission. If the conflicting requirements of the CFTC proposed guidance and EMIR is left unresolved, separate clearinghouses will necessarily develop for swaps between E.U. counterparties and swaps between U.S. counterparties, thus reducing netting opportunities for each class of swap and resulting in unnecessarily burdensome collateral requirements for market participants. There are two ways to resolve this jurisdictional overlap, either through “dual registration” or “foreign recognition.”

Dual registration would involve registration of an E.U. clearinghouse with the CFTC and of a U.S. clearinghouse with the ESMA, subjecting a dually registered clearinghouse to both E.U. and U.S. clearinghouse requirements. Where differences between the two regimes persist, a dually registered clearinghouse would comply with the more stringent requirements of either regime. A dually registered E.U. clearinghouse could clear E.U.-U.S. cross-border swaps and swaps between U.S. persons; similarly, a dually registered U.S. clearinghouse could clear E.U.-U.S. cross-border swaps as well as swaps between E.U. persons.

The “dual registration” solution presents two key concerns. First, because the more stringent requirements of each regime would apply to dually registered clearinghouses, these clearinghouses would impose more burdensome clearing requirements on their members than clearinghouses registered in only one jurisdiction. Market fragmentation and reduced netting opportunities may result if certain E.U. or U.S. clearinghouses choose to forego dual registration in order to offer members less burdensome clearing requirements. Second, although E.U. clearinghouses are able to register with the CFTC, for example LCH.Clearnet and ICE Europe,<sup>5</sup> EMIR does not allow foreign clearinghouses to register by the standard process applicable to E.U. clearinghouses.<sup>6</sup> Thus, U.S. clearinghouses would be unable to clear E.U.-U.S. cross-border swaps, or swaps between E.U. persons, while E.U. clearinghouses, registered with the CFTC, would be able to clear E.U.-U.S. cross-border swaps and swaps between U.S. persons.

The CFTC and European Commission both have the authority to grant “recognition” of a foreign clearinghouse regime. The Dodd-Frank Act authorizes the CFTC to recognize

<sup>4</sup> *Cross-Border Regulation*, *supra* note 2, at 41,234.

<sup>5</sup> *Id.*

<sup>6</sup> OTC Regulation, *supra* note 3, 25, 29.

foreign clearinghouses that are subject to “comparable, comprehensive supervision and regulation” by their home authorities. EMIR authorizes the European Commission to recognize foreign clearinghouses if the foreign regime imposes “legally binding requirements which are equivalent to” EMIR’s requirements for E.U. clearinghouses.<sup>7</sup>

In the Committee’s judgment, “foreign recognition” offers several advantages to “dual registration.” Most importantly, foreign recognized clearinghouses would only be subject to their home country’s clearinghouse requirements. Thus, unlike “dual registration,” clearinghouses that clear E.U.-U.S. cross-border swaps would not be required to impose the most stringent clearing requirements of either regime on their members. Foreign recognition would thus solve for the issues of market fragmentation and reduced netting opportunities. Furthermore, clearinghouses would not be forced to undertake the burdensome and duplicative process of registering with multiple regulatory authorities.

Foreign recognition is currently in place in certain E.U. member states. For example, the United Kingdom has recognized the U.S. clearinghouse regime. Thus, U.S. clearinghouses are able to clear for U.K. persons until EMIR and the ESMA technical standards become effective; once EMIR is effective, the European Commission will determine whether the U.S. clearinghouse regime is equivalent to the E.U. regime. Notably, because the CFTC clearinghouse final rules have been effective since May 2012, and EMIR is not yet effective, U.S. clearinghouses clearing for E.U. persons are subject to comprehensive post-crisis clearinghouse reforms, whereas E.U. clearinghouses are not. This means that U.S. clearinghouses clearing in the E.U. are at a competitive disadvantage for the time being, *i.e.*, subject to the CFTC rules while the E.U. clearers are more lightly regulated. The Committee encourages the E.U. to implement EMIR and the ESMA standards as quickly as possible so that E.U. clearinghouses are also subject to comprehensive regulation.

The Committee recommends that the European Commission and the CFTC work together to resolve the key differences between the two clearinghouse regimes so that the European Commission is able to recognize U.S. clearinghouses, and *vice versa*. Until such differences are resolved, the Committee suggests that the CFTC should extend the narrow U.S. person definition and that the European Commission should continue to allow U.S. clearinghouses recognized by individual E.U. member states to clear swaps for persons of that E.U. member state. If these differences are not resolved and foreign recognition proves infeasible, then EMIR should be revised to permit U.S. clearinghouses to register and comply with the more stringent requirements of either regime.

#### *Comparison of E.U./U.S. Regulation of Clearinghouses*

The ESMA final technical standards and CFTC Final Rule on DCO Core Principles (“CFTC Final Rule”) impose materially different minimum standards for clearinghouse margin requirements, including different confidence intervals and liquidation/holding periods.<sup>8</sup> Unlike the U.S. regime, the ESMA final technical standards also impose look-back

<sup>7</sup> OTC Regulation, *supra* note 3, at 29-30.

<sup>8</sup> ESMA Report at 116; Derivatives Clearing Organization General Provisions and Core Principles, 76 Fed. Reg. 69,334, 69,438-39 (Nov. 8, 2011) [hereinafter Core Principles Regulation].

period requirements, pro-cyclicality buffers, and portfolio margining restrictions.<sup>9</sup> However, unlike the E.U. regime, the CFTC Final Rule requires DCO members to collect greater than 100% of the DCO's initial margin requirement for customers' speculative swaps.<sup>10</sup>

The two regimes also differ in clearinghouse membership and minimum financial resource requirements. The CFTC Final Rule does not permit DCOs to impose minimum capital requirements on clearing members over \$50 million while EMIR delegates such authority to the CCP.<sup>11</sup> EMIR requires E.U. CCPs to hold sufficient financial resources to be able to withstand the default of the two clearing members to which it has the largest exposure, while the CFTC Final Rule only requires DCOs to hold sufficient financial resources to withstand the default of the clearing member to which it has the largest financial exposure.<sup>12</sup> Although the CFTC has proposed requiring systemically important DCOs to maintain sufficient financial resources to withstand a default by the two clearing members posing the largest combined financial exposure,<sup>13</sup> the CFTC has not finalized this proposal.<sup>14</sup>

According to the CFTC Final Rule, if a U.S. DCO clearing member defaults, the DCO may require non-defaulting clearing members to contribute additional funds. However, the DCO must impose a 30% haircut and a 20% cap on the contributions of non-defaulting clearing members.<sup>15</sup> The E.U. regime does not impose specific haircuts or caps on such contributions.

If an E.U. CCP clearing member defaults, EMIR requires an E.U. CCP to use its own resources before using the default fund contributions of non-defaulting clearing members.<sup>16</sup> According to the ESMA final technical standards, this amount must be at least equal to 25% of the minimum capital that the CCP is required to maintain.<sup>17</sup> Also, EMIR requires each CCP default fund to enable the CCP to withstand the default of the clearing member to which it has the largest exposure or of the second and third largest clearing members, if the sum of their exposures is larger.<sup>18</sup> The U.S. regime does not impose similar restrictions.

The CFTC recently issued a final rule amending the permissible investments for DCOs. DCOs and DCO clearing members may no longer invest in commercial paper, corporate bonds or foreign sovereign debt.<sup>19</sup> Although DCOs and DCO members may apply for an exemption to invest in foreign sovereign debt, the CFTC does not agree that foreign domiciled DCOs and DCO clearing members should necessarily be able to invest in the sovereign debt of their domicile nation.<sup>20</sup> The CFTC also revised its concentration limits on

<sup>9</sup> ESMA Report at 117-119.

<sup>10</sup> Core Principles Regulation, *supra* note 8, at 69,439.

<sup>11</sup> *Id.* at 69,437.

<sup>12</sup> OTC Regulation, *supra* note 3, at 38; Dodd-Frank Act, *supra* note 1, § 725(c).

<sup>13</sup> Core Principles Regulation, *supra* note 8, at 69, 352.

<sup>14</sup> *Id.*

<sup>15</sup> Core Principles Regulation, *supra* note 8, at 69,435-36.

