



JOINT REPORT

ON

INTERNATIONAL SWAP REGULATION

Required by Section 719(c) of the Dodd-Frank Wall Street
Reform and Consumer Protection Act

January 31, 2012

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Introduction

Effectively regulated financial markets are a necessary component of a strong economy. When the financial system failed three years ago, over-the-counter (“OTC”) derivatives were unregulated, and financial systems and participants were interconnected to a greater extent than ever before. The global nature of OTC derivatives requires comprehensive international cooperation and coordination.

Efforts to regulate OTC derivatives are under way in the United States and abroad. The financial crisis of 2008 has led to broad international consensus on the need for improved transparency, mitigation of systemic risk, and protection against market abuse, and extraordinary coordination on how best to achieve sound regulation appropriately tailored to the OTC derivatives market.¹ Jurisdictions with major OTC derivatives markets have taken steps toward regulating OTC derivatives – with variance in pace, but with consistency among many of the ultimate policy goals.

In the United States, the Dodd-Frank Wall Street Reform and Consumer Protection Act (“DFA”) provides the Commodity Futures Trading Commission (“CFTC”) and the Securities and Exchange Commission (“SEC” and, together with the CFTC, the “Commissions”) with the authority to regulate certain types of derivatives that currently are entered into bilaterally and that typically are not cleared. Subject to certain exceptions, Title VII of the DFA (“Title VII”) requires the CFTC to regulate those derivatives defined as swaps, and requires the SEC to regulate derivatives defined as security-based swaps. The Commissions are in the midst of promulgating regulations to implement this statutory mandate.

¹ See discussion *infra* under Section II (Regulatory Framework for OTC Derivatives).

DFA Section 719(c) requires the Commissions jointly to conduct a study (“Study”) and then to report to Congress (“Report”) on how swaps and security-based swaps² (collectively “Swaps”, unless otherwise indicated) are regulated in the United States, Asia, and Europe and to identify areas of regulation that are similar and other areas of regulation that could be harmonized. Section 719(c) also calls for the Report to identify major dealers, exchanges, clearinghouses, clearing members, and regulators in each geographic area and to list the major contracts (including trading volumes, clearing volumes, and notional values), the methods for clearing swaps, and the systems used for setting margin in each geographic area.

The Study is one facet of the CFTC’s and the SEC’s work in analyzing the international context and implications of the DFA. Congress directed the Commissions (and prudential regulators) in Section 752(a) of the legislation to “as appropriate . . . consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards with respect to the regulation . . . of swaps, security-based swaps, swap entities, and security-based swap entities” in order to “promote effective and consistent global regulation of swaps and security-based swaps”.

CFTC and SEC staffs have considered international standards and principles in developing regulations, have consulted and coordinated with foreign regulators, and will continue to recommend that the Commissions enter into memoranda of understanding, as appropriate, to promote access to information and cooperative oversight by regulators. Staffs of both Commissions are actively engaged in numerous international projects related to the clearing, reporting, trading, and risk management of OTC derivatives. For example, staffs currently are working on a project of the International Organization of Securities Commissions

² Section 719(c) is entitled “International Swap Regulation” and sometimes refers solely to swaps and, at other times, refers both to swaps and security-based swaps. However, Congress mandated a joint CFTC-SEC study and, accordingly, the Commissions have interpreted the terms “swap” and “swaps” to include both swap(s) and security-based swap(s) in the context of this statutory provision.

(“IOSCO”) to coordinate the application of central clearing requirements for counterparties to OTC derivatives transactions³ and on a project of the Committee on Payment and Settlement Systems (“CPSS”) and IOSCO on principles for financial market infrastructures, including derivatives central counterparties (“CCPs”) and trade repositories (“TRs”).⁴ Staffs are participating in the Financial Stability Board (“FSB”) OTC Derivatives Working Group (“ODWG”), which monitors progress being made in implementing OTC derivatives market reforms.⁵ Staffs also are participating in technical dialogues with regulatory counterparts in the European Union (“EU”), Japan, Hong Kong, Singapore, and Canada. These discussions are designed to increase understanding of each other’s regulatory approaches and to coordinate regulatory proposals to the greatest extent possible.⁶ Most recently, leaders and senior representatives of the CFTC and SEC met with regulators from Canada, the European Union, Hong Kong, Japan, and Singapore on December 8, 2011, to discuss cross-border issues related to

³ This IOSCO report is expected to be published in January 2012. *See* OTC Derivatives Market Reforms: Progress Report on Implementation (October 11, 2011) (“FSB October 2011 Report”) at p. 4 and Appendix I, available at http://www.financialstabilityboard.org/publications/r_111011b.pdf; *see also* Financial Stability Board, Implementing OTC Derivatives Market Reforms (October 25, 2010) (“FSB October 2010 Report”) at p. 5, ¶ 12 (“To minimise the potential for regulatory arbitrage, IOSCO, working with other authorities as appropriate, should coordinate the application of central clearing requirements on a product and participant level, and any exemptions from them.”), available at http://www.financialstabilityboard.org/publications/r_101025.pdf.

⁴ *See* CPSS-IOSCO Principles for Financial Market Infrastructures, Consultative Report (March 2011), available at <http://www.bis.org/publ/cpss94.pdf>. These standards will be included in a final report that is expected to be published in early 2012. *See* FSB October 2011 Report at Appendix I; *see also* FSB October 2010 Report at p. 5, ¶ 9 (“To help ensure a global regulatory level playing field and increase the safety of the financial system, CCPs that clear OTC derivatives should be subject to robust and consistently applied supervision and oversight on the basis of regulatory standards, that, at a minimum, meet evolving international standards developed jointly by CPSS and IOSCO.”).

⁵ The ODWG is led by representatives of CPSS, IOSCO, and the European Commission (“EC”). The SEC co-chairs the ODWG on behalf of IOSCO. The ODWG includes international standard setters and authorities responsible for transforming the G-20 commitments into standards and regulations. Jurisdictions include: Brazil, Canada, China, France, Germany, Hong Kong, Japan, Korea, United Kingdom, and United States. The ODWG also includes representatives from the European Central Bank (“ECB”), Bank for International Settlements (“BIS”), International Monetary Fund (“IMF”), and FSB. The ODWG makes regular progress reports to the FSB, assessing the adequacy of progress being made to fully and consistently implement the G-20 commitments to central clearing, trading on exchanges and electronic trading platforms, reporting to TRs, and capital requirements.

⁶ In addition, through staff at the U.S. Department of the Treasury, high-level discussions on OTC derivatives issues have involved a wider range of economic officials in European and Asian countries.

OTC derivatives. The authorities agreed to continue bilateral regulatory dialogues and to meet as a group again in early 2012.⁷

The Commissions also recognize that Swaps business currently flows across national borders, with agreements negotiated and executed between counterparties in different jurisdictions and individual transactions often booked and risk-managed in other jurisdictions. Accordingly, the Commissions will develop proposals seeking public input on certain cross-border issues arising from the application of Title VII.⁸

The Study has provided a comprehensive means to gather information on OTC derivatives.⁹ Staff believes that this Report will be a useful guide to OTC derivatives regulation and markets inside and outside the United States, and a timely comparative tool in the ongoing effort to achieve consistency in regulation.

This Report includes four sections. Section I discusses the Congressional mandate for the Study and Report, including the process and approach used by CFTC and SEC staff. Section II describes the regulatory framework for OTC derivatives in the Americas, European Union, and Asia, and Section III analyzes the similarities and differences across jurisdictions, discusses

⁷ Global Regulators Joint Statement on OTC Derivatives (December 9, 2011), available at <http://www.cftc.gov/PressRoom/SpeechesTestimony/opagensler-101> and <http://www.sec.gov/news/press/2011/2011-260.htm>.

⁸ In addition, CFTC and SEC staff held a public roundtable on August 1, 2011, to discuss international issues relating to implementation of Title VII. The roundtable agenda included the following topics: (1) cross-border transactions; (2) global entities; and (3) market infrastructure. The CFTC has posted a transcript of the roundtable at http://www.cftc.gov/ucm/groups/public/@swaps/documents/dfsubmission/dfsubmission21_080111-trans.pdf, and the SEC has posted a transcript at <http://www.sec.gov/news/press/2011/2011-151-transcript.pdf>. Public comments are posted on the CFTC website at <http://comments.cftc.gov/PublicComments/CommentList.aspx?id=1065>, and on the SEC website at <http://www.sec.gov/comments/4-636/4-636.shtml>.

⁹ The regulatory distinctions between the terms “swap” and “security-based swap” as used in Title VII are not co-extensive with terms used in foreign jurisdictions. Accordingly, the term “OTC derivatives”, which is used in this Report to refer to Swaps across various jurisdictions, includes products that may, or may not, fall within the DFA’s scope.

potential areas for harmonization, and makes recommendations for next steps.¹⁰ Finally, Section IV provides the conclusion of the Study and Report.

I. Congressional Study Mandate

A. Statutory Language

The DFA was enacted on July 21, 2010.¹¹ Section 719(c) of the legislation mandates the Study and this Report:

- (1) IN GENERAL.—The Commodity Futures Trading Commission and the Securities and Exchange Commission shall jointly conduct a study—
- (A) relating to—
 - (i) swap regulation in the United States, Asia, and Europe; and
 - (ii) clearing house and clearing agency regulation in the United States, Asia, and Europe; and
 - (B) that identifies areas of regulation that are similar in the United States, Asia and Europe and other areas of regulation that could be harmonized[.]
- (2) REPORT.—Not later than 18 months after the date of enactment of this Act, the Commodity Futures Trading Commission and the Securities and Exchange Commission shall submit to the Committee on Agriculture, Nutrition, and Forestry and the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Agriculture and the Committee on Financial Services of the House of Representatives a report that includes a description of the results of the study under subsection (a),^[12] including—
- (A) identification of the major exchanges and their regulator in each geographic area for the trading of swaps and security-based swaps including a listing of the major contracts and their trading volumes and notional values as well as identification of the major swap dealers participating in such markets;
 - (B) identification of the major clearing houses and clearing agencies and their regulator in each geographic area for the clearing of swaps and security-based swaps, including a listing of the major contracts and the clearing volumes and notional values as well as identification of the major clearing members of such clearing houses and clearing agencies in such markets;
 - (C) a description of the comparative methods of clearing swaps in the United States, Asia, and Europe; and
 - (D) a description of the various systems used for establishing margin on individual swaps, security-based swaps, and swap portfolios.

¹⁰ Appendix I includes information on dealers, markets, and CCPs in each region.

¹¹ See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010). The DFA text may be accessed at <http://www.cftc.gov/LawRegulation/DoddFrankAct/index.htm>.

¹² The reference to “subsection (a)” presumably should be replaced with a reference to paragraph (1) because no such subsection (a) applies to this Study.

In setting forth the scope of the Study, Section 719(c)(1) refers solely to “swap regulation” and to “clearing house and clearing agency regulation”. In mandating the Report to Congress, Section 719(c)(2) refers more broadly to swaps and security-based swaps, swap dealers, exchanges, clearinghouses, and clearing agencies. Accordingly, CFTC and SEC staff reconciled these two provisions to establish a scope for the Study that is consistent with the direction of Congress. Staffs also included regulation of TRs, given the significant work already being done in this area.

With respect to geographic scope, Section 719(c) refers to the United States, Europe,¹³ and Asia. However, Canada and Brazil also have OTC derivatives markets and are involved with efforts to regulate OTC derivatives. Accordingly, CFTC and SEC staff included these jurisdictions within the scope of the Study so as not to overlook the breadth of regulation taking place within the Americas.

B. Process and Approach

The Commissions initiated the Study by issuing a request for information through public comment (“Request for Comment”).¹⁴ They stated that the Request for Comment would be an effective and transparent means of gathering information necessary for the Study and Report from interested parties. The Commissions also stated that the public comment process would, as needed, be supplemented by other means of gathering the comprehensive range of information requested by Congress.¹⁵

¹³ In preparing this Report, staff has interpreted the mandate of Section 719(c) to mean the European Union, which includes the United Kingdom.

¹⁴ Acceptance of Public Submissions for a Study on International Swap Regulation Mandated by Section 719(c) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 Fed. Reg. 44508 (July 26, 2011), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-18763a.pdf> and <http://www.sec.gov/rules/other/2011/34-64926.pdf>.

¹⁵ The Commissions stated that staff had the discretion to consider comments filed after the close of the 60-day comment period and could consult with interested and/or relevant parties after the comment period

The timing of legislative and regulatory developments differs across jurisdictions. In the United States, the DFA was enacted in July 2010. Most regulations required under Title VII have been proposed, and some regulations have been finalized.¹⁶ Other jurisdictions have been proceeding under different timeframes. For example, the Japanese legislature adopted statutory amendments in May 2010 that are applicable to the regulation of OTC derivatives, and full implementation is expected by November 2012. European legislators are debating legislation on clearing and TRs that was proposed in September 2010, and technical standards for implementation are expected to be proposed by June 2012. Other jurisdictions have not yet proposed or adopted statutory or regulatory changes, but have published consultation documents to gather public comment on the appropriate regulation of OTC derivatives. Accordingly, CFTC and SEC staff has attempted to strike a balance between meeting the statutory deadline for the Report and providing information to Congress that is as current as possible. This Report is current as of December 31, 2011.¹⁷

Thirty-four submissions were received in response to the Request for Comment. The following 12 market infrastructure providers filed comments: CME Group, Inc.;¹⁸ IntercontinentalExchange, Inc.;¹⁹ Kansas City Board of Trade;²⁰ BM&FBOVESPA;²¹

closed in order to obtain additional or clarifying information.

