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Update on Third-Country Equivalence Under EMIR

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The European Commission has adopted “equivalence” decisions on the derivatives regulatory regimes for central counterparties in Australia, Hong Kong, Japan and Singapore. Further decisions are awaited for other jurisdictions and for other derivatives regulatory requirements. This paper summarises the equivalence decisions and technical advice that has been produced to date.

Equivalence

Under the European Market Infrastructure Regulation (“EMIR”),¹ the European Commission may adopt implementing acts declaring that the legal, supervisory and enforcement arrangements of a non-EU country are equivalent to the requirements in EMIR.² Such a decision is necessary for a central counterparty (“CCP”) or trade repository (“TR”) established in a non-EU country to provide their services in the EU. EMIR also requires equivalence decisions to be issued in respect of other obligations. These are relevant in circumstances where one of the counterparties to a trade subject to EMIR is established outside the EU, as an equivalence decision would permit both counterparties to comply with the non-EU country’s equivalent regime instead.

EMIR requires the European Securities and Markets Authority (“ESMA”) to provide technical advice to the European Commission as to the equivalence of some non-EU jurisdictions which host major derivatives markets or CCPs which have applied for recognition. ESMA’s assessment is a factual comparison of the rules in the relevant jurisdiction with the EU rules and advice to the Commission on how any differences might affect an equivalence decision or could be incorporated into an equivalence decision. The scope of the advice covers the recognition of non-EU CCPs and TRs, the clearing obligation, reporting obligation, non-financial counterparties (“NFCs”), portfolio reconciliation, dispute resolution, portfolio compression and margin requirements.

¹ Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories.

² You may like to read our client note, “Extraterritoriality Revisited: Access to the European Markets by Financial Institutions, Funds and Others from Outside Europe,” available [here](#). The note sets out the requirements for non-EU entities to gain access to the EU markets under various European legislative requirements.

The Commission's equivalence decision will be based on ESMA's advice and an assessment of the outcomes of the third country's rules, including whether the rules mitigate any risks faced by market participants in the EU to the same extent that the EMIR rules are intended to do so. The trading volumes in a jurisdiction can be relevant to an assessment of the risks posed to clearing members of a third country CCP. Those CCPs with larger trading volumes operating in larger financial markets will need to be subject to more rigorous risk mitigation requirements than those operating in smaller financial markets.

In September and October 2013, ESMA published its technical advice to the European Commission on the equivalence to the EU rules of the derivatives frameworks in several countries, including the US, Australia, Hong Kong and Japan. In certain cases, where the frameworks were still being finalised, ESMA was unable to advise fully on equivalence. Advice on the regimes for CCPs has also been provided for Hong Kong, Singapore, Switzerland, India and South Korea and on the regimes for TRs for Singapore. Advice relating to Dubai has been postponed.

Implementing Decisions for Australia, Hong Kong, Japan and Singapore were published in October 2014, declaring equivalence between the legal and supervisory framework of the four countries and EMIR for the regulation and supervision of CCPs. In addition, a Memorandum of Understanding was signed with each of the authorities in the four countries regarding arrangements for cooperation related to ESMA's monitoring of the ongoing compliance by CCPs established in each country with the recognition conditions set out in Article 25 of EMIR. Ten CCPs established in Australia, Hong Kong, Japan and Singapore obtained recognition under EMIR on 29 April 2015.³

The recognition of a third country CCP is also important for the clearing members of the CCPs. Recognition under EMIR will give the CCP the status of being a qualifying CCP ("QCCP") which is relevant for clearing member firms to calculate their capital requirements for exposures to CCPs under the EU Capital Requirements Regulation ("CRR"). Lower capital requirements are imposed for exposures to a QCCP than for exposures to a non-QCCP CCP. Under the CRR transitional measures, the enhanced capital requirements would have applied for exposures to non-QCCPs from 15 June 2014, albeit that the European Commission has used its powers to extend that deadline twice and may do so again. In particular, the deadline may be extended further given that there are CCPs established in major derivatives jurisdictions, such as the US, which are not yet recognised under EMIR.⁴

Both the Commission and ESMA have reiterated that ESMA's technical advice should not prejudice a final decision on equivalence. The advice is, nevertheless, a clear indication of those areas where equivalence decisions are likely to be forthcoming or where there is conflict with EMIR. ESMA's advice is that most of the assessed countries have effective supervisory regimes for the derivatives markets, although not in all aspects. Unqualified equivalence decisions are still difficult to achieve. For example, rules on margin requirements and segregation differ between many countries and any equivalence decision not yet made by the Commission for the CCP regime of a third country is likely to remain pending until a proper assessment has been made of those final rules.

