ACROSS THE POND

Recent U.S. Policy Developments in Financial Services

March 6, 2012
Issue 11

Regulatory Update – March 6, 2012

- As of February, roughly 25% of the 400 Dodd-Frank rulemakings have been finalized. Due to an extremely narrow time frame and the large number of regulations to be contemplated and drafted, more than half of the deadlines for rulemakings have passed – including nearly a quarter of the proposed rules that have yet to be issued in draft form. The results to date of this compressed regulatory drafting task have dire indications for other global jurisdictions facing similar time/resource constraints.

Commodity Futures Trading Commission

- The CFTC held an open meeting on February 23 to consider two rulemakings. The Commission narrowly approved a final rule related to internal business conduct standards for swap dealers and major swap participants, including requirements for participant recordkeeping and reporting. The Commission also approved a proposed rule related to swaps block trading. The meeting agenda originally included the joint SEC/CFTC final rule on entity definitions, such as swap dealer and major swap participant, but the item was removed prior to the meeting.

Securities and Exchange Commission & CFTC

- The two Commissions recently published their *Joint Report on International Swap Regulation*, which provides a comprehensive update on the status of global derivatives reform as dictated by the G20 commitments set forth in September 2009. The report is one of several that U.S. regulatory agencies are required to submit to Congress under the Dodd-Frank Act.

Congressional Oversight

- A Subcommittee of the House Financial Services Committee held a hearing on February 8th to examine the extraterritorial impact of Dodd-Frank derivatives rules, which featured testimony from industry experts and market participants. The witnesses' comments were largely consistent in their testimony and warned that an overly broad application of new Dodd-Frank rules may impede global regulatory harmonization, threaten US competitiveness overseas and lead to regulatory arbitrage.
- The hearing also focused on the bipartisan "Swap Jurisdiction Certainty Bill," which seeks to limit the extraterritorial impact of Dodd-Frank by providing foreign branches of U.S. institutions limited exemptions from certain swaps rules.

What is Washington talking about?

Volcker pushback gone global – If 15,000 comment letters weren't enough, U.S. regulators are facing intense criticism over the Volcker rule from foreign governments and central banks as well. Foreign officials, including EU Commissioner Michel Barnier, have urged U.S. regulators to re-propose the rule to limit its scope and extraterritorial impact. During a speech at the U.S. Chamber of Commerce, Barnier raised concerns about the rule's impact on liquidity in sovereign bond markets. As the rule currently stands, trading in U.S. treasuries is exempt from the ban – the rule does not, however, provide an exemption for trading in foreign sovereign bonds.

The long arm of Dodd-Frank – Concerns regarding the extraterritorial reach of Dodd-Frank are not limited to the Volcker rule. Dodd-Frank rules related to data reporting and swap data repositories, namely the indemnification and plenary access provisions, have drawn strong criticism from regulators overseas because of the potential for swap data fragmentation and a reduction in international data sharing. In the recently published SEC-CFTC *Joint Report on International Swap Regulation*, the Commissions stated that "a statutory change [to Dodd-Frank] may be necessary to ensure that the U.S. is able to fully cooperate with international regulators to share critical information regarding global risk exposure and trade data."

Romney regains momentum – Mitt Romney regained the upper hand in the race for the Republican Presidential nomination with a sweep of the Michigan and Arizona primaries on February 28. Romney now has more delegates than all of his opponents combined and remains the frontrunner for the nomination heading into the "Super Tuesday" primaries on March 6.

Do you speak Dodd-Frank?