¹⁶ The CFTC and SEC websites provide extensive information on the DFA's implementation, respectively at <http://www.cftc.gov/LawRegulation/DoddFrankAct/index.htm> and <http://www.sec.gov/spotlight/dodd-frank.shtml>.

¹⁷ The portions of the Report that discuss the U.S. regulatory framework are current as of January 23, 2012.

¹⁸ The comment filed by CME Group, Inc. ("CME Group") discusses CME Clearing, and is available at <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=49906&SearchText=>.

¹⁹ The comment filed by IntercontinentalExchange, Inc. ("ICE") discusses ICE Clear U.S., Inc.; ICE Clear Europe Ltd. ("ICE Clear Europe"); ICE Clear Canada; The Clearing Corporation; ICE Clear Credit LLC ("ICE Clear Credit"); ICE Futures U.S., Inc.; ICE U.S. OTC Markets, LLC ("ICE U.S. OTC"); ICE Futures Europe; and ICE Futures Canada. It is available at <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=49905&SearchText=>.

²⁰ The comment filed by the Kansas City Board of Trade ("KCBT") discusses the KCBT Clearing Corp., and is available at <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=48202&SearchText=>.

LCH.Clearnet Group;²² Eurex Clearing AG;²³ NYSE Euronext;²⁴ SIX Swiss Exchange Ltd.;²⁵ Japan Securities Clearing Corporation;²⁶ Singapore Exchange Derivatives Clearing Ltd.;²⁷ National Commodity and Derivatives Exchange Ltd.;²⁸ and Shanghai Clearing House.²⁹ One central bank, the ECB, filed a comment.³⁰ Five regulators filed comments: Ontario Securities Commission, Alberta Securities Commission, Financial Services Agency of Japan, Financial Supervisory Service of Korea, and Comisión Nacional del Mercado de Valores of Spain.³¹ Five

²¹ The comment filed by BM&FBOVESPA is available at <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=48244&SearchText=> and at <http://www.sec.gov/comments/4-635/4635-9.pdf>.

²² The comment filed by LCH.Clearnet Group Ltd. (“LCH Group”) discusses both LCH.Clearnet Ltd. (based in London) and LCH.Clearnet SA (based in Paris), and is available at <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=48483&SearchText=> and at <http://www.sec.gov/comments/4-635/4635-10.pdf>.

²³ The comment filed by Eurex Clearing AG (“Eurex”) is available at <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=48209&SearchText=> and at <http://www.sec.gov/comments/4-635/4635-6.pdf>.

²⁴ The comment filed by NYSE Euronext is available at <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=48213&SearchText=> and at <http://www.sec.gov/comments/4-635/4635-8.pdf>.

²⁵ The comment from SIX Swiss Exchange Ltd. is available at <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=48103&SearchText=> and at <http://www.sec.gov/comments/4-635/4635-7.pdf>.

²⁶ The comment filed by Japan Securities Clearing Corporation (“JSCC”) is available at <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=48197&SearchText=>.

²⁷ The comment filed by Singapore Exchange Derivatives Clearing Ltd. (“SGX-DC”) is available at <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=48196&SearchText=>.

²⁸ The comment filed by National Commodity and Derivatives Exchange Ltd. (“NCDEX”) is available at <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=48172&SearchText=>.

²⁹ The comment filed by Shanghai Clearing House (“SCH”) is available at <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=50009&SearchText=>.

³⁰ The comment filed by the ECB is available at <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=48391&SearchText=> and at <http://www.sec.gov/comments/4-635/4635-11.pdf>.

³¹ Comments from these regulators are available at: Ontario Securities Commission (“OSC”) (<http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=48509&SearchText=> and <http://www.sec.gov/comments/4-635/4635-12.pdf>); Alberta Securities Commission (“ASC”) (<http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=49918&SearchText=>); Financial Services Agency of Japan (“JFSA”) (<http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=48272&SearchText=>, <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=49926&SearchText=> (“JFSA Presentation”), and <http://www.sec.gov/comments/4-635/4635-5.pdf>); Financial Supervisory Service of Korea (“KFSS”)

trade or interest groups filed comments: the International Swaps and Derivatives Association, Inc.; Alternative Investment Management Association Ltd.; Association of Financial Guaranty Insurers; Better Markets, Inc.; and Americans for Financial Reform.³² Ten individuals filed comments.³³

In addition, CFTC and SEC staff relied on public sources, including the FSB³⁴ report in October 2011 on efforts across 19 jurisdictions to regulate OTC derivatives.³⁵ The FSB October 2011 Report provides a detailed assessment of progress related to central clearing, exchange and electronic platform trading, reporting to repositories, capital requirements, and standardization of OTC derivatives. The assessment relies upon information provided by FSB member

(<http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=48185&SearchText=>); and Comisión Nacional del Mercado de Valores of Spain (“CNMV”) (<http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=49971&SearchText=>).

³² Comments from these entities are available at: International Swaps and Derivatives Association, Inc. (“ISDA”) (<http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=48222&SearchText=> and <http://www.sec.gov/comments/4-635/4635-3.pdf>); Alternative Investment Management Association Ltd. (“AIMA”) (<http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=48200&SearchText=> and <http://www.sec.gov/comments/4-635/4635-2.pdf>); Association of Financial Guaranty Insurers (“AFGI”) (<http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=48178&SearchText=> and <http://www.sec.gov/comments/4-635/4635-1.pdf>); Better Markets, Inc. (“BMI”) (<http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=48225&SearchText=> and <http://www.sec.gov/comments/4-635/4635-4.pdf>); and Americans for Financial Reform (“AFR”) (<http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=48237&SearchText=>).

³³ Comments from the following submitters are available on the CFTC website at <http://comments.cftc.gov/PublicComments/CommentList.aspx?id=1072>: Ja Sto; C. Harvin; Carol C.; Roxana Wepf; Mary S. Smith; S. Walsh; Mike Straub; Hollie Bethany; Eva Trowbridge; and Dana Dellinger. None of these comments is responsive to the Request for Comment. Instead, for the most part, they urge the imposition of limits on speculators.

³⁴ The FSB was established: (1) to coordinate at the international level the work of national financial authorities and international standard setting bodies; and (2) to develop and promote implementation of effective regulatory, supervisory, and other financial sector policies. FSB members include national authorities responsible for financial stability in significant international financial centers, international financial institutions, sector-specific international groupings of regulators and supervisors, and committees of central bank experts. The SEC is a member of the FSB. FSB members represent 24 jurisdictions: Argentina, Australia, Brazil, Canada, China, France, Germany, Hong Kong, India, Indonesia, Italy, Japan, Mexico, The Netherlands, Republic of Korea, Russia, Saudi Arabia, Singapore, South Africa, Spain, Switzerland, Turkey, United Kingdom, and United States. Other members are: the BIS, ECB, EC, IMF, Organisation for Economic Co-operation and Development, and World Bank. International standard-setting bodies and other groups include: the CPSS, IOSCO, Basel Committee on Banking Supervision (“BCBS”), International Accounting Standards Board, International Association of Insurance Supervisors, and Committee on the Global Financial System (“CGFS”). More information is provided on the FSB website, available at <http://www.financialstabilityboard.org/>.

³⁵ *See supra* note 3.

jurisdictions in response to a questionnaire regarding regulation of the OTC derivatives markets.³⁶

II. Regulatory Framework for OTC Derivatives

The financial crisis that began in 2008 sparked a new international effort to strengthen financial regulation. With respect to OTC derivatives, the Group of 20 (“G-20”)³⁷ agreed in September 2009 that:

All standardised OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end-2012 at the latest. OTC derivative contracts should be reported to trade repositories. Non-centrally cleared contracts should be subject to higher capital requirements. We ask the FSB and its relevant members to assess regularly implementation and whether it is sufficient to improve transparency in the derivatives markets, mitigate systemic risk, and protect against market abuse.³⁸

At the initiative of the FSB, the ODWG was formed in April 2010 to make recommendations on implementation of the G-20 Leaders’ commitments. In June 2010, the G-20 reaffirmed its commitments on strengthening regulation of OTC derivatives:

We pledged to work in a coordinated manner to accelerate the implementation of ... OTC[] derivatives regulation and supervision and to increase transparency and standardization. We reaffirm our commitment to trade all standardized OTC derivatives contracts on exchanges or electronic trading platforms, where appropriate, and clear through [CCPs] by end-2012 at the latest. OTC derivative

³⁶ A copy of the questionnaire is included as Appendix VII to the FSB October 2011 Report. Member jurisdictions were asked to submit responses by July 1, 2011. Their responses were posted on the FSB’s internal website, but were not made publicly available. The FSB October 2011 Report includes tables summarizing member responses, but does not include the detailed responses themselves. See FSB October 2011 Report, Appendix VIII.

³⁷ The G-20 was established in 1999 to bring together systemically important industrialized and developing economies to discuss key issues in the global economy. G-20 membership includes the Finance Ministers and Central Bank Governors of 19 countries and the EU: Argentina, Australia, Brazil, Canada, China, the EU, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, the Republic of Korea, Turkey, United Kingdom, and United States. In addition, the Managing Director of the IMF, President of the World Bank, and Chairmen of the International Monetary and Financial Committee and Development Committee of the IMF and World Bank also participate in G-20 meetings on an *ex-officio* basis. More information is provided on the G-20 website, available at <http://www.g20.org/en>.

³⁸ Leaders’ Statement, The Pittsburgh Summit, ¶ 13 (subparagraph on improving OTC derivatives markets) (September 24-25, 2009), available at <http://g20mexico.org/images/stories/canalfinan/docs/uk/02pittsburgh.pdf>.

contracts should be reported to [TRs]. We will work towards the establishment of CCPs and TRs in line with global standards and ensure that national regulators and supervisors have access to all relevant information. In addition we agreed to pursue policy measures with respect to haircut-setting and margining practices for ... OTC derivatives transactions that will reduce procyclicality and enhance financial market resilience. We recognized that much work has been done in this area. We will continue to support further progress in implementing these measures. ... We committed to accelerate the implementation of strong measures to improve transparency and regulatory oversight of ... over-the-counter derivatives in an internationally consistent and non-discriminatory way.³⁹

In October 2010, the FSB released a report containing 21 recommendations for authorities, which it summarized under four categories:

- **Standardisation:** The proportion of the market that is standardised should be substantially increased in order to further the G-20's goals of increased central clearing and trading on organised platforms, and hence mitigate systemic risk and improve market transparency. [This] report sets out recommendations for authorities to work with market participants to increase standardisation, including through introducing incentives and, where appropriate, regulation.
- **Central clearing:** To implement the G-20 commitment effectively, it is necessary to specify the factors that should be taken into account when determining whether a derivative contract is standardised and therefore suitable for clearing. The recommendations do this, as well as address mandatory clearing requirements; robust risk management requirements for the remaining non-centrally cleared markets; and supervision, oversight and regulation of [CCPs] themselves.
- **Exchange or electronic platform trading:** Further work is being set in train in the coming months to identify what actions may be needed to fully achieve the G-20 commitment that all standardised products be traded on exchanges or electronic trading platforms, where appropriate.
- **Reporting to trade repositories:** Authorities must have a global view of the OTC derivatives markets, through full and timely access to the data needed to carry out their respective mandates. The recommendations help achieve this objective, including that [TR] data must be comprehensive, uniform and reliable and, if from more than one source, provided in a form that facilitates aggregation on a global scale.⁴⁰

³⁹ The G-20 Toronto Summit Declaration, Annex II, ¶¶ 25-26 (Financial Sector Reform) (June 26-27, 2010), available at <http://g20mexico.org/images/stories/canalfinan/docs/repcore/05declaration.pdf>. See also ¶ 19 (“We agreed to strengthen financial market infrastructure by accelerating the implementation of strong measures to improve transparency and regulatory oversight of ... [OTC] derivatives in an internationally consistent and nondiscriminatory way.”).

⁴⁰ Implementing OTC Derivatives Market Reforms, pp. 1-2 (October 25, 2010), available at http://www.financialstabilityboard.org/publications/r_101025.pdf.

The FSB October 2010 Report also emphasized the importance of continued international coordination and recognized that “[w]ork should be taken forward by the relevant standard setters and authorities to achieve international consistency”.⁴¹ Also in October 2010, IOSCO formed the Task Force on OTC Derivatives Regulation (“IOSCO Task Force”) to coordinate securities and futures regulators’ efforts to work together in the development of supervisory and oversight structures related to OTC derivatives markets. The IOSCO Task Force seeks to develop international standards related to OTC derivatives regulation, coordinate other international initiatives relating to OTC derivatives regulation, and serve as a centralized group within IOSCO through which IOSCO members can consult and coordinate generally on issues relating to OTC derivatives regulation.⁴²

In November 2010, the G-20 endorsed the FSB recommendations:

We also firmly recommitted to work in an internationally consistent and nondiscriminatory manner to strengthen regulation and supervision on ... OTC derivatives ... We endorsed the FSB’s recommendations for implementing OTC derivatives market reforms, designed to fully implement our previous commitments in an internationally consistent manner, recognizing the importance of a level playing field. We asked the FSB to monitor the progress regularly.⁴³

⁴¹ *Id.* at p. 2.

