

ACROSS THE POND

Recent U.S. Policy Developments in Financial Services

April 25, 2012

Issue 13

Regulatory Update – April 25, 2012

Securities and Exchange Commission & Commodity Futures Trading Commission

- The agencies recently issued the highly anticipated joint final definitions for “swap dealer,” “security-based swap dealer,” “major swap participant,” “major security-based swap participant” and “eligible contract participant.” Entities that meet the joint definitions of SDs and MSPs will be subject to greater federal oversight and more substantial statutory requirements stemming from separate rulemakings, including registration, margin, capital and business conduct standards. The CFTC estimates that roughly 125 institutions will qualify as “swap dealers” and another 6 as “major swap participants.”
- Significantly, the agencies’ final rule provides for a phase-in of the de minimus threshold for an entity to be considered a “swap dealer,” while drastically increasing the initially proposed threshold. The proposed rule set the threshold at an aggregate net notional position of \$100 million annually, while the final rule increased the threshold to effectively \$8 billion. According to the final rule, the threshold is likely to decrease to \$3 billion after five years.
- The final rule also mandates that a study of the swaps market be conducted two and a half years after transactions start to be reported to swap data repositories, which Chairman Gensler said could commence by this summer. This study will form the basis of the agencies’ decision to raise or lower the threshold.

Commodity Futures Trading Commission

- The CFTC also issued a final rule which subjects commodity options to the same laws that apply to other swap transactions. Prior to the rulemaking, agricultural swaps and commodity options were subject to a separate regulatory regime than other swaps.
- CFTC Chairman Gensler indicated that the agency will now focus on promulgating final rules related to the end-user exemption and designated contract markets (DCMs). He also stated that the Commission will soon release for public comment its interpretive guidance on the indemnification provision. The provision has gained visibility in recent weeks after the introduction of legislation that would repeal the provision from Dodd-Frank.

Congressional Oversight

- The HFSC recently approved legislation to remove several provisions from Dodd-Frank – a move that the Congressional Budget Office indicated would trim nearly \$27 billion from the federal budget. The measure would repeal Title II, which provides authority for the orderly liquidation of failed systemically important financial firms and would subject the Consumer Financial Protection Bureau to the appropriations process.
- A House Oversight and Government Reform Subcommittee recently held a hearing to assess the SEC’s capacity to conduct adequate cost-benefit analyses of proposed Dodd-Frank rulemakings. At the hearing, SEC Chairman Mary Schapiro vigorously defended the Commission’s process for promulgating new rules. A House Financial Services Subcommittee conducted a similar hearing on April 25.

What is Washington Talking About?

Volcker timeline – U.S. regulatory agencies responsible for the implementation of the Volcker Rule recently announced that financial firms will have until at least July 2014 to fully comply with the new requirement. While welcome news for the firms facing compliance, the announcement was interpreted by some policymakers, including Senator Bob Corker (R-TN), as evidence that the rule is “overly complex.” A study by SIFMA recently suggested that liquidity losses due to the Volcker Rule could reach \$300 billion.

Romney vs. Obama – With Rick Santorum officially out of the race for the Republican presidential nomination, Mitt Romney has turned his full attention to the ouster of President Obama. Speculation is increasing as to who will join Romney on the ticket, with Florida Senator Marco Rubio, Rob Portman of Ohio, former Florida Governor Jeb Bush, and New Jersey Governor Chris Christie all on the theoretical shortlist for the vice-presidential nomination.

Do you speak Dodd-Frank?

MAJOR SWAP PARTICIPANT – According to the Dodd-Frank Act, a “major swap participant” is defined as:

- “A person that maintains a substantial position in any of the major swap categories (rates, credit, equity, commodities), excluding positions held for hedging or mitigating commercial risk and positions maintained by certain employee benefit plans for hedging or mitigating any risk directly associated with the operation of the plan;
- “A person whose outstanding swaps create substantial counterparty exposure that could have serious adverse effects on the financial stability of the U.S. banking system or financial markets; or
- “Any financial entity that is highly leveraged relative to the amount of capital it holds and that is not subject to capital requirements established by the Federal banking agency and that maintains a substantial position in any of the major swap categories.”