³ The ten CCPs are ASX Clear (Futures) Pty Ltd, ASX Clear Pty Ltd, HKFE Clearing Corporation Limited, Hong Kong Securities Clearing Company Limited, OTC Clearing Hong Kong Limited, SEHK Options Clearing House Limited, Japan Securities Clearing Corporation, Tokyo Financial Exchange Inc, Singapore Exchange Derivatives Clearing Limited and The Central Depository (Pte) Limited.

⁴ A joint statement by Jonathan Hill, European Commissioner for Financial Stability, Financial Services and Capital Markets Union and Timothy Massad, Chairman of the US Commodity Futures Trading Commission published on 7 May 2015 indicates that further work is necessary before an equivalence decision for CCPs regulated and supervised by the CFTC will be made, see http://europa.eu/rapid/press-release_STATEMENT-15-4944_en.htm?locale=en.

The matrix below provides a status update and summarises the key outcomes of ESMA's technical advice for the jurisdictions on which ESMA has published advice.

NOTE:

- For Canada, ESMA concluded, on 1 October 2013, that it was not in a position to perform a conclusive analysis as Canada was still in the process of finalising its regulatory regime. ESMA will wait to receive a new mandate from the Commission before providing advice.
- For Switzerland, ESMA has provided advice for CCPs only. ESMA concluded, on 1 October 2013, that it was not in a position to perform a conclusive analysis as Switzerland was still in the process of finalizing its regulatory regime other than for CCPs. ESMA will wait to receive a new mandate from the Commission before providing advice.
- For Singapore and Hong Kong, ESMA's advice was only requested for TRs and CCPs.
- For South Korea and India, ESMA's advice was only requested for CCPs.

KEY:



Clearing obligation, risk mitigation, NFCs, margin for OTC, derivatives, effective supervision, dispute resolution



Trade repository requirements



CCP requirements

	US	JAPAN	AUSTRALIA
Clearing obligation	<p>No equivalence decision yet.</p> <p>ESMA's advice: equivalent, provided that:</p> <p>(i) the product subject to the clearing obligation in the EU is also subject to the clearing obligation in the US; and</p> <p>(ii) the entity in the US is a non-exempted entity, or, if exempted, it would benefit from an equivalent exemption in the EU.</p> <p><u>Intragroup transactions:</u></p> <p>In view of the establishment of an equivalent regime for the clearing obligation and for risk mitigation techniques (see below requirements which are part of the EMIR risk mitigation rules), ESMA advises that transactions between EU and US entities in the same group should benefit from the intragroup exemption.</p>	<p>No equivalence decision yet.</p> <p>ESMA's advice: equivalent, provided that:</p> <p>(i) the product subject to the clearing obligation in the EU is also subject to the clearing obligation in Japan; and</p> <p>(ii) the entity in Japan is a non-exempted entity, or, if exempted, it would benefit from an equivalent exemption in the EU.</p>	<p>No equivalence decision yet.</p> <p>ESMA's advice: equivalent, provided that:</p> <p>(i) the product subject to the clearing obligation in the EU is also subject to the clearing obligation in Australia; and</p> <p>(ii) the entity in Australia is a non-exempted entity, or if exempted, it would benefit from an equivalent exemption if established in the EU.</p>
Timely confirmation	<p>No equivalence decision yet.</p> <p>ESMA's advice: equivalent, provided that:</p> <p>(i) the relevant transaction is executed between a EU counterparty and a Swap Dealer ("SD") or Major Swap Participant ("MSP") subject to Commodity Futures Trading Commission ("CFTC") jurisdiction; and</p> <p>(ii) reporting of unconfirmed trades to EU national regulators is not disappplied.</p>	<p>No equivalence decision yet.</p> <p>ESMA's advice: not equivalent. There are no legally binding requirements for timely confirmation.</p>	<p>No equivalence decision yet.</p> <p>ESMA's advice: not equivalent. There are no legally binding requirements for timely confirmation. However, entities regulated by the Australian Securities and Investments Commission ("ASIC") (e.g. financial services providers) are subject to risk management requirements and have an obligation to conduct financial services honestly, efficiently and fairly. Institutions regulated by the Australian Prudential Regulation Authority ("APRA") are also subject to regulatory guidance. There are also industry conventions about timely confirmation.</p>
Portfolio reconciliation	<p>No equivalence decision yet.</p> <p>ESMA's advice: equivalent, provided that:</p> <p>(i) where the transaction is between a financial counterparty or a NFC that is above the EMIR clearing threshold ("NFC+") and a SD or MSP, the SD or MSP apply the provisions applicable to transactions between SDs and MSPs; and</p> <p>(ii) where the transaction is between a NFC that is below the EMIR clearing threshold ("NFC-") and a SD or MSP, the SD or MSP apply the provisions applicable to transactions to counterparties other than a SD or MSP.</p>	<p>No equivalence decision yet.</p> <p>ESMA's advice: not equivalent. There are no legally binding requirements for portfolio reconciliation.</p>	<p>No equivalence decision yet.</p> <p>ESMA's advice: not equivalent. There are no legally binding requirements for portfolio reconciliation. However, entities regulated by ASIC and/or APRA are subject to risk management requirements, and entities regulated by ASIC have the obligation to conduct financial services honestly, efficiently and fairly. Breaches are enforceable by ASIC and/or APRA, depending on which requirement may not have been complied with, but this is considered insufficient.</p>
Portfolio compression	<p>No equivalence decision yet.</p> <p>ESMA's advice: equivalent where the entity subject to the EMIR provisions on portfolio compression in the EU enters into transactions with a SD or MSP subject to the CFTC regime.</p>	<p>No equivalence decision yet.</p> <p>ESMA's advice: not equivalent. There are no legally binding requirements for portfolio compression.</p>	<p>No equivalence decision yet.</p> <p>ESMA's advice: not equivalent. There are no legally binding requirements for portfolio compression.</p>