<sup>16</sup> OTC Regulation, *supra* note 3, at 37.

<sup>17</sup> ESMA Report at 118.

<sup>18</sup> OTC Regulation, *supra* note 3, at 37.

<sup>19</sup> Investment of Customer Funds and Funds Held In an Account for Foreign futures and Foreign Options Transactions, 76 Fed. Reg. 78778.

<sup>20</sup> *Id.* at 78782.

permissible investments, including specific asset-based restrictions. For example, a DCO or a DCO clearing member may invest up to 100% of its funds in U.S. treasuries but only 50% of its funds in prime money market mutual funds.<sup>21</sup> The CFTC also imposes certain issuer-based restrictions and a 25% counterparty concentration limit.<sup>22</sup>

According to the ESMA final technical standards, a CCP may invest only in debt instruments that are issued or guaranteed by a government or a central bank.<sup>23</sup> EMIR and the ESMA technical standards do not prohibit CCP investment in foreign sovereign debt and do not impose specific concentration limits on CCPs. The ESMA final technical standards delegate authority to CCPs to set concentration limits at the level of individual financial instruments, types of financial instruments, individual issuers, types of issuers, and certain other counterparties.<sup>24</sup>

The ESMA final technical standards require E.U. CCPs to set concentration limits for acceptable collateral. E.U. CCPs must have collateral concentration limits for each issuer, type of issuer, type of asset, and clearing member.<sup>25</sup> The U.S. regime does not impose a similar restriction.

The E.U. and U.S. regimes also differ with regard to clearing member collateral segregation. EMIR requires E.U. CCPs to offer clearing members' customers separate segregation of their margin, which provides customers with more robust rights to recovery.<sup>26</sup> Alternatively, Section 724(a) of the Dodd-Frank Act allows DCOs to allow DCO members to commingle customers' collateral in one account.<sup>27</sup> The CFTC issued a final rule imposing a "legal segregation with operational commingling" requirement. According to the rule, a DCO and a DCO clearing member may not use a customer's collateral to cover a shortfall in another customer's account.<sup>28</sup>

There are several other differences between the two regimes' treatment of clearinghouses. The CFTC requires DCOs to offer real-time clearing services, while the E.U. regime does not.<sup>29</sup> EMIR allows for interoperability arrangements between CCPs, while the CFTC has not addressed interoperability arrangements.<sup>30</sup> The ESMA final technical standards do not permit CCP staff engaged in risk-management, compliance, and internal audit functions to be compensated based on the business performance of the CCP, while the CFTC has not imposed a similar restriction.<sup>31</sup> The ESMA final technical standards also

<sup>21</sup> *Id.* at 78780.

<sup>22</sup> *Id.* at 78785-78789.

<sup>23</sup> ESMA Report at 128, 129.

<sup>24</sup> *Id.* at 129, 131.

<sup>25</sup> *Id.* at 127.

<sup>26</sup> OTC Regulation, *supra* note 3, at 36.

<sup>27</sup> Dodd-Frank Act § 724(a).

<sup>28</sup> Protection of Cleared Swaps Customer Contracts and Collateral; Conforming Amendments to the Commodity Broker Bankruptcy Provisions, 77 Fed. Reg., at 6339.

<sup>29</sup> Customer Clearing Documentation, Timing of Acceptance for Clearing, and Clearing Member Risk Management, 77 Fed. Reg. 21,309 (Apr. 9, 2012).

<sup>30</sup> Council & Parliament Regulation 648/2012, OTC Derivatives, Central Counterparties and Trade Repositories, 2012 O.J. (L201) 40 (EU).

<sup>31</sup> ESMA Report at 108.

impose significantly more comprehensive stress testing requirements on CCPs than the U.S. regime imposes on DCOs.<sup>32</sup>

There is also an added element of uncertainty regarding the regulation and supervision of E.U. CCPs and U.S. DCOs. EMIR requires each E.U. member state (each, a “Member State”) to designate regulatory authority over a CCP to a competent authority.<sup>33</sup> According to EMIR, each Member State’s competent authority is responsible for the supervision of home-country CCPs and each E.U. Member State’s competent authority may impose additional requirements on home-country CCPs.<sup>34</sup> Thus, EMIR and the ESMA final technical standards only set forth minimum standards that may be further developed by a Member State’s competent authority.

Pursuant to Title VIII of the Dodd-Frank Act, the FSOC recently designated the largest U.S. DCOs as systemically important financial market utilities (e.g., CME, Options Clearing Corporation, ICE, and the DTCC).<sup>35</sup> Such a designation empowers the Federal Reserve Board to supervise and impose additional regulations on these DCOs. It also provides these DCOs with access to Federal Reserve liquidity.<sup>36</sup> Although, certain E.U. CCPs have access to central bank liquidity (e.g., German-based Eurex Clearing AG and LCH.Clearnet’s France-based subsidiary LCH.Clearnet SA, are incorporated as banks),<sup>37</sup> neither EMIR nor the ESMA technical standards require CCPs to have access to central bank liquidity.

Title II of the Dodd-Frank Act sets forth the Orderly Liquidation Authority (“OLA”), an alternative to bankruptcy which allows the FDIC to guarantee temporarily the debt of a failing systemically important financial company.<sup>38</sup> Although systemically important financial market utilities are not expressly covered or excluded by Title II, it is possible that if a systemically important FMU were failing, regulators might attempt to subject the DCO to an OLA receivership rather than the standard bankruptcy process.<sup>39</sup> The FDIC did not respond to a letter from the CME requesting that the FDIC clarify that the CME would not be subject to an OLA receivership.<sup>40</sup> The E.U. regime does not include an orderly resolution process for CCPs.

There are also important differences between the two regimes’ clearing requirements. For example, the ESMA final technical standards do not require E.U. non-financial

<sup>32</sup> *Id.* at 134-35.

<sup>33</sup> OTC Regulation, *supra* note 3, at 28.

<sup>34</sup> *Id.* at 8, 28.

<sup>35</sup> Press Release, U.S. Dep’t of the Treasury, Financial Stability Oversight Council Makes First Designations in Effort to Protect Against Future Financial Crises (July 18, 2012), <http://www.treasury.gov/press-center/press-releases/Pages/tg1645.aspx>.

<sup>36</sup> Dodd-Frank Act §§ 804, 805.

<sup>37</sup> Int’l Monetary Fund, Global Financial Stability Report: Meeting New Challenges to Stability and Building a Safer System 110 (Apr. 2010).

<sup>38</sup> Dodd-Frank Act §§ 201-217.

<sup>39</sup> Robert S. Steigerwald, Senior Policy Adviser, Fed. Res. Bank of Chicago, FMU Recovery and Resolution: “Orderly Liquidation” in the Shadow of the Bankruptcy Code 43 (Aug. 22, 2012), *available at* [http://www.chicagofed.org/webpages/markets/orderly\\_liquidation\\_bankruptcy.cfm](http://www.chicagofed.org/webpages/markets/orderly_liquidation_bankruptcy.cfm)

<sup>40</sup> Gretchen Morgenson, *One Safety Net that Needs to Shrink*, NEW YORK TIMES, November 3, 2012

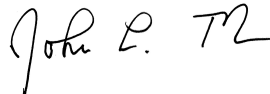
counterparties (“NFCs”) to clear any swaps unless they exceed certain €1-3 billion thresholds for speculative swaps.<sup>41</sup> If an E.U. NFC exceeds the threshold for any type of speculative swap, it must clear all swaps, including swaps for hedging purposes.<sup>42</sup> Alternatively, the U.S. regime requires NFCs to clear all speculative swaps but does not require U.S. NFCs to clear swaps for hedging purposes under any circumstances.<sup>43</sup> Furthermore, the U.S. Treasury has exempted FX swaps from the definition of swaps (and thus any of the clearing and margin requirements applicable to swaps) while the ESMA technical standards do not exempt FX swaps from the clearing obligation and require E.U. NFCs to clear speculative FX swaps above a certain threshold.<sup>44</sup>

In light of these numerous differences between the E.U. and U.S. requirements for clearinghouses, it is clear that the CFTC, the European Commission and the ESMA must work together to ensure that recognition of each clearinghouse regime is feasible. Otherwise, the E.U.-U.S. cross-border swaps market may be fragmented, unnecessarily limiting the ability of E.U. and U.S. persons to manage risk.

