EVENT REPORT

EUROPEAN CAPITAL MARKETS INSTITUTE

* * *

In May 2013, the SEC proposed a series of rules to address the application of the regulatory requirements under Title VII of the Dodd-Frank Act to the cross-border security-based swap activities. In their first trip to Brussels since the adoption of SEC's new cross-border derivatives rule (June 25, 2014), SEC officials explained the new rule and spoke about on-going international efforts to address gaps, overlaps and conflicts in the implementation of new OTC derivatives rules in the US, EU and other jurisdictions.

Speakers**:**

- **Brian A. Bussey**, Associate Director for Derivatives Policy and Trading Practices, Division of Trading and Markets, U.S. Securities and Exchange Commission
- **Eric J. Pan**, Associate Director, Office of International Affairs, U.S. Securities and Exchange Commission
- **Karel Lannoo**, CEO, CEPS [moderator]

* * *

Brian A. Bussey (SEC) explained that while FX, IR, commodity derivatives are under the remit of the CFTC, for credit and equity derivatives the SEC and CFTC share regulatory competences. In developing the final rules and guidance on cross-border activities, the SEC looked at balancing the regulatory goals of the Dodd-Frank Act with the practical needs of market participants and, in that regard, focused on the workability of SEC's rules with the existing CFTC regime.

First, on the **scope** of the adopted rules, the two key elements are the security-based swap dealer and major security-based swap participant registration requirements. More specifically, the rules explain when a cross-border transaction is deemed to be counted toward these requirements, i.e. when dealing transactions conducted in the past 12 months exceed certain thresholds. These key elements are supported by cross-cutting rules, e.g. "U.S. person" definition. The SEC also adopted a procedural rule, not a substantive standard, regarding the "substituted compliance", a U.S term of what the EU calls "equivalence". However, the final rules do not include a very controversial conduct of business related element of the proposal, that is, if transactions between two non-U.S. persons should be included in the relevant registration thresholds because one or both counterparties are engaged in security-based swap activity within the U.S. For example, a Canadian pension fund and a London-based dealer doing a transaction using a sales/trading force based in NY. Also, very often it's the case that sales force/traders in London engage in transactions on behalf of non-EU based counterparties. To this point, Mr. Bussey mentioned that in fact, under EMIR and the RTS, there is a conduct test, but it's not being laid out as such. For example, EMIR would apply to a transaction involving two Japanese banks that have branches in Frankfurt. While the EC took this particular approach, the SEC expects to solicit additional comment.

Second, with regard to the **approach** in future rulemakings, the SEC will employ an integrated, one package, "all and done" approach. In other words, the SEC is not going to break up individual components of the legislation addressing first the domestic issues and then the cross border ones. The market participants from the US and overseas will be made aware at the same time of the full set of rules, the availability of substituted compliance and the implementation timetables.
Third, on the **consultation and cooperation** on the cross-border aspects, the SEC engages in dialogue with relevant European and Asian authorities and, most notably, participates in the OTC Derivatives Regulators Group (ODRG). Actually, the EC submitted a comment formal letter to SEC in response to May 2013 Rule Proposals. The EC requested

IMPORTANT NOTICE: The views expressed by the speakers are their own individual views and do not necessarily reflect the views of their companies or institutions. The content of this event report is not a transcription of the speeches delivered by the speakers and should instead be understood as the interpretation of their views by the author. This report was authored by Cosmina Amariei, Research Assistant at ECMI. Please contact ecmi@ceps.eu for any comments or questions

the SEC to give significant guidance as to when a hedge fund has a principal place of business in the U.S. and should be subject to Dodd Frank Act or not. For example, a Cayman Islands organized hedge fund that is managed in either the US or EU. If the foreign organized hedge fund has a U.S.-based advisor or an AIFM manager, it will be considered US person or subjected to EMIR, respectively. The approaches to investment funds are very similar, with a couple of details to be worked out on the European side. The EC also wanted to make sure that alongside market participants, foreign regulators could request substituted compliance. The final rules were revised accordingly. Finally, the EC raised concerns about the transactions conducted in the US on which SEC needs to seek additional comment on before moving toward adoption.