	US	JAPAN	AUSTRALIA
Dispute resolution	No equivalence decision yet. ESMA's advice: not equivalent.	No equivalence decision yet. ESMA's advice: not equivalent.	No equivalence decision yet. ESMA's advice: not equivalent.
Effective supervisory and enforcement arrangements with respect to OTC derivatives	No equivalence decision yet. ESMA's advice: broadly equivalent.	No equivalence decision yet. ESMA's advice: equivalent.	No equivalence decision yet. ESMA's advice: equivalent.
Bilateral margin and capital for OTC derivatives	ESMA advises the Commission to suspend a decision on equivalence pending finalisation of the rules in both the EU and each jurisdiction. The Basel Committee on Banking Supervision and the International Organization of Securities Commissions announced on 18 March 2015 that the implementation date for their framework would be postponed until 1 September 2016.		
NFCs	ESMA has advised the Commission not to take a specific determination on equivalence for NFCs but to analyse the clearing obligation and risk mitigation requirements (in the above rows) also with respect to NFCs.		

	JAPAN	AUSTRALIA	HONG KONG
Trade repository requirements	No equivalence decision yet. ESMA's advice postponed (no Japanese TRs have yet indicated that they intend to apply for recognition under EMIR).	No equivalence decision yet. ESMA's advice: <u>Reporting obligation:</u> Broadly equivalent. <u>Guarantee of professional secrecy:</u> Equivalent. <u>Effective ongoing supervision and enforcement:</u> Equivalent.	No equivalence decision yet. Hong Kong is still in the process of finalising its regulatory regime for reporting to TRs. Therefore, ESMA concluded on 1 October 2013 that it was not in a position to perform a conclusive analysis and deliver a technical advice on this topic and will wait for a new mandate from the Commission before providing advice. It should be noted that the absence of an assessment on TRs does not prevent the access of Hong Kong CPs to EU-based TRs authorized by ESMA. Neither does it prevent a Hong Kong branch of a EU entity reporting to a Hong Kong TR if so required by any applicable law other than EMIR.