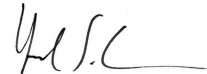
Respectfully submitted,



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<sup>41</sup> ESMA Report at 82.

<sup>42</sup> *Id.* at 15.

<sup>43</sup> Dodd-Frank Act § 723(a).

<sup>44</sup> ESMA Report at 82.

APPENDIX: COMPARISON OF E.U. – U.S. CLEARING HOUSE REGULATIONS

|                               | <b>E.U. EMIR/ ESMA Technical Standards</b>  | <b>U.S. DFA/CFTC Rules</b>  | <b>Comments</b> |
|-------------------------------|---|---|-----------------|
| Extra-territorial Application | <p><b>EMIR:</b></p> <p>Any swap between a foreign person that would be subject to the clearing obligation if it were established in the E.U. and an E.U. financial counterparty or a E.U. non-financial counterparty, is subject to EMIR’s clearing requirements.<sup>45</sup></p> <p>The Commission has the power to adopt ESMA draft technical standards, specifying which transactions entered into by entities established in third countries should be subject to EMIR. Such transactions must have a direct, substantial and foreseeable effect within the Union or must be necessary or appropriate to prevent the evasion of any provisions of EMIR.<sup>46</sup> ESMA missed the Sept. 30 deadline to issue such standards. ESMA has notified the Commission that it must set a new deadline.<sup>47</sup></p> <p><b>EMIR</b> also includes a mechanism to avoid</p> | <p><b>DFA:</b></p> <p>Section 722(d) of Dodd-Frank provides that Title VII does not apply to activities outside the U.S. unless those activities either: (1) have a direct and significant connection with activities in, or effect on, commerce of the U.S.; or (2) contravene such rules or regulations as the CFTC may prescribe or promulgate as are necessary or appropriate to prevent the evasion of any provision of Title VII of the DFA.</p> <p>[DFA sec 722(d).]</p> <p><b>CFTC Proposed Interpretive Guidance:</b></p> <p>The Proposed Guidance divides Title VII’s substantive requirements into entity and transaction requirements. Entity requirements relate largely to matters that govern a swap dealer (“SD”) or a major swaps participant (“MSP”) and include: capital adequacy, chief compliance officers, risk management, swap data recordkeeping, swap data reporting, and</p> |                 |

<sup>45</sup> Council & Parliament Regulation 648/2012, OTC Derivatives, Central Counterparties and Trade Repositories, 2012 O.J. (L201) 17 (EU).

<sup>46</sup> Council & Parliament Regulation 648/2012, OTC Derivatives, Central Counterparties and Trade Repositories, 2012 O.J. (L201) 13 (EU).

<sup>47</sup> Eur. Sec. & Mkts. Auth., Final Report: Draft technical standards under the Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC Derivatives, CCPs and Trade Repositories 6-7 (Sept. 27, 2012).



|  | <b>E.U. EMIR/ ESMA Technical Standards</b>  | <b>U.S. DFA/CFTC Rules</b>   | <b>Comments</b> |
|--|---|--|-----------------|
|  | <p>duplicative or conflicting rules with foreign nations.<sup>48</sup> EMIR provides that the Commission may adopt implementing acts declaring that the legal supervisory and enforcement arrangements of a third country are: (a) equivalent to the requirements laid down under Articles 4 (clearing obligation), 9 (reporting obligation), 10 (non-financial counterparties) and 11 (risk-mitigation techniques for OTC derivative contracts not cleared by a CCP); (b) ensure protection of professional secrecy that is equivalent to that set out in this Regulation; and (c) 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. Such implementing acts shall imply that 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.<sup>49</sup></p> <p>EMIR also includes a mechanism to recognize foreign CCPs, as described below.</p> | <p>physical commodity swaps reporting. Transaction requirements relate largely to risk mitigation and market transparency, and include: clearing and swap processing, margining and segregation for uncleared swaps, trade execution, swap trading relationship documentation, portfolio reconciliation and compression, real-time public reporting, trade confirmation, daily trading records, and (in certain circumstances) external business conduct standards.</p> <p>The Proposed Guidance subjects any swap involving a “U.S. person” to all Title VII transaction requirements, regardless of the counterparty and execution location of the transaction.</p> <p>The Proposed Guidance requires a foreign person to register with the CFTC as an SD or MSP if its swap dealings with U.S. persons exceed the same thresholds applicable to U.S. persons. If a foreign person is required to register as an SD or MSP, it is subject to Title VII’s entity requirements. However, foreign SDs or MSPs may qualify for “substituted compliance” from Title VII’s entity requirements if the CFTC determines that a foreign SD’s or MSP’s home country derivatives regime requirements are comparable</p> |                 |

<sup>48</sup> Council & Parliament Regulation 648/2012, OTC Derivatives, Central Counterparties and Trade Repositories, 2012 O.J. (L201) 2 (EU).

<sup>49</sup> Council & Parliament Regulation 648/2012, OTC Derivatives, Central Counterparties and Trade Repositories, 2012 O.J. (L201) 17, 20-24 (EU).

|                                    | <b>E.U. EMIR/ ESMA Technical Standards</b>  | <b>U.S. DFA/CFTC Rules</b>  | <b>Comments</b> |
|------------------------------------|---|---|-----------------|
|                                    |   | <p>to Title VII entity requirements.</p> <p>Substituted compliance is not available for transaction requirements.</p> <p>[Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act, 77 Fed. Reg. 41,214 (July 12, 2012).]</p>   |                 |
| Foreign Clearing House Recognition | <p><b>EMIR:</b></p> <p>EMIR only permits legal persons established in the E.U. to apply for authorization as a Central Counterparty Clearing House (“CCP”).<sup>50</sup></p> <p>Foreign CCPs may only be recognized by the <b>ESMA</b> if the <b>European Commission</b> determines that: (1) the legal and supervisory arrangements of a third country ensure that CCPs authorized in that third country comply with legally binding requirements which are equivalent to 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 authorized under third-country legal regimes; (2) that the CCP is authorized and</p> | <p><b>DFA S. 725(b):</b></p> <p>The Commission may exempt, conditionally or unconditionally, a derivatives clearing organization from registration under this section for the clearing of swaps if the Commission determines that the derivatives clearing organization is subject to comparable, comprehensive supervision and regulation by the Securities and Exchange Commission or the appropriate government authorities in the home country of the organization. Such conditions may include, but are not limited to, requiring that the derivatives clearing organization be available for inspection by the Commission and make available all information requested by the Commission.</p> <p>[DFA sec. 725(b).]</p> |                 |

<sup>50</sup> Council & Parliament Regulation 648/2012, OTC Derivatives, Central Counterparties and Trade Repositories, 2012 O.J. (L201) 17, 25 (EU).

|                                    | <b>E.U. EMIR/ ESMA Technical Standards</b>  | <b>U.S. DFA/CFTC Rules</b>   | <b>Comments</b> |
|------------------------------------|---|--|-----------------|
|                                    | <p>subject to effective supervision in that third country; (3) that ESMA has established cooperation arrangements with the third-country competent authorities; and (4) the CCP is established or authorized 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 Union in accordance with the criteria set out in the common understanding between Member States.<sup>51</sup></p> <p><b>ESMA Final Technical Standards:</b></p> <p>The ESMA clarified that it is not required to recognize foreign CCPs that meet the above conditions because other conditions may prevent fulfillment of the overall outcome of ensuring no market disruption, no competitive advantage and adequate investor protection.<sup>52</sup></p> |  |                 |
| Non-Financial Counterparties (NFC) | <p><b>ESMA Final Technical Standards:</b></p> <p>An E.U. NFC is not required to clear <b>any</b> swaps, unless the NFC exceeds one of five thresholds for speculative swaps. The thresholds depend on the asset-class and are set between EUR 1bn and 3bn. The</p>  | <p><b>DFA:</b></p> <p>NFCs are not required to clear swaps for hedging purposes. NFCs must clear all swaps for speculative purposes.</p> <p>[DFA sec. 723(a).]</p> |                 |

<sup>51</sup> Council & Parliament Regulation 648/2012, OTC Derivatives, Central Counterparties and Trade Repositories, 2012 O.J. (L201) 29 (EU).