The Volcker Rule – *The Volcker Rule, (named after former Federal Reserve chairman Paul Volcker), aims to restrict proprietary trading by banks. The rule, issued in two proposals – one by the CFTC and one issued jointly by the FDIC, the SEC, the OCC, and the Federal Reserve – prohibits banks from trading in certain financial products using their own funds. It also places restrictions on banks investing in hedge funds and private equity funds. Certain activities, such as market making and hedging against risk, are exempt under the proposed rule. Industry associations and market participants have warned, however, that the rule's narrow definition of activities considered permissible will effectively destroy legitimate market making activities and the ability of banks to hedge against risk. The proposal received roughly 15,000 comment letters, and it remains to be seen whether U.S. regulators will re-propose the rule.*

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Recent European Policy Developments in Financial Services

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Council of the EU

- After 18 months of legislative drafting, over 15 compromise texts and numerous tripartite negotiations, the Council agreed a deal on EMIR with the Parliament and Commission on 9 February. This paves the way for the drafting of regulatory standards by ESMA which are now expected by September 2012, albeit with potential delays. Following the agreement, ESMA published a discussion paper on draft technical standards, setting a deadline for 19 March.
- The Council is now focusing on other topics, namely the Capital Requirements Directive IV. Discussions are progressing slowly on the revision of the Markets in Financial Instruments Directive/Regulation (MiFID/MiFIR) and the Market Abuse Directive/Regulation – it is becoming clear that these dossiers will be finalised by future Presidencies.

European Parliament

- The Parliament will vote on the final EMIR text at the end of March and has recently shifted its attention to the discussions around MiFID/MiFIR. The Parliament report on the latter is expected by late March/mid-April, while a final vote at the Parliament's ECON Committee is scheduled for July. The rapporteur of the Parliament's report, Mr. Ferber, and key MEPs have focused on MiFID's content around pre-trade transparency, High Frequency Trading (HFT), Organized Trading Facilities-OTFs (equivalent to SEFs), and commodities derivative positions. On commodities, the Parliament would wish to see a regime closely aligned with U.S. position limits.

European Commission

- The Commission will soon present its plans on a draft regulation on Central Securities Depositories (CSD), but has pushed back several legislative initiatives such as the proposals for bank crisis resolution (expected in the summer 2012) as well as the market infrastructure resolution proposal (due Q4 2012 or Q1 2013).

What is 'Brussels' talking about?

Eurozone crisis

- **Second bailout package agreed:** Amidst a climate of social protests, increasing public disillusion with central government and political turbulence, Athens agreed on an austerity package in order to receive extra EU financial assistance. Eurozone leaders earlier agreed on a second Greek bail-out deal valued at €130 billion/$180 billion. Greece faces significant challenges ahead as it aims to trim its debt, which stands at around 160% of GDP. Moreover, the reliability of Greek politicians actually implementing reforms is tarnished and the upcoming April elections are causing nervousness amongst EU policymakers. Senior EU policymakers are already warning that a 3rd bail-out may be necessary in the coming year(s).
- **The end of an era -** Despite the deal, the Eurozone states maintain that the Greek case is a unique situation, but they are still at odds over whether the EU bail-out fund should be expanded. Germany opposes the idea of raising the lending limit of the European Stability Mechanism (ESM) above the current €500 billion, but the Commission is encouraging other Eurozone leaders to back a larger fund. Regardless, it is likely the that European social model has been irreparably damaged, and austerity measures, low credit and high unemployment rates now appear the rule rather than the exception.

Do you speak European?

A Revision on EMIR – Class Dismissed, Any Lessons Learned?

EMIR is the acronym for the European Market Infrastructure Regulation, and is part of the EU's regulatory response to the global financial crisis. It aims at recognizing and reinforcing CCPs' role in mitigating market and counterparty risk and at enhancing transparency in derivatives markets through, inter alia, mandatory reporting to trade repositories. Key points include:

- *'Eligible' OTC derivative contracts should be cleared through CCPs; exemptions granted for non-financials users of derivatives, central banks and pensions funds, among others*
- *Interoperability for equity CCPs: EMIR sets out the conditions under which interoperability of cash equity CCPs can occur while the Commission will assess by December 2014 the need to extend the scope of interoperability to other financial instruments, namely derivatives.*
- *Obligatory Reporting to Trade Repositories: All derivative transactions (OTC and exchange-traded) must be reported within one day of execution to an EU-registered or 3rd country recognized repository. ESMA will supervise trade repositories, which will be required to publish aggregate positions by class of derivatives.*
- *Third Country Issues and Extraterritoriality: EMIR allows 'third country' providers to offer services in the EU, provided the legal and supervisory regime in their country is effectively equivalent.*

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