	US	SINGAPORE	SWITZERLAND
Trade repository requiremen	<p>No equivalence decision yet. ESMA's advice:</p> <p><u>Authorisation requirements:</u> Equivalent, provided TRs adopt legally binding internal policies, procedures, rules, models and methodologies which comply with EMIR requirements relating to operational separation and collection of data on exposures (valuation and collateral).</p> <p><u>Reporting obligation:</u> Not equivalent. The reporting obligation of EMIR cannot be substituted with the reporting obligation of the US regime, which omits the requirement to report specific data on valuation of exposures and collateralisation of such exposures. However, where TRs adopt legally binding internal policies, procedures, rules, models and methodologies that ensure the collection of data on exposures (valuation and collateral), these should be taken into account under the recognition assessment.</p> <p><u>Reporting codes:</u> Broadly equivalent. Similar codes are expected to be used by EU and US TRs, also to ensure compliance with the general reconciliation and data aggregation obligations.</p> <p><u>Guarantee of professional secrecy:</u> Equivalent.</p> <p><u>Effective on-going supervision and enforcement:</u> Equivalent. Although the US regime does not provide specifically for TRs, the US supervisory regime applicable to all regulated firms applies and is equivalent.</p>	<p>No equivalence decision yet. ESMA's advice:</p> <p><u>Authorisation requirements:</u> Equivalent, provided TRs adopt internal policies, procedures and rules that constitute legally binding requirements ensuring the following:</p> <ul style="list-style-type: none"> (a) operational separation of ancillary services; (b) business continuity, in particular the existence of a second backup site; (c) position calculation by TRs; (d) no duplication of reports: requires TR users to match data and the TR to validate reports upon receipt; (e) deadline to report: TR to be ready to receive reports one day after the execution of the contracts, at the latest; and (f) disclosure to the public and relevant authorities in a similar manner as prescribed under EMIR and relevant technical standards. <p><u>Effective on-going supervision and enforcement:</u> Equivalent.</p>	<p>No equivalence decision yet. ESMA's advice postponed.</p>

	JAPAN	AUSTRALIA	HONG KONG	SINGAPORE
CCPs subject to ongoing supervision and enforcement	Equivalent under Commission Implementing Decision 2014/752/EU.	Equivalent under Commission Implementing Decision 2014/755/EU.	Equivalent under Commission Implementing Decision 2014/754/EU	Equivalent under Commission Implementing Decision 2014/753/EU.
Effective system for recognition of CCPs authorised under the legal regime of a third country	Equivalent under Commission Implementing Decision 2014/752/EU.	Equivalent under Commission Implementing Decision 2014/755/EU.	Equivalent under Commission Implementing Decision 2014/754/EU	Equivalent under Commission Implementing Decision 2014/753/EU.
CCP authorisation requirements	Equivalent under Commission Implementing Decision 2014/752/EU.	Equivalent under Commission Implementing Decision 2014/755/EU.	Equivalent under Commission Implementing Decision 2014/754/EU. Note that this is limited to entities authorized under the Securities and Futures Ordinance only.	Equivalent under Commission Implementing Decision 2014/753/EU.
	US	INDIA	SOUTH KOREA	SWITZERLAND
CCPs subject to ongoing supervision and enforcement	No equivalence decision yet. ESMA's advice: equivalent.	No equivalence decision yet. ESMA's advice: equivalent.	No equivalence decision yet. ESMA's advice: equivalent.	No equivalence decision yet. ESMA's advice: equivalent.
Effective system for recognition of CCPs authorised under the legal regime of a third country	No equivalence decision yet. ESMA's advice: equivalent, however, the US authorities do not use the equivalent system on a long-term basis. In addition, the US authorities require CCPs authorised outside of the US to be subject to the direct jurisdiction of the SEC and the CFTC and the application of two sets of rules, which represents a departure from the third country CCP regime prescribed in EMIR.	No equivalence decision yet. ESMA's advice: not equivalent.	No equivalence decision yet. ESMA's advice: equivalent for CCPs providing clearing services to the South Korean OTC derivative markets but not for CCPs providing clearing services for financial instruments other than OTC derivatives.	No equivalence decision yet. ESMA's advice: equivalent.
CCP authorisation requirements	No equivalence decision yet. ESMA's advice: equivalent, provided the CCP adopts legally binding internal policies, procedures, rules, models and methodologies which comply with certain requirements for CCPs under EMIR - ESMA identifies the following specific areas of requirements: For CCPs under the CFTC Derivatives Clearing Organisation ("DCO") regime: (a) Risk Committee;	No equivalence decision yet. ESMA's advice: equivalent, provided the CCP adopts legally binding internal policies, procedures, rules, models and methodologies which comply with certain requirements for CCPs under EMIR - ESMA identifies the following specific areas of requirements: (a) Organisational, including governance, compliance, audit etc. (b) Requirements for senior management	No equivalence decision yet. ESMA's advice: equivalent, provided the CCP adopts legally binding internal policies, procedures, rules, models and methodologies which comply with certain requirements for CCPs under EMIR - ESMA identifies the following specific areas of requirements: (a) Organisational; (b) Requirements for senior management and the Board;	No equivalence decision yet. ESMA's advice: equivalent.