<sup>52</sup> Eur. Sec. & Mkts. Auth., Final Report: Draft technical standards under the Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC Derivatives, CCPs and Trade Repositories 30 (Sept. 27, 2012).

|          | <b>E.U. EMIR/ ESMA Technical Standards</b>   | <b>U.S. DFA/CFTC Rules</b>  | <b>Comments</b>  |
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|          | <p>clearing thresholds are: (a) EUR 1 billion in gross notional value for OTC credit derivative contracts; (b) EUR 1 billion in gross notional value for OTC equity derivative contracts; (c) EUR 3 billion in gross notional value for OTC interest rate derivative contracts; (d) EUR 3 billion in gross notional value for OTC foreign exchange derivative contracts; and (e) EUR 3 billion in gross notional value for OTC commodity derivative contracts and other OTC derivative contracts not defined under points (a) to (d).<sup>53</sup></p> <p>If a E.U. NFC exceeds the speculative swap threshold for one class of swap, it must clear <b>all</b> swaps (for hedging or speculative purposes).<sup>54</sup></p> |   |  |
| FX Swaps | <p><b>EMIR:</b></p> <p>Based on criteria set forth by the <b>ESMA final technical standards</b>, the European Commission will determine the types of swaps that must be cleared. According to EMIR, “The predominant risk for transactions in some classes of OTC derivative contracts may relate to settlement risk, which is addressed through</p>   | <p><b>DFA:</b></p> <p>Treasury has authority to exempt FX swaps from definition of a swap. Thus, FX swaps would not be subject to clearing requirements or any margin requirements applicable to bilaterally cleared swaps.</p> <p>[DFA sec. 722(h).]</p> | <p><b>Note:</b></p> <p>According to ESMA chair the greatest risk of regulatory arbitrage is for bi-lateral FX swaps. The Treasury exemption would not require margin to be held against bi-lateral</p> |

<sup>53</sup> Eur. Sec. & Mkts. Auth., Final Report: Draft technical standards under the Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC Derivatives, CCPs and Trade Repositories 82 (Sept. 27, 2012).

<sup>54</sup> Eur. Sec. & Mkts. Auth., Final Report: Draft technical standards under the Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC Derivatives, CCPs and Trade Repositories 18 (Sept. 27, 2012).

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|               | <p>separate infrastructure arrangements, and may distinguish certain classes of OTC derivative contracts (such as foreign exchange) from other classes. CCP clearing specifically addresses counterparty credit risk, and may not be the optimal solution for dealing with settlement risk. The regime for such contracts should rely, in particular, on preliminary international convergence and mutual recognition of the relevant infrastructure.”<sup>55</sup></p> <p><b>ESMA Final Technical Standards:</b></p> <p>Did not include an exemption for FX swaps or set forth any special treatment for FX swaps in its clearing obligation criteria. The ESMA final technical standards require an NFC trading in speculative FX swaps to clear all swaps if it exceeds the specified Euro threshold.<sup>56</sup></p> | <p><b>Treasury Final Rule:</b></p> <p>Treasury issued a proposed rule to exempt FX swaps from the definition of swap in April 2011.</p> <p>Treasury is expected to finalize the rule as proposed by the end of 2012. [Emmanuel Olaoye, <i>U.S. Treasury to Move by Year End on Plan to Exempt Forex Swaps</i>, <i>Sources Say</i>, REUTERS, Oct. 24, 2012.]</p> | <p>FX swaps. The ESMA chair has stated that margin requirements will definitely apply to bi-lateral FX swaps in the EU.</p> <p>(See FX Week, “Greatest risk of regulatory arbitrage is for non-cleared FX, says ESMA’s Chair” Feb 8, 2012)</p> <p>Basel-IOSCO working group on margin requirements is expected to set forth a recommendation for FX swaps.</p> |
| CCP Regulator | <p><b>EMIR:</b></p> <p>CCPs will be authorized and supervised by the competent authority of the Member State where the CCP is established (Member State may designate more than one competent authority). <b>Importantly, a Member State competent authority may</b></p>  | <p><b>DFA:</b></p> <p>The CFTC regulates DCOs that clear swaps. The SEC regulates clearing agencies that clear security-based swaps. In the case of a clearing house that clears swaps and security-based swaps, the DFA directs the SEC and CFTC to determine which agency is the “Supervisory</p>   |  |

<sup>55</sup> Council & Parliament Regulation 648/2012, OTC Derivatives, Central Counterparties and Trade Repositories, 2012 O.J. (L201) 25-26 (EU).

<sup>56</sup> Eur. Sec. & Mkts. Auth., Final Report: Draft technical standards under the Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC Derivatives, CCPs and Trade Repositories 82 (Sept. 27, 2012).

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|                         | <p><b>impose additional restrictions on its CCPs.</b> The competent authority will consult with a CCP-specific “college” organized to assist in the regulation of a CCP. (Each CCP college shall consist of ESMA, CCP competent authority, competent authorities responsible for the supervision of the clearing members of the CCP that are established in the three Member States with the largest contributions to the default fund of the CCP, the competent authorities responsible for the supervision of trading venues served by the CCP, the central banks of issue of the most relevant E.U. currencies of the financial instruments cleared.)<sup>57</sup></p> | <p>Agency”; if the agencies are unable to agree, the FSOC has the authority to make the determination. The “Supervisory Agency” shall be the lead regulator of the clearing house.</p> <p>[DFA sec. 802.]</p> <p>The FSOC may designate a clearing house as systemically important. If FSOC makes such a determination, the Fed may impose additional requirements on systemically important clearing houses.</p> <p>[DFA sec. 804.]</p>                     |   |
| CCP Margin Requirements | <p><b>ESMA Technical Standards:</b></p> <p>All cleared OTC derivatives (i.e., not listed/traded on an exchange) must have a minimum confidence interval of 99.5% with a minimum liquidation/holding period of 5 days.<sup>58</sup></p> <p>However, if a CCP proves to the <b>competent authority</b> that the OTC contracts cleared have the same risk characteristics of listed products and if risks are properly mitigated, a lower</p>  | <p><b>CFTC Final Rule DCO Core Principles:</b></p> <p>All cleared swaps shall have a minimum 99% confidence interval with a minimum liquidation/holding period of 5 days.</p> <p>[Derivatives Clearing Organization General Provisions and Core Principles, 76 Fed. Reg. 69,334, 69,438 (Nov. 8, 2011).]</p> <p>However, swaps on agricultural commodities, energy commodities and metals may have a minimum liquidation/holding period of <b>1 day</b>.</p> | <p><b>Note:</b></p> <p>In the EU, all swaps that have the same characteristics of listed products may have a minimum liquidation/holding period of 2 days while in the U.S., only swaps on agricultural commodities, energy commodities and</p> |

<sup>57</sup> Council & Parliament Regulation 648/2012, OTC Derivatives, Central Counterparties and Trade Repositories, 2012 O.J. (L201) 25-27 (EU).

<sup>58</sup> Eur. Sec. & Mkts. Auth., Final Report: Draft technical standards under the Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC Derivatives, CCPs and Trade Repositories 116-17 (Sept. 27, 2012).