⁴² IOSCO Forms Task Force on OTC Derivatives Regulation (October 15, 2010), available at <http://www.iosco.org/news/pdf/IOSCONEWS191.pdf>. The IOSCO Task Force is led by the CFTC, SEC, the Financial Services Authority of the United Kingdom (“UK FSA”), and the Securities and Exchange Board of India (“SEBI”). The Task Force will set out international standards in the areas of trading, data reporting (including minimum requirements and standardized formats, and methodology and mechanisms for aggregation of data), clearing, oversight of dealers and other market participants and, to the extent desirable and feasible, exchange and electronic trading.

In addition to the groups and initiatives already mentioned, staff of the CFTC and SEC participate in two other groups active in OTC derivatives:

(1) OTC Derivatives Supervisors Group (“ODSG”) – originated in 2005, when the Federal Reserve Bank of New York (“New York Fed”) hosted a meeting with representatives of major OTC derivatives market participants and their domestic and international supervisors to address the emerging risks of inadequate infrastructure for the rapidly growing market in credit derivatives. For more information on the ODSG and its efforts to increase process and product standardization, please visit http://newyorkfed.org/markets/otc_derivatives_supervisors_group.html.

(2) OTC Derivatives Regulators’ Forum (“ODRF”) – formed in 2009 to provide regulators with a means to cooperate, exchange views, and share information related to OTC derivatives CCPs and TRs. For more information on the ODRF, please visit <http://www.otcdrf.org/>.

⁴³ The G20 Seoul Summit Leaders’ Declaration, The Seoul Summit Document, ¶ 37 (November 11-12,

The FSB released its first progress report on implementation of the G-20 Leaders' commitments in April 2011.⁴⁴ The report pointed to several international developments,⁴⁵ but expressed concern regarding the likelihood of many jurisdictions meeting the G-20's end-2012 deadline. The FSB recognized that implementation was just beginning, but said it was "concerned with the substantial variation across jurisdictions in the pace of implementation" and warned that "jurisdictions need to take substantial, concrete steps toward implementation immediately" in order to meet the G-20's end-2012 deadline.⁴⁶

As mentioned above, the FSB released its second progress report in October 2011. The FSB October 2011 Report, issued more than two years after agreement to the G-20 Leaders' commitments and a bit more than a year before the end-2012 deadline, provides a more detailed assessment of progress toward the G-20 Leaders' commitments. The FSB reiterated its concerns about the pace of regulatory efforts and again emphasized the importance of cooperation:

The FSB believes that the highest current priority in implementation of OTC derivatives markets reforms is to increase the pace of legislative and regulatory action to ensure that frameworks are in place as soon as possible. Jurisdictions should aggressively push forward to meet the end-2012 deadline in as many areas as possible, including accelerating jurisdictional policy decision-making with regard to organised platform trading. ... To ensure consistency in implementation, and avoid overlaps, gaps, and conflicts in legislative and regulatory frameworks that may risk compromising reform objectives, specific overlaps, gaps, and

2010), available at <http://g20mexico.org/images/stories/canalfinan/docs/repcore/01seoul.pdf>.

⁴⁴ OTC Derivatives Market Reforms: Progress Report on Implementation (April 15, 2011) ("FSB April 2011 Report"), available at http://www.financialstabilityboard.org/publications/r_110415b.pdf.

⁴⁵ Developments include, *e.g.*: IOSCO Report on Trading of OTC Derivatives (February 2011) (recommending a flexible approach in defining "exchanges or electronic trading platforms" for the purposes of addressing the G-20 objectives and to be followed up by additional analysis on market use of multi- or single-dealer platforms), available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD345.pdf>; and CPSS-IOSCO Report on OTC Derivatives Data Reporting and Aggregation Requirements, Consultative Report (August 2011) (to be finalized by end-2011), available at <http://www.bis.org/publ/cpss96.pdf>. CFTC and SEC staff continues to be actively engaged in many such international projects on the clearing, reporting, trading, and risk management of OTC derivatives.

⁴⁶ FSB April 2011 Report at p. 4. This report is based upon responses to a questionnaire FSB members completed in January 2011.

conflicts should continue to be discussed, as a matter of priority, bilaterally between or multilaterally among jurisdictions. Solutions also should come through consistency across jurisdictions in application of international standards that either address such issues directly or set out processes and expectations for international cooperation between authorities.⁴⁷

The FSB's ODWG will continue to monitor implementation of OTC derivatives reforms.

The FSB will continue to encourage full and consistent implementation of the G-20 Leaders' commitments through development of international standards, adoption of legislative and regulatory frameworks, and changes in market structures and activities.

In November 2011, the G-20 continued to endorse the FSB recommendations:

Reforming the over the counter derivatives markets is crucial to build a more resilient financial system. All standardized over-the-counter derivatives contracts should be traded on exchanges or electronic trading platforms, where appropriate, and centrally cleared, by the end of 2012; OTC derivatives contracts should be reported to [TRs], and non-centrally cleared contracts should be subject to higher capital requirements. We agree to cooperate further to avoid loopholes and overlapping regulations. A coordination group is being established by the FSB to address some of these issues, complementing the existing OTC derivatives working group. We endorse the FSB progress report on implementation and ask the CPSS and IOSCO to work with FSB to carry forward work on identifying data that could be provided by and to [TRs], and to define principles or guidance on regulators' and supervisors' access to data held by [TRs]. We call on the [BCBS and IOSCO] together with other relevant organizations to develop for consultation standards on margining for non-centrally cleared OTC derivatives by June 2012, and on the FSB to continue to report on progress towards meeting our commitments on OTC derivatives.⁴⁸

CFTC and SEC staff will continue to monitor and participate in international efforts by the G-20 and other groups to help coordinate regulation of OTC derivatives.

⁴⁷ FSB October 2011 Report at p. 21.

⁴⁸ Cannes Summit Final Declaration, ¶ 24 (November 4, 2011), available at <http://www.g20.org/images/stories/canalffin/docs/01cannes.pdf>; *see also* ¶ 27 (“We agree to intensify our monitoring of financial regulatory reforms, report on our progress and track our deficiencies. To do so, we endorse the FSB coordination framework for implementation monitoring, notably on key areas such as ... OTC derivatives reforms ...”) and ¶ 31 (“We also call on IOSCO to assess the functioning of credit default swap (CDS) markets and the role of those markets in price formation of underlying assets by our next Summit. We support the creation of a global legal entity identifier (LEI) which uniquely identifies parties to financial transactions. We call on the FSB to take the lead in helping coordinate work among the regulatory community to prepare recommendations for the appropriate governance framework, representing the public interest, for such a global LEI by our next Summit.”).

A. The Americas

1. United States

Title VII amends the Commodity Exchange Act (“CEA”),⁴⁹ the Securities Act of 1933 (“Securities Act”),⁵⁰ and the Securities Exchange Act of 1934 (“Exchange Act”)⁵¹ to establish a comprehensive new regulatory framework for Swaps to reduce risk, increase transparency, and promote market integrity within the financial system. Among other things, Title VII: (1) provides for the registration and comprehensive regulation of swap dealers (“SDs”), security-based swap dealers (“SBSDs”), major swap participants (“MSPs”), and major security-based swap participants (“MSBSP”); (2) imposes clearing and trade execution requirements on Swaps, subject to certain exceptions; (3) creates recordkeeping and real-time reporting regimes; and (4) enhances the Commissions’ rulemaking and enforcement authorities with respect to certain products, entities, and intermediaries subject to the Commissions’ oversight.⁵²

DFA Sections 754 and 774 state that, unless otherwise provided, DFA provisions are effective on the later of 360 days after the DFA’s enactment (*i.e.*, July 16, 2011) (“self-effectuating”) or, to the extent rulemaking is required, not less than 60 days after publication of the final regulation. The Commissions are continuing to implement the DFA, and also have taken certain actions to minimize undue disruption and uncertainty for markets and participants during the transition period. In June 2011, the SEC issued an exemptive order to provide guidance as to which of DFA Title VII’s requirements would apply to security-based swaps as of July 16, 2011, and temporary relief to market participants from compliance with certain of those

⁴⁹ 7 U.S.C. §1 *et seq.*, *as amended.*

⁵⁰ 15 U.S.C. §77a *et seq.*, *as amended.*

⁵¹ 15 U.S.C. §78a *et seq.*, *as amended.*

⁵² In addition, Title I of the DFA establishes the Financial Stability Oversight Council (“FSOC”), which is comprised of the leaders of various financial regulators (including the CFTC and SEC Chairmen) and other participants. DFA Section 112 directs the FSOC, among other things, to monitor and respond to emerging risks to the stability of the U.S. financial system, including risks arising from the Swaps market.

requirements.⁵³ In July 2011, the CFTC issued an order (“CFTC July 2011 Order”) granting temporary relief from certain statutory provisions that otherwise would have taken effect on July 16, 2011, and setting an expiration date of December 31, 2011, at the latest, for the relief.⁵⁴ In December 2011, the CFTC amended the CFTC July 2011 Order to extend the latest expiration date to July 16, 2012.⁵⁵ In addition, in September 2011, the CFTC proposed a phased-in approach to implementation whereby compliance with specified requirements would be mandated first within 90 days by certain swap entities, then within 180 days by certain other market participants, and then within 270 days by others.⁵⁶

a. Types of OTC Derivatives

Title VII gives the CFTC authority to regulate “swaps” and gives the SEC authority to regulate “security-based swaps”, as such terms are defined in the DFA.⁵⁷ The swap definition is comprehensive and includes a wide range of agreements, contracts, and transactions, as well as

⁵³ Temporary Exemptions and Other Temporary Relief, Together with Information on Compliance Dates for New Provisions of the Securities Exchange Act of 1934 Applicable to Security-Based Swaps, 76 Fed. Reg. 36287 (June 22, 2011), available at <http://www.sec.gov/rules/exorders/2011/34-64678fr.pdf>.

⁵⁴ Effective Date for Swap Regulation, 76 Fed. Reg. 42508 (July 19, 2011) (“CFTC July Order”), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-18248a.pdf>. The CFTC Order, which was effective on July 14, 2011, provided temporary relief from compliance with self-effectuating provisions that reference terms requiring further definition and from certain CEA provisions that may have applied as of July 16, 2011, as a result of the repeal of various exemptions and exclusions in current law.

⁵⁵ Amendment to July 14, 2011 Order for Swap Regulation, 76 Fed. Reg. 80233 (December 23, 2011), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-32841a.pdf>.

⁵⁶ Swap Transaction Compliance and Implementation Schedule: Trading Documentation and Margining Requirements under Section 4s of the CEA, 76 Fed. Reg. 58176 (September 20, 2011), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-24128a.pdf>; and Swap Transaction Compliance and Implementation Schedule: Clearing and Trade Execution Requirements under Section 2(h) of the CEA, 76 Fed. Reg. 58186 (September 20, 2011), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-24124a.pdf>.

⁵⁷ DFA Section 721(a)(21) Act amended CEA Section 1a by adding a swap definition in subsection (47), and DFA Section 761(a)(6) amended Section 3(a) of the Exchange Act by adding a security-based swap definition in paragraph (68).

various exclusions and rules of construction.⁵⁸ The security-based swap definition defines security-based swaps as swaps with certain specified characteristics.⁵⁹

DFA Section 712(d)(1) provides that the CFTC and the SEC, in consultation with the Board of Governors of the Federal Reserve System (“Federal Reserve Board”), shall jointly further define the terms “swap”, “security-based swap”, and “security-based swap agreement” (“SBSA”).⁶⁰ DFA Section 712(a)(8) provides further that the Commissions, after consultation with the Federal Reserve Board, shall jointly prescribe such regulations regarding “mixed swaps” as may be necessary to carry out the purposes of Title VII.⁶¹ In addition, DFA Sections

⁵⁸ CEA Section 1a(47) provides: In general, a swap, subject to enumerated exceptions, is any agreement, contract, or transaction: (i) that is a put, call, cap, floor, collar, or similar option of any kind that is for the purchase or sale, or based on the value, of 1 or more interest or other rates, currencies, commodities, securities, instruments of indebtedness, indices, quantitative measures, or other financial or economic interests or property of any kind; (ii) that provides for any purchase, sale, payment, or delivery (other than a dividend on an equity security) that is dependent on the occurrence, nonoccurrence, or the extent of the occurrence of an event or contingency associated with a potential financial, economic, or commercial consequence; (iii) that provides on an executory basis for the exchange, on a fixed or contingent basis, of 1 or more payments based on the value or level of 1 or more interest or other rates, currencies, commodities, securities, instruments of indebtedness, indices, quantitative measures, or other financial or economic interests or property of any kind, or any interest therein or based on the value thereof, and that transfers, as between the parties to the transaction, in whole or in part, the financial risk associated with a future change in any such value or level . . . including any agreement, contract, or transaction commonly known as— (I) an interest rate swap; (II) a rate floor; (III) a rate cap; (IV) a rate collar; (V) a cross-currency rate swap; (VI) a basis swap; (VII) a currency swap; (VIII) a foreign exchange (“FX”) swap; (IX) a total return swap; (X) an equity index swap; (XI) an equity swap; (XII) a debt index swap; (XIII) a debt swap; (XIV) a credit spread; (XV) a credit default swap; (XVI) a credit swap; (XVII) a weather swap; (XVIII) an energy swap; (XIX) a metal swap; (XX) an agricultural swap; (XXI) an emissions swap; and (XXII) a commodity swap; (iv) that is an agreement, contract, or transaction that is, or in the future becomes, commonly known to the trade as a swap . . . ; or (v) that is any combination or permutation of, or option on, any agreement, contract, or transaction described in any of the foregoing clauses. Security-based swaps are excluded from the swap definition.