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Recent European Policy Developments in Financial Services

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Council of the EU

- The Danish Presidency is seeking a compromise deal on the Capital Requirements Directive IV before the summer.
- Meanwhile, progress is being made on MiFID/MiFIR, with the Danes expected to issue an initial draft proposal by mid-May. The proposal will serve as an unofficial state-of-play account of Member State discussions to provide guidance to the Cypriot Presidency when it takes office on 1 July. Political agreement is not expected before September 2012.
- The Council has also begun deliberations on the draft Central Securities Depositories proposal, with political agreement expected by Q3 2012.
- EU finance ministers are working on alternatives to the Financial Transaction Tax (FTT) ahead of their 2 May meeting. The German proposal for a tax that looks like a stamp duty is gaining ground, as a significant number of EU countries appear to support an EU-wide transaction tax that only applies to exchange-traded corporate shares.

European Parliament

- MEPs have agreed that the legislative process of MiFID/MiFIR and Market Abuse (MAD/R) should be aligned. However, the two draft parliamentary reports on the initiatives have conflicting provisions with regards to the OTF category (a new trading venue category similar to SEFs). The MiFID report proposes to restrict the use of OTFs to non-equity products, whilst the MAD report suggests deletion of the OTF category. This difference sparked inter-Parliamentary debates and strengthened the call for delays in the decision-making timeline.

European Commission

- The Commission published an explanatory statement on OTFs and Systematic Internalisers in the context of MiFID/R reflecting to a great extent the Council and industry's calls for clarification.
- The Commission's priority has shifted to the proposal on crisis management and resolution, which is due in June. The European resolution framework will provide authorities with a range of options that would allow them to deal with banks in crisis.

What is 'Brussels' talking about?

- **Europe in election mode:** France held its first round of Presidential elections on 22 April with a second round scheduled for 6 May. Socialist candidate Francois Holland led the first round of voting by a single point over President Sarkozy, with a surprisingly strong finish in 3rd place by the far-right National Front candidate Madame Le Pen. Sarkozy is the first French President to seek re-election and fail to lead in the first round of voting and, should he lose in two weeks, he will be the 11th Eurozone leader to fail at the ballot box since the beginning of the financial crisis. Greece announced that it will hold elections on 6 May and a coalition government is likely to emerge.
- **Europe in crisis mode:** Saving Greece still remains the number one priority for the EU amidst rising fears of the potential outcome of the Greek elections. French and German leaders clashed on the ECB's role, with France proclaiming a more growth-oriented role and Germany traditionally opposing any expansion of the ECB's mandate.
- **Interoperability:** EMIR embeds the concept of CCP interoperability for cash equity markets, acknowledging the significant benefits of generating scale economies to bring down costs of EU clearing as well as eliminating CCPs as a potential single point of failure for a national market. NASDAQ OMX's recent last minute decision to pause its interoperability project in the Nordic region has raised concerns amongst Nordic policymakers about the potential future competitiveness of their market.

Do you speak European?

THE LAMFALUSSY PROCESS – Named after the prominent chair of the EU advisory committee that created it, Alexandre Lamfalussy, the process is one approach to the development of European financial regulation. It is composed of 4 levels, with each level focusing on a specific stage of the implementation of legislation. The creation of the new pan-European supervisory authorities (ESMA for securities, EIOPA for insurance and EBA for banks) has resulted in some changes to the process:

- Level I: The European Parliament and Council adopt framework legislation setting out the core principles and defining implementing powers/guidelines on its implementation (e.g EMIR was adopted in February)
- Level II: The law is processed by sectoral regulators, who advise on technical details and regulatory standards, then bring it to a vote before EU legislators (e.g. ESMA is set to draft regulatory standards on EMIR by 30 September, and then send to Commission, which in its turn will send to parliament and Council for approval)
- Level III: EU and national regulators work on coordinating new regulations with other nations.
- Level IV: Compliance and enforcement of the new rules and laws.

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