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|  | <p>confidence interval than 99.5% and a liquidation period of 2 days can be adopted.<sup>59</sup></p> <p>For all financial instruments other than OTC swaps (this includes exchange listed swaps) a minimum 99% confidence interval may be used with a minimum liquidation period of <b>2 days</b>.<sup>60</sup></p> <p><b>EU-only requirements: ESMA Technical Standards:</b></p> <p>1. Look-back period has to include at least the past 12 months and must include a full range of market conditions, including period of market stress. Note: Setting a specific time horizon for the calculation of historic volatility is a major departure from CCP best practice and rejected during the development of CPSS-IOSCO Principles for FMIs.<sup>61</sup></p> | <p>[Derivatives Clearing Organization General Provisions and Core Principles, 76 Fed. Reg. 69,334, 69,438 (Nov. 8, 2011).]</p> <p>All other financial instruments shall have a minimum confidence interval of 99% with a minimum liquidation/holding period of <b>1 day</b>.</p> <p>[Derivatives Clearing Organization General Provisions and Core Principles, 76 Fed. Reg. 69,334, 69,438 (Nov. 8, 2011).]</p> <p><b>U.S.-only requirements: CFTC DCO Core Principles Final Rule:</b></p> <p>A DCO shall require its clearing members to collect customer initial margin, from their customers, for non-hedge positions, at a level that is greater than 100 percent of the DCO's initial margin requirements with respect to each product and swap portfolio. DCOs must collect margin on a gross basis for each clearing member's customer account(s). (Clearinghouses currently calculate margin requirements on a net basis and lack sufficient information about individual customer positions to calculate</p> | <p>metals are permitted to have a lower liquidation/holding period than 5 days.</p> |

<sup>59</sup> Eur. Sec. & Mkts. Auth., Final Report: Draft technical standards under the Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC Derivatives, CCPs and Trade Repositories 38, 118 (Sept. 27, 2012).

<sup>60</sup> Eur. Sec. & Mkts. Auth., Final Report: Draft technical standards under the Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC Derivatives, CCPs and Trade Repositories 116-18 (Sept. 27, 2012).

<sup>61</sup> Eur. Sec. & Mkts. Auth., Final Report: Draft technical standards under the Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC Derivatives, CCPs and Trade Repositories 117 (Sept. 27, 2012).

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|  | <p>2. CCPs must account for potential procyclicality of margin requirements. A CCP shall do so by either: implementing a buffer of 25% to minimum margin requirements; assigning a weight of at least 25% to the stress observations considered in the calculated look-back period; or ensuring that the margins are no lower than those calculated considering a 10 year look-back period.<sup>62</sup></p> <p>3. Portfolio Margining restriction: Where portfolio margining covers multiple instruments, the amount of margin reductions shall be no greater than 80% of the difference between the sum of the margins for each product calculated on an individual basis and the margin calculated based on a combined estimation of the exposure for the combined portfolio. Where the CCP is not exposed to any potential risk from the margin reduction, it may apply a reduction of up to 100% of this difference.<sup>63</sup></p> <p>ESMA Final Technical Standards discussion portion:</p> | <p>margin at the level of each individual customer; clearinghouses are working towards creating an industry-wide mechanism.)</p> <p>[Derivatives Clearing Organization General Provisions and Core Principles, 76 Fed. Reg. 69,334, 69,438 (Nov. 8, 2011).]</p> |                 |

<sup>62</sup> Eur. Sec. & Mkts. Auth., Final Report: Draft technical standards under the Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC Derivatives, CCPs and Trade Repositories 118-119 (Sept. 27, 2012).

<sup>63</sup> Eur. Sec. & Mkts. Auth., Final Report: Draft technical standards under the Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC Derivatives, CCPs and Trade Repositories 117-18 (Sept. 27, 2012).



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|                    | <p>Portfolio Margining: “ESMA considers that introducing a haircut on offsets is appropriate where such offset is determined by model calculations or it relies on assumptions about future correlations, as such offsets introduce extra risks to the CCPs and these need to be adequately mitigated.”<sup>64</sup></p> <p><b>Note:</b> Setting a specific time horizon for the calculation of historic volatility is a major departure from CCP best practice and rejected during the development of CPSS IOSCO Principles for FMIs.</p> |   |                 |
| Real-time Clearing | <p><b>EMIR and ESMA technical standards:</b></p> <p>Do not require that a CCP “accept or reject for clearing as quickly after submission to the derivatives clearing organization as would be technologically practicable if fully automated systems were used.”</p> <p>While ESMA agrees with a real-time clearing approach, ESMA does not have an authorizing provision for requiring fully automated systems. Thus, market participants in the E.U. are not required to develop such systems.<sup>65</sup></p>                          | <p><b>CFTC DCO Core Principles Final Rule:</b></p> <p>“Each derivatives clearing organization shall coordinate with each clearing member that is a futures commission merchant, swap dealer, or major swap participant to establish systems that enable the clearing member, or the derivatives clearing organization acting on its behalf, to accept or reject each trade submitted to the derivatives clearing organization for clearing by or for the clearing member or a customer of the clearing member as quickly as would be technologically practicable if fully automated systems were used.”</p> |                 |

<sup>64</sup> Eur. Sec. & Mkts. Auth., Final Report: Draft technical standards under the Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC Derivatives, CCPs and Trade Repositories 40 (Sept. 27, 2012).

<sup>65</sup> Eur. Sec. & Mkts. Auth., Final Report: Draft technical standards under the Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC Derivatives, CCPs and Trade Repositories 21-22 (Sept. 27, 2012).

|                                     | <b>E.U. EMIR/ ESMA Technical Standards</b>  | <b>U.S. DFA/CFTC Rules</b>   | <b>Comments</b> |
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|                                     |   | Customer Clearing Documentation, Timing of Acceptance for Clearing, and Clearing Member Risk Management, 77 Fed. Reg. 21,278, 21,309 (Apr. 9, 2012).   |                 |
| CCP Membership Minimum Requirements | <p><b>EMIR:</b></p> <p>Delegates authority for determining clearinghouse membership criteria to the CCP.<sup>66</sup></p> <p>"Such criteria shall be non-discriminatory, provide fair and open access to the CCP and ensure that clearing members have sufficient financial resources and operational capacity to meet the obligations arising from participation in a CCP. Criteria that restrict access shall be permitted only to the extent that their objective is to control risk for the CCP."<sup>67</sup></p> <p>A CCP may impose specific additional obligations on clearing members, such as the participation in auctions of a defaulting clearing member's position. Such additional obligations shall be proportional to the risk brought by the clearing member and shall not restrict participation to certain categories of clearing members.<sup>68</sup></p> | <p><b>CFTC DCO Core Principles Final Rule:</b></p> <p>Prevents DCOs from requiring clearing members to hold more than \$50 million in capital.</p> <p>Derivatives Clearing Organization General Provisions and Core Principles, 76 Fed. Reg. 69,334, 69,437 (Nov. 8, 2011).</p> <p>However, the Final Rule also requires clearing members to have access to sufficient financial resources to meet obligations arising from participation in the derivatives clearing organization in extreme but plausible market conditions.</p> <p>Derivatives Clearing Organization General Provisions and Core Principles, 76 Fed. Reg. 69,334, 69,437 (Nov. 8, 2011).]</p> <p>(Thus, it is likely clearing members with low levels of capital will only be able to participate in a clearing house to a limited extent.)</p> |                 |

<sup>66</sup> Council & Parliament Regulation 648/2012, OTC Derivatives, Central Counterparties and Trade Repositories, 2012 O.J. (L201) 35 (EU).

<sup>67</sup> Council & Parliament Regulation 648/2012, OTC Derivatives, Central Counterparties and Trade Repositories, 2012 O.J. (L201) 35 (EU).

<sup>68</sup> Council & Parliament Regulation 648/2012, OTC Derivatives, Central Counterparties and Trade Repositories, 2012 O.J. (L201) 35 (EU).