US	INDIA	SOUTH KOREA	SWITZERLAND
<ul style="list-style-type: none"> (b) Business continuity; (c) Margin; (d) Default fund; (e) Other financial resources; (f) Liquidity risk control; (g) Default waterfall; (h) Collateral; (i) Investment policy; and (j) Review of models, stress testing and back testing. 	<ul style="list-style-type: none"> and Securities and Exchange SEBI of India; (c) Risk Committee requirements for CCPs under Reserve Bank of India (“RBI”) supervision; (d) Record keeping; (e) Requirements for shareholders and members with qualifying holdings for CCPs under RBI supervision; 	<ul style="list-style-type: none"> (c) Risk Committee; (d) Record keeping; (e) Shareholders and members with qualifying holdings (for CCPs other than Korean Exchange); (f) Information to competent authorities (for CCPs other than Korean Exchange); (g) Assessment of qualifying holdings (for CCPs other than Korean Exchange); 	
<p>For CCPs under the Securities and Exchange Commission (“SEC”) regime:</p>	<ul style="list-style-type: none"> (f) Requirements for the assessment of qualifying holdings for CCPs under RBI supervision; 	<ul style="list-style-type: none"> (h) Conduct of business rules—general provisions (for CCPs other than Korean Exchange); 	
<ul style="list-style-type: none"> (a) Risk Committee; (b) Business continuity; (c) Outsourcing; (d) Segregation and portability; (e) Margin; (f) Default fund; (g) Other financial resources; (h) Liquidity risk control; (i) Default waterfall; (j) Collateral; (k) Investment policy; (l) Default procedure; and (m) Review of models, stress testing and back testing. 	<ul style="list-style-type: none"> (g) Conflict of interest requirements for CCPs under RBI; (h) Business continuity; (i) Outsourcing; (j) General conduct of business requirements for CCPs under RBI supervision; (k) Participation; (l) Transparency; (m) Segregation and portability; (n) Exposure management requirements for CCPs under RBI supervision; (o) Margin; (p) Default fund; (q) Other financial resources; (r) Liquidity risk control; (s) Default waterfall; (t) Collateral; (u) Investment policy; (v) Default procedure; (w) Review of models, stress testing and back testing; and (x) Settlement. 	<ul style="list-style-type: none"> (i) Participation; (j) Transparency; (k) Segregation and portability; (l) Margin; (m) Default fund; (n) Other financial resources; (o) Liquidity risk control; (p) Default waterfall; (q) Collateral; (r) Investment policy; (s) Default procedure; (t) Review of models, stress testing and back testing; and (u) Settlement. 	
<p>CCPs under the CFTC’s regime for systemically important DCOs and Opt-In DCOs:</p>	<ul style="list-style-type: none"> (n) Exposure management requirements for CCPs under RBI supervision; 	<p>The CCP must ensure that no changes are made to its internal policies, procedures, rules or methodologies which would mean that it would no longer comply with the standards required by EMIR.</p>	
<ul style="list-style-type: none"> (a) Risk Committee; (b) Margin; (c) Default fund; (d) Other financial resources; (e) Default waterfall; 	<p>The CCP must ensure that no changes are</p>		

US	INDIA	SOUTH KOREA	SWITZERLAND
<p>(f) Collateral;</p> <p>(g) Investment policy; and</p> <p>(h) Review of models, stress testing and back testing.</p> <p>The CCP must ensure that no changes are made to its internal policies, procedures, rules or methodologies which would mean that it would no longer comply with the standards required by EMIR.</p>	<p>made to its internal policies, procedures, rules or methodologies which would mean that it would no longer comply with the standards required by EMIR.</p>		

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This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

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