⁵⁹ Section 3(a)(68) of the Exchange Act provides that security-based swaps are defined as swaps (without regard to the exclusion from the swap definition for security-based swaps) that also are based on certain underlying assets, including a single security, a loan, a narrow-based group or index of securities, or events relating to a single issuer or issuers of securities in a narrow-based security index.

⁶⁰ This provision also provides for further definition of the terms “swap dealer”, “security-based swap dealer”, “major swap participant”, “major security-based swap participant”, and “eligible contract participant”.

⁶¹ Section 721(a) of the DFA describes the category of “mixed swap” by adding new Section 1a(47)(D) to the CEA, and Section 761(a) of the DFA includes the category of “mixed swap” by adding new Section 3(a)(68)(D) to the Exchange Act. A mixed swap is defined as a subset of security-based swaps that also are based on the value of one or more interest or other rates, currencies, commodities, instruments of indebtedness, indices, quantitative measures, other financial or economic interest or property of any kind (other than a single security or a narrow-based security index), or the occurrence, non-occurrence, or the

721(b) and 761(b) provide that the Commissions may adopt regulations to further define terms included in Subtitles A and B of Title VII, respectively, and DFA Sections 721(c) and 761(b) provide the Commissions with authority to define the terms “swap” and “security-based swap” (as well as the terms “swap dealer”, “major swap participant”, “eligible contract participant”, “security-based swap dealer”, and “major security-based swap participant”), to include transactions and entities that have been structured to evade the requirements of Subtitles A and B, respectively, of Title VII.

After receiving public input in response to an Advance Notice of Proposed Rulemaking (“ANPRM”) issued in August 2010,⁶² the CFTC and the SEC published a joint proposed release for public comment in May 2011 with respect to the swap, security-based swap, and security-based swap agreement definitions and the regulation of mixed swaps.⁶³ Although the Commissions stated that extensive further definition of the terms by regulation was not necessary, they proposed interpretive guidance, and in some cases regulations, regarding, among other things: (1) the regulatory treatment of certain types of agreements, contracts, and transactions, such as insurance products and certain consumer and commercial contracts; (2) the exclusion of forward contracts from the swap and security-based swap definitions; (3) the status of certain commodity-related products including various FX products and forward rate

extent of the occurrence of an event or contingency associated with a potential financial, economic, or commercial consequence (other than the occurrence, non-occurrence, or extent of the occurrence of an event relating to a single issuer of a security or the issuers of securities in a narrow-based security index, provided that such event directly affects the financial statements, financial condition, or financial obligations of the issuer).

⁶² Definitions Contained in Title VII of Dodd-Frank Wall Street Reform and Consumer Protection Act, 75 Fed. Reg. 51429 (August 20, 2010) (“Definitions ANPRM”), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2010-20567a.pdf>.

⁶³ Further Definition of “Swap,” “Security-Based Swap,” and “Security-Based Swap Agreement”; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, 99 Fed. Reg. 29818 (May 23, 2011), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-11008a.pdf>; *see also* Correction (numbering and citation), 76 Fed. Reg. 32880 (June 7, 2011), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-13976a.pdf>.

agreements; (4) the regulatory treatment of swaps and security-based swaps involving interest (or other) rates and yields; (5) the regulatory treatment of total return swaps; (6) the application of the definition of “narrow-based security index” in distinguishing between certain swaps and security-based swaps, including credit default swaps (“CDS”) and index CDS; and (7) the specification of certain swaps and security-based swaps that are, and are not, mixed swaps. The Commissions also proposed regulations: (1) establishing books and records requirements applicable to SBSAs;⁶⁴ (2) providing a mechanism for requesting that the Commissions interpret whether a particular type of agreement, contract, or transaction (or class of agreements, contracts, or transactions) is a swap, security-based swap, or both (*i.e.*, a mixed swap); and (3) providing a mechanism for evaluating the applicability of certain regulatory requirements to particular mixed swaps. In addition, the CFTC proposed regulations to implement the anti-evasion authority provided in the DFA.

Pursuant to CEA Section 1a(47)(E)(i), as enacted by DFA Section 721(a)(21), FX forwards and FX swaps⁶⁵ are considered swaps unless the Secretary of the U.S. Department of the Treasury (“Treasury Secretary”) issues a written determination that either FX swaps, FX forwards, or both: (1) should not be regulated as swaps under the DFA; and (2) are not structured to evade the DFA in violation of any regulation promulgated by the CFTC pursuant to DFA Section 721(c). However, even after such a determination, the transactions still would be

⁶⁴ The CEA includes the definition of “security-based swap agreement” in subparagraph (A)(v) of the swap definition in CEA Section 1a(47). Section 761(a) of the DFA defines the term “security-based swap agreement” by adding new Section 3(a)(78) to the Exchange Act. “Security-based swap agreement” is defined as a “swap agreement” (as defined in Section 206A of the Gramm-Leach-Bliley Act, of which “a material term is based on the price, yield, value, or volatility of any security or any group or index of securities, including any interest therein” but does not include a security-based swap.

⁶⁵ See CEA Sections 1a(24) and 1a(25) (defining the terms “foreign exchange forward” and “foreign exchange swap”, respectively).

subject to reporting to a TR, or the CFTC if no TR accepts such transaction, and SDs and MSPs engaging in such transactions still would be subject to business conduct standards.⁶⁶

The Treasury Secretary has proposed excluding FX swaps and forwards from the swap definition under the CEA.⁶⁷ This proposed exclusion would not affect other products involving foreign currency. If the Treasury Secretary issues a final determination, an exclusion of FX forwards and FX swaps would become effective upon the Treasury Secretary's submission of the final determination to the appropriate Congressional committees.⁶⁸

b. Types of Market Participants

Title VII gives the CFTC authority to regulate entities that fall within the definition of the terms “swap dealer” or “major swap participant” and gives the SEC authority to regulate entities that fall within the definition of the terms “security-based swap dealer” or “major security-based swap participant”.⁶⁹ The statute sets forth the two dealer definitions in terms of whether an entity engages in certain types of activities: (1) holding oneself out as a dealer in Swaps; (2) making a market in Swaps; (3) regularly entering into Swaps with counterparties as an ordinary course of business for one's own account; or (4) engaging in activity causing oneself to be commonly known in the trade as a dealer or market maker in Swaps.⁷⁰ Entities that enter into swaps or security-based swaps for their own accounts, either individually or in a fiduciary

⁶⁶ See CEA Sections 1a(47)(E)(iii) and (iv) (reporting and business conduct standards, respectively). In addition, such transactions remain subject to antifraud and anti-manipulation prohibitions if they are traded on an exchange or execution facility, or if they are cleared. See CEA Section 1a(47)(F)(i).

⁶⁷ Notice of Proposed Determination of Foreign Exchange Swaps and Foreign Exchange Forwards under the Commodity Exchange Act, 76 Fed. Reg. 25774 (May 5, 2011), available at <http://www.gpo.gov/fdsys/pkg/FR-2011-05-05/pdf/2011-10927.pdf>.

⁶⁸ See CEA Section 1a(47)(E)(ii).

⁶⁹ DFA Section 721(a)(21) amended CEA Section 1a by adding a swap dealer definition in subsection (49) and a major swap participant definition in subsection (33). DFA Section 761(a)(6) amended Section 3(a) of the Exchange Act by adding a security-based swap dealer definition in paragraph (71) and a major swap participant definition in paragraph (67).

⁷⁰ In addition, the swap dealer definition (but not the definition of security-based swap dealer) provides that an insured depository institution (“IDI”) is not to be considered a swap dealer to the extent it offers to enter into a swap with a customer in connection with originating a loan with that customer.

capacity but not as part of a regular business, are not included within the definitions. The definitions provide for the Commissions to exempt from the dealer designation an entity that engages in a *de minimis* quantity of dealing in connection with transactions with or on behalf of its customers. In the major participant context, the two statutory definitions focus on the market impacts and risks associated with an entity's Swap positions, and specifically encompass: (1) entities that maintain a "substantial position"⁷¹ in any of the "major" categories of Swaps, as those categories are determined by the CFTC or the SEC as applicable;⁷² (2) entities whose outstanding Swaps create "substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets"; or (3) any financial entity that is "highly leveraged relative to the amount of capital such entity holds and that is not subject to capital requirements established by an appropriate Federal banking agency" and that maintains a "substantial position" in Swaps for any of the "major" categories of Swaps.⁷³ With respect to the dealer or major participant designation, an entity may be designated for one or more types, classes or categories of Swaps or (in the case of dealers) activities.

⁷¹ The statute directs the CFTC or the SEC to define the term "substantial position" for the respective definition at the threshold determined to be "prudent for the effective monitoring, management, and oversight of entities that are systemically important or can significantly impact the financial system of the United States." The definitions further provide that the Commissions shall consider the entity's "relative position in uncleared as opposed to cleared [swaps or security-based swaps] and may take into consideration the value and quality of collateral held against counterparty exposures."

⁷² This portion of the definition excludes both "positions held for hedging or mitigating commercial risk" and positions maintained by or contracts held by any employee benefit plan (as defined in paragraphs (3) and (32) of Section 3 of the Employee Retirement Income Security Act of 1974 ("ERISA")) for the primary purpose of hedging or mitigating risks directly associated with the operation of the plan.

⁷³ In addition, the major swap participant definition (but not the definition of major security-based swap participant) includes an exception for any "entity whose primary business is providing financing, and uses derivatives for the purpose of hedging underlying commercial risks related to interest rate and foreign currency exposures, 90 percent or more of which arise from financing that facilitates the purchase or lease of products, 90 percent or more of which are manufactured by the parent company or another subsidiary of the parent company."

As noted above, DFA Section 712(d)(1) provides that the CFTC and the SEC, in consultation with the Federal Reserve Board, shall jointly further define the terms “swap dealer”, “security-based swap dealer”, “major swap participant”, “major security-based swap participant”, and “eligible contract participant”. In addition, DFA Sections 721(b) and 761(b) provide that the Commissions may adopt regulations to further define terms included in Subtitles A and B of Title VII, respectively, and DFA Sections 721(c) and 761(b) Act provide the Commissions with authority to define the terms “swap dealer”, “major swap participant”, “security-based swap dealer”, and “major security-based swap participant” to include transactions and entities that have been structured to evade the requirements of Subtitles A and B, respectively, of Title VII.

After receiving public input in response to the Definitions ANPRM,⁷⁴ the CFTC and the SEC issued joint proposed regulations and interpretive guidance in December 2010 with respect to the definitions of the terms “swap dealer”, “security-based swap dealer”, “major swap participant”, “major security-based swap participant”, and “eligible contract participant”.⁷⁵ The Commissions proposed certain factors that are relevant to entities when determining their status with respect to the defined terms and also recognized the importance of crafting regulations that maximize the benefits of the framework created by the DFA in a way that is flexible enough to respond to market developments. The proposed regulations further define certain aspects of the meaning of the terms “swap dealer” and “security-based swap dealer” and provide guidance on how the Commissions propose to interpret these terms: (1) the types of activities that would cause a person to be an SD or SBSB, including differences in how the two definitions should be

⁷⁴ Definitions ANPRM, available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2010-20567a.pdf>.

⁷⁵ Further Definition of “Swap Dealer,” “Security-Based Swap Dealer,” “Major Swap Participant,” “Major Security-Based Swap Participant” and “Eligible Contract Participant”, 75 Fed. Reg. 80174 (December 21, 2010) (“Definition Proposal”), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2010-31130a.pdf>.

applied; (2) the statutory provisions requiring the Commissions to exempt entities from the dealer definitions in connection with *de minimis* activity; (3) the exception from the SD definition in connection with loans by IDIs; (4) the possibility that a person may be considered a dealer for some types, classes or categories of swaps, security-based swaps, or activities but not others; and (5) certain interpretative issues that arise in particular situations. In addition, the proposed regulations further define the MSP and MSBSP definitions by specifically addressing: (1) the “major” categories of Swaps; (2) the meaning of the term “substantial position”; (3) the meaning of the phrase “hedging or mitigating commercial risk”; (4) the meaning of the phrase “substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets”; (5) the meanings of the terms “financial entity” and “highly leveraged”; and (6) certain interpretive issues.⁷⁶

i. Registration Requirements

Entities that act as SDs or SBSDs, or that are MSPs or MSBSPs (“Swaps Entities”) must register as such.⁷⁷ In addition, an entity required to be registered as an SD or MSP shall register with the CFTC regardless of whether it also is registered with the SEC as an SBSD or MSBSP, and *vice versa*.⁷⁸

CEA Section 4s(b)(2) provides that the CFTC shall prescribe the form and manner, and the information required to be provided, to apply for registration as SDs or MSPs. The CFTC promulgated final regulations in January 2012.⁷⁹ The regulations set forth a process for

⁷⁶ The Commissions also proposed regulations to specify the use of a daily average methodology for identifying whether an entity meets one of the major participant definitions, provide for a reevaluation period for certain entities that exceed the relevant daily average by a small amount, and provide for a minimum length of time before an entity may no longer be deemed a major participant.