Fourth, the rules adopted will be effective 60 days after their publication in the Federal Register. However, these will not impose requirements on market participants until after relevant substantive rulemakings have been completed. The SEC has signaled that the reporting requirements to Trade Repositories (TRs) will be the **next set of rules** to be adopted. After that, the 2012 SEC "Roadmap" on Phase-in of Derivatives Regulation calls for implementing the registration security-based swap dealers and major security-based participants and then moving on security-based swap execution facility and trade execution requirements. The SEC is currently working at staff level on the approach to mandatory clearing determination, something that CFTC has already done, and on finalizing the Enhanced Requirements for the CCPs deemed to be systematically important or that have complex risk profiles that were proposed in March 2014. There are still lot of difficult issues to resolve when trying to implement a robust framework for regulation of derivatives, including mitigating potential threats of overlapping with the EU, Asia requirements and minimizing the costs for industry participants.

With regard to consistency with CFTC rules, there is only one significant area where SEC and CFTC are different and that is on the U.S. person definition with respect to private funds. Hypothetically, an UK based advisor advising a Cayman Islands organized fund that has 100% U.S. ownership, will, under CFTC guidance, be considered a U.S. person. However, under SEC guidance, that fund would be considered a non-U.S. person. Under EMIR, that fund will be viewed as E.U. based. Another issue that is left for the EU is that a U.S. managed fund based in the Cayman Islands will get the benefit of equivalence under EMIR, art 13.3. In practice, many of the US managed funds organized outside of the US are treated as US person but they may not get the benefit of equivalence in their transaction with the European dealers under EMIR. According to Mr. Bussey, this is not desirable result and in fact it will be an issue of conflict between the EU and the US regimes. This inconsistency should be avoided not only for regulators trying to achieve policy objectives but also for the industry as they strive to comply with potentially multiple regimes. So far, the bulk of the negotiation took place between EC and CFTC. More progress is expected in the future also from SEC.

Eric J. Pan (SEC) outlined that SEC needs to have further discussion on the equivalence determinations that the EC is giving, called broadly the deference issues. SEC officials expect the focus of these EU deference decisions to be based upon regulatory objectives and movements toward some reciprocity type of an arrangement to be avoided. Also SEC will begin substitute compliance fitting in terms on how to offer substitute compliance, start reviewing applications and requests.

Other points were on the importance to protect transferred data for supervisory and enforcement purpose, insure complete reporting of data and access to TRs). The SEC is concerned about any legal barriers that jurisdictions may have, secrecy/privacy laws or blocking statutes that may require some counterparty information masking to TRs. In his view, the whole purpose could be undermined if incomplete information is being shared or relevant stakeholders, such as regulators, are prevented from having access to data captured by TRs. With regard to the sharing of information, there is also a possible problem with the written indemnification agreement provision in the Dodd Frank (recourse to data in EU terms), this posing a challenge for non-US regulators to have access to data from US-based TRs. On the European side, EMIR has the requirement there should be an international agreement This creates barriers as well to US regulators in getting access to data from EU TRs or for US TRs to be found equivalent by the EC. Mr. Bussey also stressed that these problems have to be solved within the bounds of the law, the law not being infinitely flexible. If there is no way, then it will be necessary to go back and seek some legislative change. The desirable outcome for the two biggest derivatives markets is to be able to come up with a combined database to look at the market activity.

On the inclusion of financial services in the TTIP, Mr. Pan indicated that the EU proposal looks very sensible at first sight. However, the notion of adding difficult regulatory problems that require a high degree of technical analysis, putting them in a dispute resolution regime, or having some type of ex-ante provisions in a trade agreement is considered to be very problematic. Moreover, he argued that the burden of proof is not on why U.S. thinks TTIP should not include financial services, but for the EU to explain how it is expected to work in practice. This calls for creativity and good faith discussions with the EU regulators and co-legislators, but the history of the past couple of years indicated this was not possible.

Find more information about this event at www.eurocapitalmarkets.org

.