|  | <b>E.U. EMIR/ ESMA Technical Standards</b> | <b>U.S. DFA/CFTC Rules</b>  | <b>Comments</b> |
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|  |  | <p>Also, a DCO shall not require that clearing members maintain a swap portfolio of any particular size, or that clearing members meet a swap transaction volume threshold. A DCO shall not adopt restrictive clearing member standards if less restrictive requirements that achieve the same objective and that would not materially increase risk to the derivatives clearing organization or clearing members could be adopted.</p> <p>[Derivatives Clearing Organization General Provisions and Core Principles, 76 Fed. Reg. 69,334, 69,436 (Nov. 8, 2011).]</p> <p><b>CFTC Final Rule discussion portion:</b></p> <p>“The Commission does not believe that the rule will increase risk. Section 39.12(a)(2)(ii) requires DCOs to impose capital requirements that are scalable to the risks posed by clearing members. Accordingly, a small clearing member should not be able to expose a DCO to significant risk even if it is able to clear at multiple DCOs because its exposure at each DCO would be limited. DCOs that participate in the Shared Market Information System (SHAMIS) will be able to see a clearing member’s pays and collects across participating DCOs, and a DCO also could on its own initiative require clearing members to directly report their clearing activity at other DCOs. The</p> |                 |

|  | <b>E.U. EMIR/ ESMA Technical Standards</b> | <b>U.S. DFA/CFTC Rules</b>  | <b>Comments</b> |
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|  |  | <p>Commission also will be able to monitor clearing member exposure by means of DCO end-of-day reporting under the reporting requirements of § 39.19(c)(1)(i), which the Commission is adopting herein. It will also be able to monitor the financial strength of clearing members that are registrants pursuant to financial reporting requirements.</p> <p>The Commission does not believe that the \$50 million threshold would lead to a DCO having to admit clearing members that are unable to participate in the default management process. As discussed above, the regulation does not preclude highly-capitalized entities (such as swap dealers) from participating in a DCO as clearing members. Thus, the addition of smaller clearing members does not eliminate the role that larger clearing members can play in default management—it merely spreads the risk.</p> <p>The Commission wishes to emphasize that it will review DCO membership rules as a package in light of all of the provisions of § 39.12(a). Thus, a DCO may not circumvent § 39.12(a)(2)(iii) by enacting some additional financial requirement that effectively renders the \$50 million threshold meaningless for some potential clearing members.”</p> <p>[Derivatives Clearing Organization General Provisions and Core Principles, 76 Fed. Reg. 69,334, 69,356 (Nov. 8, 2011).]</p> |                 |

|  | <b>E.U. EMIR/ ESMA Technical Standards</b>  | <b>U.S. DFA/CFTC Rules</b>  | <b>Comments</b> |
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| CCP Minimum Financial Resources/ Minimum Capital Requirement | <p><b>EMIR:</b></p> <p>CCPs must have minimum capital of at least EUR 7.5 million. A CCP’s capital, including retained earnings and reserves, shall be proportionate to the risk stemming from the activities of the CCP. A CCP shall maintain sufficient pre-funded available financial resources to cover potential losses that exceed the losses to be covered by margin requirements and the default fund. Such pre-funded financial resources shall include dedicated resources of the CCP, shall be freely available to the CCP and shall not be used to meet the minimum capital requirement. <b>The default fund and pre-funded financial resources shall at all times enable the CCP to withstand the default of at least the two clearing members to which it has the largest exposures under extreme but plausible market conditions.</b> A CCP may require non-defaulting clearing members to provide additional funds in the event of a default of another clearing member. <b>The clearing members of a CCP shall have limited exposures toward the CCP.</b><sup>69</sup></p> | <p><b>DFA:</b></p> <p>Each DCO must have adequate financial resources to enable the organization to meet its financial obligations to its members and participants notwithstanding a default by the member or participant creating the largest financial exposure for that organization in extreme but plausible market conditions; and enable the derivatives clearing organization to cover the operating costs of the derivatives clearing organization for a period of 1 year (as calculated on a rolling basis).</p> <p>[DFA sec. 725(c).]</p> <p><b>CFTC DCO Core Principles Final Rule:</b></p> <p>No minimum DCO capital requirement. CFTC requires that a DCO have adequate financial, operational, and managerial resources, as determined by CFTC, to discharge its responsibilities. <b>Those financial resources shall, at a minimum, exceed the total amount that would (39.11(a)(1) enable the DCO to meet its obligations despite a default by a member creating the largest financial exposure in extreme, but plausible, market conditions and (39.11(a)(2)) enable the DCO to cover its operating costs for a 1-year period.</b> DCOs may require non-defaulting</p> |                 |

<sup>69</sup> Council & Parliament Regulation 648/2012, OTC Derivatives, Central Counterparties and Trade Repositories, 2012 O.J. (L201) 38 (EU).

|              | <b>E.U. EMIR/ ESMA Technical Standards</b>  | <b>U.S. DFA/CFTC Rules</b>  | <b>Comments</b> |
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|              |   | <p>clearing members to contribute in the event of a default of another clearing member. If a DCO imposes additional guarantee fund (default fund) contributions from members to meet its 39.11(a)(1) requirement, it shall: <b>apply a 30 percent haircut to the value of potential assessments, only count the value of assessments, after the haircut, to meet up to 20 percent of its 39.11(a)(1) obligations.</b> (EU: Doesn't include a similar haircut/cap.)</p> <p>[Derivatives Clearing Organization General Provisions and Core Principles, 76 Fed. Reg. 69,334, 69,435 (Nov. 8, 2011).]</p> |                 |
| Default Fund | <p><b>EMIR:</b></p> <p>The <b>default fund</b> shall at least enable the CCP to withstand, under extreme but plausible market conditions, the default of the clearing member to <b>which it has the largest exposures or of the second and third largest clearing members, if the sum of their exposures is larger.</b><sup>70</sup></p> <p><b>ESMA Technical Standards:</b></p> <p>“Extreme but plausible market conditions” shall include a range of historical scenarios, including periods of extreme market movements observed over the past</p> | <p><b>CFTC Final Rule DCO Core Principles:</b></p> <p>“A derivatives clearing organization shall adopt rules and procedures designed to allow for the efficient, fair, and safe management of events during which clearing members become insolvent or default on the obligations of such clearing members to the derivatives clearing organization.”</p> <p>[Derivatives Clearing Organization General Provisions and Core Principles, 76 Fed. Reg. 69,334, 69,442 (Nov. 8, 2011).]</p>  |                 |

<sup>70</sup> Council & Parliament Regulation 648/2012, OTC Derivatives, Central Counterparties and Trade Repositories, 2012 O.J. (L201) 37 (EU).

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|                   | 30 years, or as long as reliable data have been available, that would have exposed the CCP to greatest financial risk. <sup>71</sup>   |                            |                 |
| Default Waterfall | <p><b>E.U.-only requirements: EMIR:</b></p> <p>“A CCP shall use dedicated own resources before using the default fund contributions of non-defaulting clearing members.”<sup>72</sup></p> <p><b>ESMA Technical Standards:</b></p> <p>A CCP shall keep, and indicate separately in its balance sheet, an amount of dedicated own resources for the purpose set out in Article 45(4) of Regulation (EU) No 648/2012. This amount shall be at least equal to the 25% of the minimum capital, including retained earnings and reserves, held in accordance with Article 16 of EMIR.<sup>73</sup></p> <p><b>Note:</b> Article 16(2) requires a CCP to maintain capital proportional to its risk. So, 25% of 16(2) for a large CCP is likely a very substantial contribution to the default waterfall.</p> | Nothing similar.           |                 |

<sup>71</sup> Eur. Sec. & Mkts. Auth., Final Report: Draft technical standards under the Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC Derivatives, CCPs and Trade Repositories 119 (Sept. 27, 2012).

<sup>72</sup> Council & Parliament Regulation 648/2012, OTC Derivatives, Central Counterparties and Trade Repositories, 2012 O.J. (L201) 38 (EU).

<sup>73</sup> Eur. Sec. & Mkts. Auth., Final Report: Draft technical standards under the Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC Derivatives, CCPs and Trade Repositories 123 (Sept. 27, 2012).