⁷⁷ DFA Section 731 adds Section 4s to the CEA, and governs the registration and regulation of SDs and MSPs. DFA Section 764 adds Section 15F to the Exchange Act, and governs the registration and regulation of SBSDs and MSBSPs.

⁷⁸ See CEA Section 4s(c) and Exchange Act Section 15F(c).

⁷⁹ Registration of Swap Dealers and Major Swap Participants, 77 Fed. Reg. 2613 (January 19, 2012),

registering SDs and MSPs,⁸⁰ and would require such entities to become members of a registered futures association and to confirm that persons associated with them are not subject to a statutory disqualification under the CEA before permitting such persons to effect or be involved in effecting swap transactions.

Exchange Act Section 15F(d)(1) provides that the SEC shall adopt regulations for entities registered as SBSBs or MSBSBs. The SEC issued proposed regulations in October 2011,⁸¹ and the comment period closed on December 19, 2011. The proposal set forth a process for registering SBSBs and MSBSBs, and would require those entities that reside outside the United States to identify a U.S. agent that can accept legal documents on behalf of the entity and to certify and submit an opinion of counsel that the non-U.S. entity is able to provide the SEC with access to its books and records and submit to onsite inspections and examination by the SEC.⁸²

In addition, DFA Section 716 prohibits an IDI from receiving Federal assistance if it also is an SD or SBSB that engages in activities that are not covered by the exclusion in DFA Section 716(d) (known as the “Push-Out Rule”).⁸³ The prohibition does not apply to the extent the IDI SD or SBSB engages in hedging and other risk-mitigating activities or acts as an SD or SBSB

available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2012-792a.pdf>.

⁸⁰ Registration continues until the effective date of any revocation or withdrawal of such registration.

⁸¹ Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants, 76 Fed. Reg. 65784 (October 24, 2011), available at <http://www.gpo.gov/fdsys/pkg/FR-2011-10-24/pdf/2011-26889.pdf>.

⁸² *Id.*

⁸³ In addition, DFA Section 716(m) provides that banking entities must comply with the ban on proprietary trading and restrictions on investing in and sponsoring private equity and hedge funds set forth in DFA Section 619 (known as the “Volcker Rule”). In November 2011, the Office of the Comptroller of the Currency (“OCC”), Federal Reserve Board, Federal Deposit Insurance Corporation (“FDIC”), and SEC published proposed regulations to implement this statutory provision. Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds, 76 Fed. Reg. 68846 (November 7, 2011), available at <http://www.gpo.gov/fdsys/pkg/FR-2011-11-07/pdf/2011-27184.pdf>. Public comments must have been received on or before January 13, 2012. The CFTC issued proposed regulations in January 2012. Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Covered Funds (January 11, 2012), available at <http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/federalregister011112c.pdf>.

for Swaps involving rates or reference assets that are permissible investments for national banks.⁸⁴ Under DFA Section 716(c), an IDI (that is part of a holding company supervised by the Federal Reserve) can retain its access to such assistance if it transfers covered activities to a non-IDI affiliate (“Push-Out Affiliate”) that is a Swaps Entity, if the affiliate complies with the requirements of DFA Section 716(c), including such requirements as the CFTC, SEC, or Federal Reserve Board may establish. The CFTC has not proposed specific requirements for Push-Out Affiliates, but any such entity that falls within the SD or MSP definition would be subject to registration and regulation as such. Similarly, any such entity that falls within the SBSB or MSBSP definition would be subject to registration and regulations by the SEC.

ii. Prudential and other Risk-Related Requirements

Prudential regulatory requirements include requirements related to capital, margin, risk management, segregation, and liquidity. Title VII imposes requirements in each of these areas.

Under Title VII, Swaps Entities are required to comply with minimum capital and minimum initial and variation margin requirements. In general, minimum capital requirements are designed to provide firms with sufficient liquidity to meet unsubordinated obligations to customers and counterparties and sufficient resources to wind-down in an orderly manner without the need for a formal proceeding. Minimum margin requirements are generally intended to regulate the amount of credit directed into Swaps and related transactions and to help protect Swaps Entities and their customers from price fluctuations and against losses arising from undue leverage. Minimum margin requirements also can help manage counterparty credit risk.

CEA Section 4s(e)(1)(B) provides that the CFTC shall prescribe capital and margin requirements for SDs and MSPs for which there is not a prudential regulator⁸⁵ and Exchange Act

⁸⁴ Permissible activities of national banks are set forth in 12 U.S.C. Section 24 (Seventh) and regulations thereunder.

⁸⁵ The term “prudential regulator” is defined in CEA Section 1a(39), as amended by DFA Section 721, and

Section 15F(e)(1)(B) provides that the SEC shall prescribe capital and margin requirements for SBSBs and MSBSPs for which there is not a prudential regulator. CEA Section 4s(e)(1)(A) and Exchange Act Section 15F(e)(1)(A) provide that the prudential regulators shall prescribe capital and margin requirements for Swaps Entities for which there is a prudential regulator. To offset the greater risk that uncleared Swaps pose to Swaps Entities and the financial system, CEA Section 4s(e)(3)(A) and Exchange Act Section 15F(e)(3)(A) direct the CFTC, SEC, and prudential regulators to adopt capital and margin requirements that: (1) help ensure the safety and soundness of the registrant; and (2) are appropriate for the risk associated with the uncleared Swaps they hold.⁸⁶ In May 2011, the prudential regulators proposed capital and margin requirements for Swaps Entities within their jurisdiction,⁸⁷ and the CFTC proposed regulations for capital and margin requirements for uncleared swaps of SDs and MSPs in May 2011⁸⁸ and April 2011,⁸⁹ respectively. The SEC plans to propose capital, margin, segregation, and other prudential and risk-related regulatory requirements for SBSBs and MSBSPs in 2012.⁹⁰

includes the Federal Reserve Board, OCC, FDIC, Farm Credit Administration, and Federal Housing Finance Agency. In the case of the Federal Reserve Board, it is the prudential regulator for certain banks, as well as for bank holding companies and any foreign banks treated as bank holding companies. It also is the prudential regulator for subsidiaries of these bank holding companies and foreign banks, but not their nonbank subsidiaries that are required to be registered with the CFTC or SEC as Swaps Entities.

⁸⁶ CEA Section 4s(e)(2)(C) and Exchange Act Section 15F(e)(2)(C) further require the regulators, in setting capital requirements for entities designated as Swaps Entities for a single type or single class or category of Swap or activities, to take into account the risks associated with other types/classes/categories of Swap and other activities conducted by that entity that are not otherwise subject to regulation by virtue of its status as a Swaps Entity. In addition, CEA Section 4s(e)(3)(C) and Exchange Act Section 15F(e)(3)(C) permit the use of noncash collateral, as the regulators each determine to be consistent with preserving the financial integrity of markets trading Swaps and preserving the stability of the U.S. financial system.

⁸⁷ Margin and Capital Requirements for Covered Swap Entities, 76 Fed Reg. 27564 (May 11, 2011), available at <http://www.federalregister.gov/articles/2011/06/24/2011-16004/margin-and-capital-requirements-for-covered-swap-entities>.

⁸⁸ Capital Requirements of Swap Dealers and Major Swap Participants, 76 Fed. Reg. 27802 (May 12, 2011), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-10881a.pdf>.

⁸⁹ Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 76 Fed Reg. 23732 (April 28, 2011), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-9598a.pdf>. The proposed regulations would not impose margin requirements on nonfinancial end users.

⁹⁰ Swaps entered into by SEC-registered broker-dealers are currently subject to the SEC's existing financial

CEA Section 4s(j)(2) and Exchange Act Section 15F(j)(2) require registered Swaps Entities to establish robust and professional risk management systems adequate for managing their businesses. The CFTC issued proposals related to risk management for SDs and MSPs in November 2010⁹¹ and risk management for cleared trades by futures commission merchants (“FCMs”), SDs, and MSPs that are clearing members of derivatives clearing organizations (“DCOs”) in August 2011.⁹² The SEC proposed regulations related to risk management in July 2011.⁹³

DFA Sections 724(c) and 763(d), which added CEA Section 4s(l) and Exchange Act Section 3E(f), respectively, set forth certain requirements concerning the rights of counterparties to Swaps Entities with respect to the treatment of margin for uncleared swaps: (1) a Swaps Entity must notify each counterparty at the beginning of a Swap transaction that the counterparty has the right to require segregation of the funds or other property that it supplies to margin, guarantee, or secure its obligations; and (2) at the request of the counterparty, the Swaps Entity must segregate such funds or other property with an independent third party. The CFTC proposed regulations in this area in December 2010.⁹⁴ As noted above, the SEC plans to propose regulations in 2012.

responsibility program for broker-dealers, which includes capital, margin, segregation, and other prudential regulatory requirements.

⁹¹ Regulations Establishing and Governing the Duties of Swap Dealers and Major Swap Participants, 75 Fed. Reg. 71397 (November 23, 2010) (“SD and MSP Duties Proposal”), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2010-29009a.pdf>.

⁹² Clearing Member Risk Management, 76 Fed. Reg. 45724 (August 1, 2011), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-19362a.pdf>.

⁹³ Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants, 76 Fed. Reg. 42396 (July 18, 2011) (“SBSD and MSBSP Business Conduct Proposal”), available at <http://www.sec.gov/rules/proposed/2011/34-64766fr.pdf>.

⁹⁴ Protection of Collateral of Counterparties to Uncleared Swaps; Treatment of Securities in a Portfolio Margining Account in a Commodity Broker Bankruptcy, 75 Fed. Reg. 75432 (December 3, 2010), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2010-29831a.pdf>.

With respect to cleared swaps, DFA Section 724(a), adding CEA Section 4d(f)(2), requires that each FCM⁹⁵ and DCO segregate customer collateral supporting cleared swaps. The FCM and the DCO: (1) must hold such customer collateral in a segregated account (or location), separate from the property belonging to the FCM or DCO; and (2) must not use the collateral of one customer to cover the obligations of another customer or the obligations of the FCM or DCO. DFA Section 763, adding Exchange Act Section 3E, imposes substantially identical requirements for brokers, dealers, and SBSDs. The CFTC released final regulations in this area in January 2012,⁹⁶ and the SEC plans to propose regulations in 2012.

Finally, DFA Sections 724(a) and 763(d), adding CEA Section 4d(f)(4) and Exchange Act Section 3E(d), respectively, provide that segregated customer collateral supporting cleared Swaps may only be invested in obligations of the United States, obligations fully guaranteed as to principal and interest by the United States, general obligations of any State or of any political subdivision thereof, or any other investment that the CFTC or SEC, as applicable, may permit. CFTC Regulation 1.25⁹⁷ addresses the investment of customer funds. The CFTC's Customer Segregation Rulemaking permits FCMs and DCOs to invest cleared swaps customer collateral in accordance with CFTC Regulation 1.25. In December 2011, the CFTC promulgated final regulations amending Regulation 1.25.⁹⁸ Pursuant to these amendments, FCMs and DCOs only may invest customer funds in U.S. Treasury bonds, municipal securities, securities issued by

⁹⁵ SDs must register as FCMs in order to intermediate cleared swaps. *See* DFA Section 724(a), adding CEA Section 4d(f)(1).

⁹⁶ Protection of Cleared Swaps Customer Contracts and Collateral; Conforming Amendments to the Commodity Broker Bankruptcy Provisions (January 11, 2012) ("Customer Segregation Rulemaking"), available at <http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/federalregister011112d.pdf>.

⁹⁷ CFTC regulations are found at 17 CFR Ch. 1 (2011) and are accessible on the Commission's website at <http://www.cftc.gov>.

⁹⁸ Investment of Customer Funds and Funds Held in an Account for Foreign Futures and Foreign Options Transactions, 76 Fed. Reg. 78776 (December 19, 2011), available at <http://www.cftc.gov/ucm/groups/public/@lfederalregister/documents/file/2011-31689a.pdf>.

U.S. government sponsored entities, U.S.-backed commercial paper, U.S.-backed corporate notes, certificates of deposit, and money market mutual funds. Permitted investments also are subject to various limitations, such as concentration and time-to-maturity limits, in order to further protect customer funds from credit, liquidity, and market risks. The CFTC also eliminated in-house transactions and repurchase agreements with affiliates. The SEC plans to propose regulations related to Section 3E(d) of the Exchange Act in 2012.

iii. Business Conduct Requirements

Registered Swaps Entities must comply with business conduct requirements in Title VII. Such requirements address, among other things, interaction with counterparties, disclosure, supervision, reporting, recordkeeping, documentation, confirmation, valuation, conflicts of interest, and avoidance of fraud and other abusive practices.

CEA Section 4s(f) and Exchange Act Section 15F(f) require registered Swaps Entities to comply with reporting and recordkeeping requirements established by either the CFTC or SEC, as applicable, and for their books and records to be open to inspection and examination by the regulator. CEA Section 4s(g) and Exchange Act Section 15F(g) require registered Swaps Entities to maintain daily trading and related records and recorded communications as required by the applicable Commission. Requirements include daily trading records for each counterparty in a manner and form that are identifiable with each Swap transaction and a complete audit trail for conducting comprehensive and accurate trade reconstructions. The CFTC proposed regulations in this area in December 2010.⁹⁹ The SEC plans to propose regulations in this area in 2012.

