

SEC and ASIC reveal Emir equivalency concerns

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KEY TAKEAWAYS

- **On May 1, the US SEC released its proposals for substituted compliance for non-US CCPs in the OTC derivatives market;**
- **Substituted compliance is outcomes-based, and has been described as a ‘middle ground’ compared to other proposals in the market;**
- **Outcomes-based substituted compliance contrasts with Emir’s equivalency regime, which takes a rule-by-rule approach;**
- **Currently, a non-equivalency determination of a jurisdiction’s OTC derivatives regulations would mean that all CCPs from that jurisdiction would not be able to do business in the EU.**

Although Title VII of the US’ Dodd-Frank Act has attracted much frustration related to extraterritorial regulations of OTC derivatives, regulators and market participants are beginning to turn their attention to European regulations.

The European Securities and Markets Authority’s (Esma’s) over-the-counter (OTC) derivatives reforms fall under the European Market Infrastructure Regulation (Emir). Emir came into force in August 2012 but requires further implementing legislation in Europe before becoming effective.

Regulators from the Australian Securities and Investments Commission (Asic) and the US Securities and Exchange Commission (SEC) noted their concerns about extraterritorial regulations at a May 28 [panel](#), on enhancing Hong Kong’s future as a leading international financial centre.

Asic’s Laurence White, senior manager of post-trading and OTC derivatives, financial market infrastructure, said, “What we do as regulators should not be counterproductive. We should not make these markets less effective in mitigating risk than they are today.”

Substituted compliance

On May 1 the SEC released its [proposed rules for cross-border security-based swap activity](#). Although the SEC has a much smaller role in regulating the OTC derivatives market than the Commodity Futures Trading Commission (CFTC), the regulator is promoting a 'middle ground' between an all-in line-by-line approach or broad recognition and reciprocity.

In an [April speech at the American Bar Association's Spring Meeting](#), former SEC chairman Elisse Walter advocated the importance of substituted compliance based on key categories of regulation and focusing on regulatory outcomes.

The SEC's proposed rules reflect Walters' approach, and will allow foreign market participants to follow home country regulations rather than US regulations as long as they achieve comparable outcomes.

Brian Bussey, the SEC's associate director for derivatives policy and trading practices in the division of trading and markets, added, "We see the two dominant regulators of OTC derivatives – the CFTC and Esma/EC – taking paths that have potential issues.

Our hope is that putting forward a proposal – a reasoned middle way – will help facilitate dialogue and reach some kind of workable resolution of cross-border issues in the coming months, he said.

Asic chairman Greg Medcraft advocated a similar approach – focused on equivalence of outcomes rather than equivalence of regimes – in [January at Hong Kong's Asian Financial Forum](#). He stressed that regulations should consider objectives and outcomes rather than trying to replicate laws.

Emir equivalency

But there are questions regarding Esma and the European Commission's (EC's) approach to Emir's equivalency regime, which includes a so-called all or nothing approach.

A recent [Asia Securities Industry and Financial Markets Association \(Asifma\) update](#) to a Global Financial Markets Association (Gfma) study published last April noted that Emir requires that the legal and supervisory arrangements for a non-EU CCP must be equivalent to those under Emir rather than equivalent to those recommended by international standards, such as the CPSS-Iosco Principles.

Under Emir, Esma will make a recommendation on whether a regime is equivalent, but the final decision will lie with the EC.

White warned that if the Esma advice on equivalency is made public at the time it is given, it may put some CCPs in a position in which they don't apply for recognition and lose their spot in the queue.

"If eventually the EC does determine equivalency, they may have missed the boat," he added.

Further, if a jurisdiction's regime is determined non-equivalent, CCPs from that jurisdiction will no longer be able to do business in the EU, resulting in international fragmentation of this global market.

But non-equivalency may lead to further legal uncertainty.

"I suspect that one of the issues under Emir is that there's no Commission act to enshrine a negative assessment – only a positive one," said White. "The EC can consult on an act enshrining a positive assessment under a legislative act, but doesn't have a provision under its statute for a negative assessment act."

Equivalency itself may prove challenging as jurisdictions have diverse legal histories, jurisprudence and regulatory regimes.

Speaking on the May 28 panel, Eric Pan, associate director of the US SEC's office of international affairs, said that it is challenging for regulators in Brussels or Paris to understand a foreign jurisdiction's laws, regulations and supervisory approaches in sufficient detail to make a sophisticated determination on whether the foreign jurisdiction's laws regulations and approaches are equivalent.

He urged the EU to be more transparent with its equivalency determinations.

"It's crucial that the EU opens up its equivalency determination process to public scrutiny to give market participants and other members of the public, who are very knowledgeable about how foreign regimes work, the opportunity to share their insights to ensure a proper equivalency determination is done," he said.

More input needed

But many jurisdictions have not yet promulgated their proposed rules on cross-border regulation of OTC derivatives, which has challenged regulators looking to cooperate.

Pan noted that it is difficult to have a discussion about the scope of jurisdiction, how the regulatory regime of one jurisdiction interacts with another and how that interaction produces conflicts, gaps and overlaps until you know where authorities are going to draw their lines.

“Until authorities provide greater detail about how they intend to regulate cross-border activities it will be very hard to have that discussion,” he added.

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