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| Ownership Restrictions | <p><b>EMIR:</b></p> <p>Competent authority may reject any transfer of ownership that would result in an entity owning over 10% of the CCP. Contrary to the proposed U.S. rule, member states <b>may not</b> impose prior conditions in respect of the level of holdings that shall be required.<sup>74</sup></p> | <p><b>DFA:</b></p> <p>In order to mitigate conflicts of interest, the CFTC shall adopt rules, <b>which may include numerical limits on the control of</b>, or the voting rights with respect to, any DCO.</p> <p>[DFA sec. 726(a).]</p> <p><b>CFTC Proposed rule October 2010/not finalized in recent DCO Core Principles rulemaking (CFTC has reserved the right to finalize at a later date):</b></p> <p>A CCP must comply with one of two alternative limits: (1) No member may own more than 20% of the voting equity, and specified financial entities (whether or not members) may not own more than 40% of the voting equity in the aggregate; or (2) No specified financial entity (whether or not a member) may own more than 5% of the voting equity.</p> <p>[Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest, 75 Fed. Reg. 63,732 (Oct. 18, 2010).]</p> |                 |
| Limits on Remuneration | <p><b>EU-only: ESMA Final Technical Standards:</b></p>   | <p>The CFTC has proposed rules that would require the compensation of Public Directors and other non-executive members of the DCO's</p>  |                 |

<sup>74</sup> Council & Parliament Regulation 648/2012, OTC Derivatives, Central Counterparties and Trade Repositories, 2012 O.J. (L201) 32-33 (EU).



|                             | <b>E.U. EMIR/ ESMA Technical Standards</b>   | <b>U.S. DFA/CFTC Rules</b>  | <b>Comments</b> |
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|                             | The remuneration policy shall be designed to align the level and structure of remuneration with prudent risk management. The remuneration policy shall provide that staff engaged in risk management, compliance and internal audit functions are remunerated in a manner that is independent of the business performance of the CCP. <sup>75</sup>  | board not to be linked to the performance of the DCO. CFTC Proposed Regulation 40.9(b)(4).  |                 |
| Permissible CCP Investments | <p><b>ESMA Final Technical Standards:</b></p> <p>A CCP may only invest in a debt instrument which has been issued or explicitly guaranteed by: a government; a central bank; a multilateral development bank; or the European Financial Stability Facility or the European Stability Mechanism.<sup>76</sup> The average time to maturity of a CCP’s investment portfolio may not exceed two years. Investments must have “an active outright sale or repurchase agreement market, with a diverse group of buyers and sellers, including in stressed conditions and to which the CCP has reliable access” and reliable price data on</p> | <p><b>CFTC Final Rule DCO Core Principles:</b></p> <p>Funds and assets belonging to clearing members and their customers that are invested by a DCO shall be held in instruments with minimal credit, market, and liquidity risks.</p> <p>[Derivatives Clearing Organization General Provisions and Core Principles, 76 Fed. Reg. 69,334, 69,442 (Nov. 8, 2011).]</p> <p><b>CFTC Final Rule Investment of Customer Funds:</b></p> <p>A DCO or DCO clearing member may only invest in: U.S. government securities, municipal</p> |                 |

<sup>75</sup> Eur. Sec. & Mkts. Auth., Final Report: Draft technical standards under the Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC Derivatives, CCPs and Trade Repositories 107-08 (Sept. 27, 2012).

<sup>76</sup> Eur. Sec. & Mkts. Auth., Final Report: Draft technical standards under the Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC Derivatives, CCPs and Trade Repositories 128-129 (Sept. 27, 2012).

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|  | <p>these instruments must be published on a regular basis.<sup>77</sup> <b>A CCP must determine concentration limits at the level of: individual financial instruments; types of financial instruments; individual issuers; types of issuers; and certain other counterparties. The average time to maturity of the CCP’s portfolio shall not exceed two years.</b><sup>78</sup></p> <p><b>ESMA Final Technical Standards discussion portion:</b></p> <p><b>“It was argued that the majority of debt instruments issued by eligible institutions are for terms greater than two years.... In response to the feedback received, ESMA notes that the draft RTS prescribes an average time to maturity and not an absolute time to maturity. It is therefore possible for a CCP to invest in individual debt instruments with a time to maturity of greater than two years.”</b><sup>79</sup></p> <p><b>Note:</b> The ESMA final technical standards</p> | <p>securities, U.S. agency obligations, certificates of deposit, and interests in money market mutual funds</p> <p><i>Asset-based concentration limits for direct investments.</i> Investments in U.S. government securities shall not be subject to a concentration limit. Investments in U.S. agency obligations may not exceed 50 percent of the total assets. Investments in certificates of deposit may not exceed 25 percent of the total assets. Investments in municipal securities may not exceed 10 percent of the total assets. Investments in money market mutual funds comprising only U.S. government securities shall not be subject to a concentration limit. Investments in prime money market mutual funds may not exceed 50 percent of the total assets. Investments in money market mutual funds comprising less than \$1 billion in assets and/or which have a management company comprising less than \$25 billion in assets, may not exceed 10 percent of the total assets.</p> <p><i>Issuer-based concentration limits for direct investments.</i> Securities of any single issuer of</p> |                 |

<sup>77</sup> Eur. Sec. & Mkts. Auth., Final Report: Draft technical standards under the Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC Derivatives, CCPs and Trade Repositories 128-29 (Sept. 27, 2012).

<sup>78</sup> Eur. Sec. & Mkts. Auth., Final Report: Draft technical standards under the Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC Derivatives, CCPs and Trade Repositories 131 (Sept. 27, 2012).

<sup>79</sup> Eur. Sec. & Mkts. Auth., Final Report: Draft technical standards under the Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC Derivatives, CCPs and Trade Repositories 49 (Sept. 27, 2012).

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|                              | <p>do not include a concentration limit exemption for investments in sovereign bonds.</p>   | <p>U.S. agency obligations may not exceed 25 percent of total assets. Securities of any single issuer of municipal securities, or certificates of deposit, may not exceed 5 percent of total assets. Interests in any single family of prime money market mutual fund may not exceed 25 percent of total assets. Interests in any individual prime money market mutual fund may not exceed 10 percent of total assets.</p> <p><i>Counterparty concentration limits.</i> Securities purchased by a DCO clearing member or DCO from a single counterparty, subject to an agreement to resell to that counterparty, shall not exceed 25 percent of total assets.</p> <p><i>Time-to-maturity.</i> Except for investments in money market mutual funds, the dollar-weighted average of the time-to-maturity of the portfolio may not exceed 24 months.</p> <p>[Investment of Customer Funds 76 Fed. Reg. 78798-78800 (December 19, 2011)]</p> |                 |
| <p>Acceptable Collateral</p> | <p><b>EMIR:</b></p> <p>A CCP shall accept highly liquid collateral with minimal credit and market risk to cover its initial and ongoing exposure to its clearing members. A CCP may accept bank guarantees as collateral from non-financial counterparties. It shall apply adequate haircuts to asset values that reflect the potential for their value to decline over the</p> | <p><b>CFTC Final Rule DCO Core Principles:</b></p> <p>A DCO shall limit the assets it accepts as initial margin to those that have minimal credit, market, and liquidity risks. A DCO may accept letters of credit as initial margin for futures and options on futures but shall not accept letters of credit as initial margin for swaps. A DCO shall apply appropriate reductions in value to reflect credit, market, and liquidity risks (haircuts), to</p>  |                 |

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|  | <p>interval between their last revaluation and the time by which they can reasonably be assumed to be liquidated.<sup>80</sup></p> <p><b>ESMA Technical Standards:</b></p> <p><b>A CCP must have concentration limits for each issuer; type of issuer, type of asset, and each clearing member. A CCP shall ensure that no more than 10% of its collateral is guaranteed by a single credit institution.<sup>81</sup></b></p> <p><b>ESMA Final Technical Standards discussion portion:</b></p> <p>It is necessary to avoid concentration at each clearing member so as to: 1) avoid that CCPs end up with only one type of collateral to be liquidated following a CM default, which would then expose the CCP to concentration risk when the collateral needs to be used; 2) ensure a level playing field among CMs.<sup>82</sup></p> <p>“As for the sovereign bonds, concentration risk may come from them as well, so it</p> | <p>the assets that it accepts in satisfaction of initial margin obligations, taking into consideration stressed market conditions. A DCO shall apply appropriate limitations or charges on the concentration of assets posted as initial margin. [Derivatives Clearing Organization General Provisions and Core Principles, 76 Fed. Reg. 69,334, 69,439 (Nov. 8, 2011).]</p> |                 |

<sup>80</sup> Council & Parliament Regulation 648/2012, OTC Derivatives, Central Counterparties and Trade Repositories, 2012 O.J. (L201) 38-39 (EU).

<sup>81</sup> Eur. Sec. & Mkts. Auth., Final Report: Draft technical standards under the Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC Derivatives, CCPs and Trade Repositories 123, 127-28 (Sept. 27, 2012).

<sup>82</sup> Eur. Sec. & Mkts. Auth., Final Report: Draft technical standards under the Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC Derivatives, CCPs and Trade Repositories 47 (Sept. 27, 2012).