⁹⁹ Reporting, Recordkeeping, and Daily Trading Records Requirements for Swap Dealers and Major Swap Participants, 75 Fed. Reg. 76666 (December 9, 2010), available at <http://www.cftc.gov/ucm/groups/public/@Irfederalregister/documents/file/2010-30884a.pdf>.

CEA Section 4s(h) and Exchange Act Section 15F(h) require registered Swaps Entities to comply with business conduct standards established by the CFTC or SEC, as applicable, that include verification that their counterparties meet the standards for eligible contract participants (“ECPs”);¹⁰⁰ disclosure to their counterparties (that are not also Swaps Entities) of information about the material risks and characteristics of the Swap, any material incentives or conflicts of interests the Swaps Entity may have in connection with the Swap, the daily mark of the transaction received from the appropriate DCO or clearing agency if the Swap is cleared and the counterparty requests the information, and the daily mark of the transaction from the Swaps Entity for an uncleared Swap; and a duty to communicate in a fair and balanced manner based on principles of fair dealing and good faith. The statutes also authorize the Commissions to impose standards that relate to fraud, manipulation, and other abusive practices; diligent supervision; adherence to applicable position limits; and such other matters as the Commission(s) may deem appropriate. Additional requirements apply to dealings with “special entities”, including municipalities, pension plans, and endowments.¹⁰¹ Among other things, an SD or SBSB acting as advisor to a special entity has a duty to act in the best interests of such a special entity, and a Swaps Entity that is a counterparty to a special entity must have a reasonable basis to believe that the special entity is advised by an independent representative that meets certain statutory criteria.

¹⁰⁰ Under DFA Section 723(a)(2), adding CEA Section 2(e), a person who is not an ECP cannot enter into a swap except on a DCM. Under DFA Section 763(e), adding Exchange Act Section 6(1), a person who is not an ECP cannot enter into a security-based swap except on a registered national securities exchange. Under DFA Section 768(b), adding Securities Act Section 5(d), a person may not offer to sell, offer to buy or purchase, or sell a security-based swap to a person that is not an ECP unless a registration statement under the Securities Act is in effect with respect to that security-based swap. The term “eligible contract participant” is defined in CEA Section 1a(18). Under Exchange Act Section 3(a)(65), the term “eligible contract participant” has the same meaning as in CEA Section 1a. The CFTC and SEC published a joint proposed release for public comment in December 2010 further defining the term “eligible contract participant”. See Definition Proposal, available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2010-31130a.pdf>.

¹⁰¹ See CEA Section 4s(h)(2)(C) and Exchange Act Section 15F(h)(2)(C). These additional requirements do not apply if the special entity initiates the transaction on an exchange or Swap execution facility and the Swaps Entity does not know the identity of the counterparty to the transaction. See CEA Section 4s(h)(7) and Exchange Act Section 15F(h)(7).

The CFTC released final regulations with respect to business conduct standards in January 2012.¹⁰² The CFTC promulgated final regulations in July 2011 with respect to fraud, manipulation, and other abusive practices (which apply to all persons, not just Swaps Entities)¹⁰³ and in November 2011 with respect to adherence to applicable position limits (which apply to all traders, not just Swaps Entities).¹⁰⁴ The SEC issued proposed regulations with respect to business conduct standards in July 2011 and proposed regulations with respect to fraud, manipulation, and other abusive practices (which apply to all persons, not just Swaps Entities) in November 2010.¹⁰⁵

CEA Section 4s(i) and Exchange Act Section 15F(i) require registered Swaps Entities to comply with documentation standards established by the CFTC or SEC, as applicable, that relate to timely and accurate confirmation, processing, netting, documentation, and valuation of all Swaps. The CFTC proposed regulations in this area in December 2010 and February, March, and August 2011.¹⁰⁶ In its Confirmation Proposal, the CFTC noted that it expects that SDs and

¹⁰² Business Conduct Standards for Swap Dealers and Major Swap Participants with Counterparties, (January 11, 2012), available at <http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/federalregister011112e.pdf>.

¹⁰³ Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation, 76 Fed. Reg. 41398 (July 14, 2011) (adopted to implement Section 753 of the DFA, which amended CEA Section 6(c)), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-17549a.pdf>.

¹⁰⁴ Position Limits for Futures and Swaps, 76 Fed. Reg. 71626 (November 18, 2011), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-28809a.pdf>.

¹⁰⁵ SBSB and MSBSP Business Conduct Proposal, available at <http://www.sec.gov/rules/proposed/2011/34-64766fr.pdf>; Prohibition Against Fraud, Manipulation, and Deception in Connection with Security-Based Swaps, 75 Fed. Reg. 68560 (November 8 2010), available at <http://www.sec.gov/rules/proposed/2010/34-63236fr.pdf>.

¹⁰⁶ Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants, 76 Fed. Reg. 6715 (February 8, 2011), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-2643a.pdf>; Confirmation, Portfolio Reconciliation, and Portfolio Compression Requirements for Swap Dealers and Major Swap Participants, 75 Fed. Reg. 81519 (December 28, 2010) (“Confirmation Proposal”), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2010-32264a.pdf>; Orderly Liquidation Termination Provision in Swap Trading Relationship Documentation for Swap Dealers and Major Swap Participants, 76 Fed. Reg. 6708 (February 8, 2011) (noting that the proposal would not be applicable to cleared swaps, which are covered by DFA Section 210(c)(8)(G)), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-2642a.pdf>; Requirements

MSPs would be able to comply with the confirmation requirements by executing a swap on a swap execution facility (“SEF”) or on a designated contract market (“DCM”), or by clearing a swap through a DCO, and that it expects that SDs and MSPs would be able to comply with the portfolio reconciliation and portfolio compression requirements by clearing a swap through a DCO. The SEC proposed regulations in January 2011¹⁰⁷ that would govern the delivery of trade acknowledgments and the verification of those trade acknowledgments in security-based swap transactions by SBSDs and MSBSPs. The proposal also stated that SBSDs and MSBSPs could satisfy certain requirements if a clearing agency provided a trade acknowledgment and verified the terms of such trade acknowledgment for an applicable security-based swap.

CEA Section 4s(j) and Exchange Act Section 15F(j) require registered Swaps Entities to comply at all times with several duties: monitoring of trading to prevent violations of applicable position limits, risk management procedures,¹⁰⁸ disclosure of information to the Commissions and prudential regulators, the ability to obtain information to perform functions and provide to the Commissions and prudential regulators, implementation of systems and procedures related to addressing conflicts of interest, and satisfaction of antitrust considerations. The CFTC proposed regulations in this area in November 2010,¹⁰⁹ and the SEC proposed regulations in July 2011.¹¹⁰

for Processing, Clearing, and Transfer of Customer Positions, 76 Fed. Reg. 13101 (March 10, 2011), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-4707a.pdf>; and Customer Clearing Documentation and Timing of Acceptance for Clearing, 76 Fed. Reg. 45730 (August 1, 2011), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-19365a.pdf>, and Correction (incorrect text corrected), 76 Fed. Reg. 47529 (August 5, 2011), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-19874a.pdf>.

¹⁰⁷ Trade Acknowledgement and Verification of Security-Based Swap Transactions, 76 Fed. Reg. 3859 (January 21, 2011), available at <http://www.gpo.gov/fdsys/pkg/FR-2011-01-21/pdf/2011-1218.pdf>.

¹⁰⁸ Risk management requirements are discussed in the previous section.

¹⁰⁹ SD and MSP Duties Proposal, available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2010-29009a.pdf>; and Implementation of Conflicts of Interest Policies and Procedures by Swap Dealers and Major Swap Participants, 75 Fed. Reg. 71391 (November 23, 2010), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2010-29006a.pdf>.

¹¹⁰ SBSB and MSBSP Business Conduct Proposal, available at <http://www.sec.gov/rules/proposed/2011/34->

CEA Section 4s(k) and Exchange Act Section 15F(k) require registered Swaps Entities to designate a chief compliance officer, who must carry out certain enumerated duties and must prepare annual compliance reports. The CFTC proposed regulations in this area in November 2010,¹¹¹ and the SEC proposed regulations in July 2011.¹¹²

c. Clearing Requirements

Title VII requires Swaps that the CFTC or SEC determines are required to be cleared to be submitted for clearing to a registered or exempt clearinghouse. The mandatory clearing requirement applies to “persons” engaging in such Swaps, but certain end-users that use these Swaps to hedge or mitigate commercial risk are excepted from this requirement. Title VII also sets forth comprehensive requirements with which clearinghouses must comply.

i. Clearing Mandate

Swaps that are required to be cleared must be submitted for clearing to a registered or exempt clearinghouse.¹¹³ DFA Sections 723(a)(3) and 763(a), which added CEA Section 2(h) and Exchange Act Section 3C, respectively, each provide for two approaches to the determination of which swaps are to be cleared: (1) the CFTC or SEC may determine upon its own initiative whether a Swap or a group, category, type, or class of Swaps should be required to

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¹¹¹ Designation of a Chief Compliance Officer; Required Compliance Policies; and Annual Report of a Futures Commission Merchant, Swap Dealer, or Major Swap Participant, 75 Fed. Reg. 70881 (November 19, 2010), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2010-29021a.pdf>.

¹¹² SBSB and MSBSP Business Conduct Proposal, available at <http://www.sec.gov/rules/proposed/2011/34-64766fr.pdf>.

¹¹³ CEA Section 2(h)(1) mandates that swaps that are required to be cleared must be submitted to a registered or exempt DCO, and Exchange Act Section 3C(a)(1) mandates that security-based swaps that are required to be cleared must be submitted for clearing to a registered or exempt clearing agency. The term “derivatives clearing organization” is defined in CEA Section 1a(15). The term “clearing agency” is defined in Exchange Act Section 3(a)(23). Further, CEA Section 2(h)(6) and Exchange Act Section 3C(f) provide that Swaps entered into before the DFA’s enactment (July 21, 2010) or before application of the clearing requirement are exempt from clearing if reported to a registered repository or to the appropriate Commission.

be cleared (“top-down approach”); or (2) a clearinghouse initiates such a determination by the CFTC or SEC if it plans to accept for clearing a Swap or a group, category, type, or class of Swaps (“bottom-up approach”).¹¹⁴

CEA Section 2(h)(2)(D) and Exchange Act Section 3C(b)(4) enumerate five factors that must be taken into account in making the mandatory clearing determination: (1) the existence of significant outstanding notional exposures, trading liquidity, and adequate pricing data; (2) the availability of rule framework, capacity, operational expertise and resources, and credit support infrastructure to clear the contract on terms that are consistent with the material terms and trading conventions on which the contract is then traded; (3) the effect on the mitigation of systemic risk, taking into account the size of the market for such contract and the resources of the clearinghouse available to clear the contract; (4) the effect on competition, including appropriate fees and charges applied to clearing; and (5) the existence of reasonable legal certainty in the event of the insolvency of the relevant clearinghouse or one of more of its clearing members with regard to the treatment of customer and Swap counterparty positions, funds, and property.¹¹⁵

With respect to end-users, CEA Section 2(h)(7) and Section 3C(g) of the Exchange Act provide an exception from the mandatory clearing requirement for Swaps if one of the Swap counterparties: (1) is not a financial entity;¹¹⁶ (2) is using Swaps to hedge or mitigate

¹¹⁴ Pursuant to CEA Section 2(h)(2)(B)(ii) and Exchange Act Section 3C(b)(2)(B), Swaps already listed for clearing as of the date of the DFA’s enactment (July 21, 2010) are considered submitted to the CFTC or SEC, respectively, for mandatory clearing determinations.

¹¹⁵ Pursuant to CEA Section 2(h)(1)(B) and Exchange Act Section 3C(a)(2), the rules of a clearinghouse that clears Swaps required to be cleared must provide for open access such that Swaps with the same terms and conditions may be offset with each other within the clearinghouse, and the clearinghouse must provide for non-discriminatory clearing of a Swap executed bilaterally or on or through the rules of an unaffiliated market, exchange, or execution facility.

¹¹⁶ CEA Section 2(h)(7)(C)(ii) requires the CFTC to consider whether to except small banks, savings associations, farm credit systems institutions, and credit unions from the definition of financial entity, including those with total assets of \$10 billion or less (“SFI”). This type of exception would permit SFIs to use the end-user exception from the mandatory clearing requirement, which is otherwise unavailable to financial entities. Exchange Act Section 3C(g)(3)(B) imposes a similar requirement on the SEC.

commercial risk; and (3) notifies the CFTC (for swaps) or the SEC (for security-based swaps) how the counterparty generally meets its financial obligations associated with entering into non-cleared Swaps. The term “financial entity” means: (1) an SD; (2) an SBSB; (3) an MSP; (4) an MSBSP; (5) a commodity pool;¹¹⁷ (6) a private fund;¹¹⁸ (7) an employee benefit plan;¹¹⁹ or (8) a person predominantly engaged in activities that are in the business of banking or in activities that are financial in nature.¹²⁰

CEA Sections 2(h)(2)(E) and 2(h)(3)(D) require the CFTC, and Exchange Act Sections 3C(b)(5) and 3C(c)(4) require the SEC, to adopt regulations for the review of a clearinghouse’s submission of a Swap, or a group, category, type, or class of Swaps, it seeks to accept for clearing and, in the context of a stay of the clearing requirement, for the review of a clearinghouse’s clearing of a Swap, or a group, category, type, or class of Swaps. The CFTC promulgated final regulations in July 2011 that establish procedures for determining the eligibility of a DCO to clear swaps,¹²¹ for the submission of swaps by a DCO to the CFTC for a mandatory clearing determination, for CFTC-initiated reviews of swaps, and for staying a clearing requirement.¹²² In December 2010, the CFTC proposed regulations on the end-user exception.¹²³ In December 2010, the SEC proposed regulations on the process for the submission of security-based swaps to the SEC for review for a mandatory clearing

¹¹⁷ See CEA Section 1a(10).

¹¹⁸ See Section 202(a) of the Investment Advisers Act of 1940.

¹¹⁹ See Sections 3(3) and 3(32) of ERISA.

¹²⁰ See Section 4(k) of the Bank Holding Company Act of 1956.

¹²¹ DFA Section 745(b), adding CEA Section 5c(c)(5)(C)(iii), requires the CFTC to prescribe criteria, conditions, or regulations under which the Commission will determine the initial eligibility or the continuing qualification of a clearinghouse to clear swaps.

¹²² Process for Review of Swaps for Mandatory Clearing, 76 Fed. Reg. 44464 (July 26, 2011), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-18663a.pdf>.

¹²³ End-User Exception to Mandatory Clearing of Swaps, 75 Fed. Reg. 80747 (December 23, 2010), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2010-31578a.pdf>.

determination and for staying a clearing determination.¹²⁴ Also in December 2010, the SEC proposed regulations on the end-user exception, including rule text that would give certain small financial institutions an opportunity to qualify for the end-user exception through an exemption from the definition of a financial entity in Exchange Act Section 3C(g)(3)(A).¹²⁵

ii. Registration Requirements for CCPs

An entity acting as a CCP for swaps must be registered with the CFTC as a DCO, and an entity acting as a CCP for security-based swaps must be registered with the SEC as a clearing agency (unless the entity is operating under an exemption granted by either Commission). An entity may register in both capacities. DFA Section 725(a) amended CEA Section 5b(a), which requires registration of entities performing the functions of a DCO with respect to, among other things, a swap.¹²⁶ DFA Section 763(b) added Section 17A(g)-(m) to the Exchange Act and requires registration of entities performing the functions of a clearing agency with respect to a security-based swap that is required to be centrally cleared.¹²⁷

¹²⁴ Process for Submissions for Review of Security-Based Swaps for Mandatory Clearing and Notice Filing Requirements for Clearing Agencies; Technical Amendments to Rule 19b-4 and Form 19b-4 Applicable to All Self-Regulatory Organizations, 75 Fed. Reg. 82490 (December 30, 2010), available at <http://sec.gov/rules/proposed/2010/34-63557fr.pdf>; *see also* Exemptions for Security-Based Swaps Issued by Certain Clearing Agencies, 76 Fed. Reg. 34920 (June 15, 2011), available at <http://www.sec.gov/rules/proposed/2011/33-9222fr.pdf>; Extension of Temporary Exemptions for Eligible Credit Default Swaps to Facilitate Operation of Central Counterparties to Clear and Settle Credit Default Swaps, 76 Fed. Reg. 40223 (July 8, 2011) (final temporary rules), available at <http://www.sec.gov/rules/final/2009/33-9063fr.pdf>; and Exemptions for Security-Based Swaps, 76 Fed. Reg. 40605 (July 11, 2011) (interim final rules), available at <http://www.sec.gov/rules/interim/2011/33-9231fr.pdf>.

¹²⁵ End-User Exception to Mandatory Clearing of Security-Based Swaps, 75 Fed. Reg. 79992 (December 21, 2010), available at <http://www.sec.gov/rules/proposed/2010/34-63556fr.pdf>.

¹²⁶ CEA Section 5b(b) also permits voluntary registration of entities clearing agreements, contracts, or transactions that are not required to be cleared under the CEA. In addition, DFA Section 725(b) added CEA Section 5b(g), which provides that a registered clearing agency (or a depository institution) that is required to be registered as a DCO is deemed to be registered under CEA Section 5b to the extent that, prior to enactment (July 21, 2010), the clearing agency cleared swaps (or the depository institution cleared swaps as a multilateral clearing organization).

¹²⁷ Exchange Act Section 17A(h) also permits voluntary registration of entities clearing agreements, contracts, or transactions that are not required to be cleared under Title VII. Exchange Act Section 17A(l) provides that a registered DCO (or a depository institution) that is required to be registered as a clearing agency is deemed to be registered solely for the purpose of clearing security-based swaps to the extent that, prior to

The CFTC and SEC each have discretion to determine whether to grant an exemption from registration for a particular clearinghouse. CEA Section 5b(h) and Exchange Act Section 17A(k) provide:

The [CFTC/SEC] may exempt, conditionally or unconditionally, a [DCO/clearing agency] from registration under this section for the clearing of [swaps/security-based swaps] if the [CFTC/SEC] determines that the [DCO/clearing agency] is subject to comparable, comprehensive supervision and regulation by the [SEC/CFTC] or the appropriate government authorities in the home country of the [organization/agency]. Such conditions may include, but are not limited to, requiring that the [DCO/clearing agency] be available for inspection by the Commission and make available all information requested by the Commission.

iii. Regulatory Requirements for CCPs

To be registered and to maintain registration as a DCO, CEA Section 5b(c)(2)(A), as amended by DFA Section 725(c), requires DCOs to comply with specified core principles and any requirements the CFTC may impose by rule or regulation. To be registered and to maintain registration as a clearing agency, Exchange Act Sections 17A(b) and (i) require clearing agencies to comply with regulatory standards as established by SEC rule.¹²⁸ Subject to CFTC or SEC rule or regulation, registered clearinghouses have reasonable discretion in establishing their manner of compliance.

CEA Section 5b(i) and Exchange Act Section 3C(j) require each registered clearinghouse to designate a chief compliance officer who must comply with certain specified duties and must prepare and file an annual report. In addition, DFA Section 725(c) amended CEA Section 5b(c)(2) to revise existing core principles in, and add new core principles to, the existing CEA

enactment (July 21, 2010), the DCO cleared swaps pursuant to an exemption from registration as a clearing agency (or the depository institution cleared swaps as a multilateral clearing organization).

¹²⁸ Exchange Act Section 17A(j) requires the SEC to adopt rules governing registered clearing agencies for security-based swaps. With respect to international coordination, Exchange Act Section 17A(i) provides that “[i]n establishing any such standards, and in the exercise of its oversight of such a clearing agency pursuant to this title, the Commission may conform such standards or oversight to reflect evolving United States and international standards.” In addition, Exchange Act Section 17A(m) provides that the SEC “may conform the core principles established in this section to reflect evolving United States and international standards.”

regime for DCOs. These core principles include (as lettered in the CEA): (A) compliance; (B) financial resources; (C) participant and product eligibility; (D) risk management; (E) settlement procedures; (F) treatment of funds; (G) default rules and procedures; (H) rule enforcement; (I) system safeguards; (J) reporting; (K) recordkeeping; (L) public information; (M) information sharing; (N) antitrust considerations; (O) governance fitness standards; (P) conflicts of interest; (Q) composition of governing boards; and (R) legal risk. DFA Section 725(d) required the CFTC to promulgate regulations mitigating conflicts of interest in connection with the conduct of business by an SD or MSP with a DCO that clears swaps in which the SD or MSP has a material debt or material equity investment.¹²⁹ DFA Section 725(e) adds CEA Section 5b(k),¹³⁰ which requires DCOs that clear swaps to provide the CFTC with all information that is deemed necessary and requires the CFTC to adopt data collection and maintenance requirements for swaps cleared by DCOs that are comparable to corresponding requirements for swaps data reported to swap data repositories (“SDRs”) and swaps traded on SEFs.

The CFTC promulgated final regulations for DCOs in October 2011.¹³¹ The CFTC stated that its regulations are consistent with current international standards for CCPs.¹³² The SEC

¹²⁹ See also DFA Sections 726 (requiring CFTC rulemaking) and 765 (requiring SEC rulemaking); Governance Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities; Additional Requirements Regarding the Mitigation of Conflicts of Interest, 76 Fed. Reg. 722 (January 6, 2011) (“Governance and Conflicts Proposal”), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2010-31898a.pdf>; and Ownership Limitations and Governance Requirements for Security-Based Swap Clearing Agencies, Security-Based Swap Execution Facilities, and National Securities Exchanges with Respect to Security-Based Swaps under Regulation MC, 75 Fed. Reg. 65882 (October 26, 2010) (“Ownership and Governance Proposal”), available at <http://www.gpo.gov/fdsys/pkg/FR-2010-10-26/pdf/2010-26315.pdf>.

¹³⁰ Subject to CEA Section 8 and upon request, the CFTC shall share information on cleared swaps that is collected from DCOs pursuant to CEA Section 5b(k)(2) with foreign financial supervisors (including foreign futures authorities), foreign central banks, foreign ministries, and any other person that the CFTC determines to be appropriate. CEA Section 5b(k)(5) requires that the CFTC’s sharing of such information be contingent upon receipt of a written agreement to comply with the confidentiality requirements described in CEA Section 8 and an agreement to indemnify the CFTC for any expenses arising from litigation related to the information provided under CEA Section 8. The restriction does not affect a DCO’s ability to share information.

¹³¹ Derivatives Clearing Organization General Provisions and Core Principles, 76 Fed. Reg. 69334 (November 8, 2011), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011->

proposed regulations for clearing agencies that it believes are consistent with current international standards for CCPs in March 2011.¹³³

d. Reporting Requirements

Title VII requires all Swaps to be reported to a registered data repository or, if no such repository will accept the Swap, to the appropriate Commission. Swaps also are subject to post-trade transparency requirements. In addition, Title VII sets forth comprehensive requirements with which data repositories must comply.

i. Reporting Mandate

Several provisions in DFA Title VII address the reporting requirement for Swaps. DFA Sections 727 and 763(i) added CEA Section 2(a)(13)(G) and Exchange Act 13(m)(1)(G), respectively, which require that both cleared and uncleared Swaps be reported to a registered repository. DFA Section 723(a) added Section 2(h)(5)(B) to the CEA and DFA Section 763(a) added Section 3C(e) to the Exchange Act, and they provide that reporting regulations that the Commissions adopt also cover the reporting of Swaps entered into before enactment of the DFA on July 21, 2010 (“pre-enactment Swaps”) and for the reporting of Swaps entered into on or after that date (“post-enactment Swaps”). DFA Sections 729 and 766 established in new CEA Section 4r(a)(2)(A) and new Exchange Act Section 13A(a)(2)(A), respectively, that uncleared pre-enactment Swaps whose terms have not expired as of the enactment date must be reported to a

27536a.pdf; *see also* Provisions Common to Registered Entities, 76 Fed. Reg. 44776 (July 27, 2011), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-18661a.pdf>.

¹³² These standards consist of those developed several years ago by IOSCO and CPSS: Recommendations for Securities Settlement Systems (November 2001) and Recommendations for Central Counterparties (November 2004), which are available at <http://www.bis.org/publ/cpss46.pdf> and <http://www.bis.org/publ/cpss64.pdf>, respectively. These recommendations eventually will be replaced by the CPSS-IOSCO Principles for Financial Market Infrastructures, which are expected to be finalized in early 2012. *See* CPSS-IOSCO Principles for Financial Market Infrastructures, Consultative Report (March 2011), available at <http://www.bis.org/publ/cpss94.pdf>.

¹³³ Clearing Agency Standards for Operation and Governance, 76 Fed. Reg. 14472 (March 16, 2011), available at <http://sec.gov/rules/proposed/2011/34-64017fr.pdf>; *see also* Ownership and Governance Proposal, available at <http://www.gpo.gov/fdsys/pkg/FR-2010-10-26/pdf/2010-26315.pdf>.

registered data repository or to the CFTC or SEC, as applicable, and in new CEA Section 4r(a)(2)(B) and new Exchange Act Section 13A(a)(2)(B) that the Commissions promulgate interim final regulations in this area. CEA Section 4r(b)-(d) and Exchange Act Section 13A(b)-(d) set forth separate reporting and recordkeeping requirements in connection with uncleared Swaps for which data has not been accepted by a repository. DFA Section 730 added Section 4t to the CEA, which requires large trader reporting for swaps or compliance with CFTC-specified limits where the Commission determines that a swap performs a significant price discovery function with respect to registered entities.¹³⁴ DFA Section 763(h) added Section 10B(d) to the Exchange Act, which authorizes the SEC to require large trader reporting for security-based swaps.

With respect to reporting to the public, DFA Section 727 added CEA Section 2(a)(13) and DFA Section 763(i) added Exchange Act Section 13(m) to require real-time public reporting, defined as the reporting of data relating to a Swap transaction, including price and volume, as soon as technologically practicable after the time at which the transaction has been executed. CEA Section 2(a)(13)(C) and Exchange Act Section 13(m)(1)(C) authorize Commission rulemaking, and CEA Section 2(a)(13)(E) and Exchange Act Section 13(m)(1)(E) require (with respect to cleared Swaps) protection of the identity of participants, specification of criteria and timing for large notional transactions, and consideration of whether public disclosure will materially reduce market liquidity.¹³⁵ CEA Section 2(a)(13)(D) and Exchange Act Section 13(m)(1)(D) provide that the Commissions may require registered entities to publicly disseminate the transaction and pricing data required to be reported. CEA Section 2(a)(13)(F)

¹³⁴ The term “registered entity” is defined in CEA Section 1a(40) and includes DCMs; registered DCOs, SEFs, and SDRs; and electronic trading facilities (*see* CEA Section 1a(16)) on which a significant price discovery contract, as determined by the CFTC, is executed or traded.