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|                                     | would not be appropriate to introduce exceptions for such a case.” <sup>83</sup>  |   |                 |
| Collateral Segregation Requirements | <p><b>EMIR:</b></p> <p>Requires a CCP to maintain detailed records that allow for the immediate distinction of assets and positions held by any individual clearing member. Further, a CCP must offer clearing members segregation services that: (1) readily distinguish clearing member proprietary assets from the assets of its clients in the aggregate (defined as “omnibus client segregation”); and (2) distinguish each individual clearing member clients assets as separate from any other clients of the same clearing member (defined as “individual client segregation”). According to EMIR, clearing members must offer its clients the choice between omnibus and individual segregation, with a precise definition of the fees and legal implications associated with each choice. Individual segregation allows for the clear and separate treatment of the client’s margin along with more robust rights to recovery.<sup>84</sup></p> | <p><b>DFA:</b></p> <p>Allows a DCO clearing member to commingle all of its client collateral in one account and deposit it with a DCO.</p> <p>[DFA sec. 724(a)]</p> <p><b>CFTC DCO Core Principles Final Rule:</b></p> <p>In order to commingle funds, a DCO must file for CFTC approval, which would require a specific set of information to be provided regarding liquidity, risk characteristics, and a description of management procedure, among other criteria. This account must at all times remain separate from that of the DCO, but there is no requirement for the availability of quick and clear distinction between customer assets in the commingled fund.</p> <p>[Derivatives Clearing Organization General Provisions and Core Principles, 76 Fed. Reg. 69,334, 69,441 (Nov. 8, 2011).]</p> <p>CFTC Final Rule Protection of Cleared Swaps Customer Contracts and Collateral</p> <p>The CFTC adopted the “legally separated with</p> |                 |

<sup>83</sup> Eur. Sec. & Mkts. Auth., Final Report: Draft technical standards under the Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC Derivatives, CCPs and Trade Repositories 47 (Sept. 27, 2012).

<sup>84</sup> Council & Parliament Regulation 648/2012, OTC Derivatives, Central Counterparties and Trade Repositories, 2012 O.J. (L201) 36 (EU).

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|  |  | <p>operational commingling” (LSOC) model<br/>                     Under the LSOC Model, each DCO clearing member and DCO would enter (or “segregate”), in its books and records, the cleared swaps of each individual customer and relevant collateral. Each DCO clearing member and DCO would ensure that such entries are separate from entries indicating (i) DCO clearing member or DCO obligations, or (ii) the obligations of non-cleared swaps customers. Operationally, however, each DCO clearing member and DCO would be permitted to hold (or “commingle”) the relevant collateral in one account. Each DCO clearing member and DCO would ensure that such account is separate from any account holding DCO clearing member or DCO property or holding property belonging to non-cleared swaps customers.</p> <p>The DCO clearing member would ensure that the DCO does not use the collateral of one cleared swaps customer to support the obligations of another customer by making certain that the value of the cleared swaps customer collateral that the DCO holds equals or exceeds the value of all cleared swaps customer collateral that it has received to secure the contracts of the DCO clearing member’s customers. Following a double default, the DCO would be permitted to access the collateral of the defaulting cleared swaps customers, but not the collateral of the non-</p> |                 |

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|                |  | defaulting cleared swaps customers.<br><br>[Protection of Cleared Swaps Customer Contracts and Collateral, 77 Fed. Reg. 6339 (February 7, 2012)]   |                 |
| Stress Testing | <p><b>ESMA Final Technical Standards:</b></p> <p>On a daily basis, CCPs must stress test and back test margin coverage, default fund contributions and financial resources coverage. A CCP’s stress-testing programme shall ensure that its combination of (1) margin, (2) default fund contributions and (3) other financial resources are sufficient to cover the default of at least the two clearing members to which it has the largest exposures under extreme but plausible market conditions. A CCP’s stress-testing programme shall ensure that its (1) margins and (2) default fund are sufficient to cover at least the default of the clearing member to which it has the largest exposures or of the second and third largest clearing members, if the sum of their exposures is larger. A CCP shall also stress test the position of clearinghouse members.</p> <p>On a daily basis, A CCP will also stress test the liquidity of its financial resources.</p> | <p><b>CFTC Final Rule DCO Core Principles:</b></p> <p>On a daily basis, DCOs must conduct stress tests with respect to each large trader who poses significant risk to a clearing member or the DCO. On a daily basis, DCOs must backtest products or portfolios that are experiencing significant market volatility. On at least a monthly basis, a DCO shall conduct back tests to assess the adequacy of all of its initial margin requirements. On at least a weekly basis, a DCO shall conduct stress tests with respect to each clearing member account, by house origin and by each customer origin. A DCO must conduct stress tests on a monthly basis to make a reasonable calculation of the financial resources it needs to meet the its financial obligations to its clearing members notwithstanding a default by the clearing member creating the largest financial exposure for the DCO in extreme but plausible market conditions. <b>No reverse stress test requirement. No sensitivity analysis requirement.</b></p> |                 |

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|   | At least quarterly, a CCP shall conduct reverse stress tests, which are designed to identify under which market conditions the combination of its margin, default fund and other financial resources may provide insufficient coverage of credit exposures and for which its liquid financial resources may be insufficient. Sensitivity analysis shall be conducted at least monthly. <sup>85</sup>   | [Derivatives Clearing Organization General Provisions and Core Principles, 76 Fed. Reg. 69,334, 69,348 (Nov. 8, 2011).]  |                 |
| Interoperability Arrangements               | <b>EMIR:</b><br>Allows for interoperability arrangements between CCPs. EMIR sets forth risk management standards and margin requirements for interoperability arrangements. EMIR requires ESMA to publish by Dec. 31, 2012 guidelines on interoperability. EMIR restricts the scope of interoperability arrangements to transferable securities and money-market instruments. However, by Sept. 30, 2014, ESMA should submit a report to the Commission on whether an extension of that scope to other financial instruments would be appropriate. <sup>86</sup> | DFA and CFTC have not addressed interoperability arrangements.   |                 |
| Central Bank Access and Orderly Liquidation | Neither EMIR nor the ESMA technical standards require clearing houses to have access to central bank liquidity. However, certain European CCPs (e.g.,  | Pursuant to authority granted by Title VIII of the DFA, the FSOC has designated 8 U.S. clearinghouses, including CME, Options Clearing Corporation, ICE and the DTCC, as |                 |

<sup>85</sup> Eur. Sec. & Mkts. Auth., Final Report: Draft technical standards under the Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC Derivatives, CCPs and Trade Repositories 133 (Sept. 27, 2012).

<sup>86</sup> Council & Parliament Regulation 648/2012, OTC Derivatives, Central Counterparties and Trade Repositories, 2012 O.J. (L201) 40 (EU).



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| Process | <p>German-based Eurex Clearing AG and France-based LCH.Clearnet SA) already have access to central bank funds – but this is only by virtue of the fact that they are licensed as banks. Also, some European central banks (for example, the Sveriges Riksbank and the Swiss National Bank) offer intraday liquidity to regulated nonbank financial institutions, including investment firms, clearing houses, and insurance companies.<sup>87</sup></p> <p>There is not an orderly resolution process in the E.U. that is comparable with the U.S. OLA.</p> | <p>systemically important financial market utilities.</p> <p>[Press Release, U.S. Dep’t of the Treasury, Financial Stability Oversight Council Makes First Designations in Effort to Protect Against Future Financial Crises (July 18, 2012), <a href="http://www.treasury.gov/press-center/press-releases/Pages/tg1645.aspx">http://www.treasury.gov/press-center/press-releases/Pages/tg1645.aspx</a>.]</p> <p>Such a designation empowers the Federal Reserve to impose additional prudential regulations on such entities and provides such entities with discount and borrowing privileges from the Federal Reserve.</p> <p>[DFA Title VIII.]</p> <p>Importantly, Title II of the Dodd-Frank Act sets forth the Orderly Liquidation Authority, an alternative to bankruptcy which allows the relevant regulator to temporarily guarantee the debt of a failing systemically important financial company. It is unclear whether systemically important financial market utilities will have OLA access.</p> <p>[DFA Title II]</p> |                 |

<sup>87</sup> Int’l Monetary Fund, Global Financial Stability Report: Meeting New Challenges to Stability and Building a Safer System 91-118 (Apr. 2010).