¹³⁵ In addition, CEA Section 2(a)(13)(C)(iii) requires that the business transactions and market positions of any person with respect to most uncleared swaps not be disclosed.

and Exchange Act Section 13(m)(1)(F) require counterparties (including their agents) to report transaction information to the appropriate registered entity in a timely manner as may be prescribed by the CFTC or SEC, respectively.

With respect to aggregate data, CEA Section 2(a)(14) and Exchange Act Section 13(m)(2) provide that the Commissions shall issue semiannual and annual written reports to make publicly available information relating to trading and clearing in major Swap categories and market participants and developments in new products. The Commissions must consult with the OCC, BIS, and other regulatory bodies as necessary, and may delegate their public reporting responsibilities.

The CFTC promulgated final regulations in January 2012 that establish swap data recordkeeping and reporting requirements applicable to registered SDRs, DCOs, DCMs, SEFs, SDs, MSPs, and non-SD/MSP counterparties.¹³⁶ The regulations require that all DCOs, DCMs, SEFs, and swap counterparties keep full, complete, and systematic records (together with all pertinent data and memoranda) of all activities relating to the business of such entities or persons with respect to swaps. The regulations also require that reporting include data from each of two important stages in the existence of a swap – the creation of the swap and the continuation of the swap over its existence until its final termination or expiration. The CFTC stated that it is committed to a cooperative international approach to recordkeeping and reporting, and noted that it had consulted extensively with various foreign regulatory authorities in the process of promulgating the regulations.

In addition, the CFTC issued interim final regulations in October 2010 requiring reporting of unexpired pre-enactment swaps¹³⁷ and in December 2010 to ensure preservation of

¹³⁶ Swap Data Recordkeeping and Reporting Requirements, 77 Fed. Reg. 2136 (January 13, 2012), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-33199a.pdf>.

¹³⁷ Interim Final Rule for Reporting Pre-Enactment Swap Transactions, 75 Fed. Reg. 63080 (October 14,

data related to post-enactment swaps.¹³⁸ In April 2011, the CFTC proposed regulations on recordkeeping and reporting requirements for unexpired pre-enactment swaps and for swaps entered into after DFA enactment but before the compliance date specified in the Commission’s final reporting regulations (“transition swaps”).¹³⁹ In July 2011, the CFTC issued final regulations on large trader reporting for physical commodity swaps.¹⁴⁰ With respect to real-time public reporting, the CFTC promulgated final regulations in January 2012.¹⁴¹

The SEC proposed regulations in December 2010 that would establish security-based swap reporting and real-time public reporting requirements,¹⁴² as well as recordkeeping for security-based swap data repositories (“SBSDRs”).¹⁴³ The proposal identifies the transaction information that would be required to be reported, establishes reporting obligations, and specifies the timeframes for reporting and disseminating information. In addition, the SEC issued an interim final temporary rule in October 2010 relating to unexpired security-based swaps entered into before DFA enactment.¹⁴⁴

2010), available at <http://www.cftc.gov/ucm/groups/public/@Irfederalregister/documents/file/2010-25325a.pdf>.

¹³⁸ Reporting Certain Post-Enactment Swap Transactions, 75 Fed. Reg. 78892 (December 17, 2010), available at <http://www.cftc.gov/ucm/groups/public/@Irfederalregister/documents/file/2010-31579a.pdf>.

¹³⁹ Swap Data Recordkeeping and Reporting Requirements: Pre-Enactment and Transition Swaps, 76 Fed. Reg. 22833 (April 25, 2011), available at <http://www.cftc.gov/ucm/groups/public/@Irfederalregister/documents/file/2011-9446a.pdf>.

¹⁴⁰ Large Trader Reporting for Physical Commodity Swaps, 76 Fed. Reg. 43851 (July 22, 2011), available at <http://www.cftc.gov/ucm/groups/public/@Irfederalregister/documents/file/2011-18054a.pdf>.

¹⁴¹ Real-Time Public Reporting of Swap Transaction Data, 77 Fed. Reg. 1182 (January 9, 2012), available at <http://www.cftc.gov/ucm/groups/public/@Irfederalregister/documents/file/2011-33173a.pdf>.

¹⁴² Regulation SBSR – Reporting and Dissemination of Security-Based Swap Information, 75 Fed. Reg. 75208 (December 2, 2010), available at <http://www.sec.gov/rules/proposed/2010/34-63346fr.pdf>.

¹⁴³ Security-Based Swap Data Repository Registration, Duties, and Core Principles, Exchange Act Release No. 63347 (November 19, 2010), 75 Fed. Reg. 77306 (December 10, 2010), corrected at 75 Fed. Reg. 79320 (December 20, 2010) and 76 Fed. Reg. 2287 (January 13, 2011) (“SBSDR Proposal”), available at <http://www.sec.gov/rules/proposed/2010/34-63347fr.pdf>.

¹⁴⁴ Reporting of Security-Based Swap Transaction Data, 75 Fed. Reg. 64643 (October 20, 2010), available at <http://www.sec.gov/rules/interim/2010/34-63094.pdf>.

ii. Registration Requirements for Repositories

DFA Section 728 added Section 21 to the CEA, which requires registration of entities performing the functions of an SDR.¹⁴⁵ DFA Section 763(i) added Section 13(n) to the Exchange Act, which requires registration of entities performing the functions of a SBSDR.¹⁴⁶ SDRs and SBSDRs are subject to inspection and examination by any representative of the CFTC or SEC, respectively.

CEA Section 21(h) and Exchange Act Section 13(n)(9) provide that the CFTC and SEC, respectively, shall adopt rules governing registered repositories. The CFTC promulgated final regulations in September 2011.¹⁴⁷ The CFTC noted its extensive coordination with foreign regulators and stated that its regulations reflect the intent to harmonize its approach to the extent possible with the EC proposal on regulation of TRs¹⁴⁸ and to largely adopt CPSS-IOSCO recommendations on TRs.¹⁴⁹ The SEC proposed rules in November 2010.¹⁵⁰ The proposal sets forth a process for registering SBSDRs, and discussed certain issues related to those that are domiciled outside the United States. The SEC stated that its proposed rules draw from the

¹⁴⁵ The term “swap data repository” is defined in CEA Section 1a(48) to mean “any person that collects and maintains information or records with respect to transactions or positions in, or the terms and conditions of, swaps entered into by third parties for the purpose of providing a centralized recordkeeping facility for swaps.” CEA Section 21(a)(1)(B) permits DCOs to register as SDRs, and CEA Section 21(g) requires SDR registration regardless of whether the repository also is licensed as a bank or registered with the SEC as an SBSDR.

¹⁴⁶ The term “security-based swap data repository” is defined in Exchange Act Section 3(a)(75) as “any person that collects and maintains information or records with respect to transactions or positions in, or the terms and conditions of, security-based swaps entered into by third parties for the purpose of providing a centralized recordkeeping facility for security-based swaps.” Exchange Act Section 13(m)(1)(H) permits clearing agencies to register as SBSDRs, and Exchange Act Section 13(n)(8) requires SBSDR registration regardless of whether the repository also is registered with the CFTC as an SDR.

¹⁴⁷ Swap Data Repositories: Registration Standards, Duties and Core Principles, 76 Fed. Reg. 54538 (September 1, 2011) (“SDR Final Regulations”), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-20817a.pdf>.

¹⁴⁸ See *infra* Section II.B.1.

¹⁴⁹ See CPSS-IOSCO Considerations for Trade Repositories in OTC Derivatives Markets, Consultative Report (May 2010), available at <http://www.bis.org/publ/cpss90.pdf>.

¹⁵⁰ SBSDR Proposal, available at <http://www.sec.gov/rules/proposed/2010/34-63347fr.pdf>.

CPSS-IOSCO recommendations for TRs and from ODRF recommendations on the functionality of TRs.¹⁵¹

iii. Regulatory Requirements for Repositories

To be registered and to maintain registration as an SDR, CEA Section 21(a)(3) requires SDRs to comply with DFA requirements and core principles and any requirements the CFTC may impose by rule or regulation. To be registered and to maintain registration as an SBSDR, Exchange Act Section 13(n)(3) requires SBSDRs to comply with DFA requirements and core principles and any requirements the SEC may impose by rule or regulation. Unless otherwise determined by the CFTC or SEC, as applicable, in a rule or regulation, repositories have reasonable discretion in establishing the manner in which they comply with the core principles.¹⁵²

CEA Section 21(b) and Exchange Act Section 13(n)(4) provide that the Commissions shall prescribe data element, data collection, and data maintenance standards for repositories, and that such data element standards must be consistent for registered entities and reporting counterparties.¹⁵³ CEA Section 21(c) and Exchange Act Section 13(n)(5) set forth several duties with which repositories must comply, including: (1) acceptance, confirmation, and maintenance of data; (2) provision of direct electronic access to the CFTC or SEC, as applicable, or any designee; (3) establishment at the direction of the CFTC or SEC, as applicable, of automated systems for monitoring, screening, and analyzing data;¹⁵⁴ (4) maintenance of the privacy of any and all transaction information; and (5) sharing of data on a confidential basis with certain

¹⁵¹ *Id.* at 75 Fed. Reg. 77317. See OTC Derivatives Regulators' Forum Overview, available at <http://www.otcdrf.org/>.

¹⁵² See CEA Section 21(a)(3)(B) and Exchange Act Section 13(n)(3)(B).

¹⁵³ The data element, data collection, and data maintenance standards also must be comparable to data standards for clearinghouses in connection with their clearing of Swaps.

¹⁵⁴ CEA Section 21(c)(5) also includes compliance and frequency of end-user clearing exception claims.

specified entities or those determined to be appropriate, upon request and after Commission notification.¹⁵⁵

CEA Section 21(d) and Exchange Act Section 13(n)(5)(H) require receipt by the repository of a written agreement on confidentiality and indemnification before data may be shared with certain specified entities and those determined to be appropriate.¹⁵⁶ In addition CEA Section 21(e) and Exchange Act Section 13(n)(6) require each repository to designate a chief compliance officer who must comply with certain specified duties and must prepare and file an annual compliance report, which must accompany each appropriate financial report of the repository. CEA Section 21(f) and Exchange Act Section 13(n)(7) require repositories to comply with core principles related to the following areas: (1) antitrust considerations; (2) governance arrangements; and (3) conflicts of interest. Moreover, the CFTC or SEC may develop additional duties applicable to repositories, including duties to minimize conflicts of interest, protect data, ensure compliance, and guarantee the safety and security of such entities.¹⁵⁷

CEA Section 21(h) and Exchange Act Section 13(n)(9) provide that the CFTC and SEC, respectively, shall adopt regulations governing registered repositories. As described above, the CFTC promulgated final regulations in September 2011.¹⁵⁸ Pursuant to authority granted in

¹⁵⁵ CEA Section 21(c)(8) also requires establishment and maintenance of emergency procedures, backup facilities, and a disaster recovery plan.

¹⁵⁶ In its release, the CFTC clarified that the indemnification and notification requirements do not apply when a repository is registered with the CFTC and also is registered in a foreign jurisdiction; and the foreign regulator, acting within the scope of its jurisdiction, seeks information directly from the repository, applicable statutory confidentiality provisions are met, and a memorandum of understanding is in place between the CFTC and regulator(s). The SEC addressed issues regarding indemnification and notification requirements in the SBSDR Proposal and requested comments, which it is currently reviewing.

¹⁵⁷ CEA Section 21(f)(4)(C) provides that the CFTC shall establish additional duties for registered SDRs in order to minimize conflicts of interest, protect data, ensure compliance, and guarantee the safety and security of such entities. Exchange Act Section 13(n)(7)(D)(iii) provides that the SEC shall establish comparable duties for persons to whom the SEC delegates public reporting responsibilities. With respect to international coordination, CEA Section 21(f)(4)(B) and Exchange Act Section 13(n)(7)(D)(ii) provide that the Commissions “may take into consideration any evolving standard of the United States or the international community”.

¹⁵⁸ SDR Final Regulations, available at

CEA Section 21(f)(4), the CFTC adopted three duties in addition to those specified in the statute, – maintenance of sufficient financial resources; provision of a disclosure document to market participants; and a requirement of open, non-discriminatory access to SDR services. The SEC proposed regulations governing SBSDR registration, duties, and core principles in December 2010.¹⁵⁹

e. Execution Requirements

Title VII requires the execution of those Swaps that are required to be cleared to occur on a DCM or a registered or exempt SEF (in the case of swaps) or an exchange or a registered or exempt security-based swap execution facility (“SBSEF”) (in the case of security-based swaps), unless no such entities make these Swaps available to trade.¹⁶⁰ Title VII also sets forth comprehensive registration, operational, and self-regulatory requirements with which execution facilities must comply.

i. Execution Mandate

DFA Sections 723(a) and 763(a), which added CEA Section 2(h)(8) and Exchange Act Section 3C(h), respectively, provide that Swaps subject to the mandatory clearing requirement must be executed by counterparties on either an organized market or on a registered or exempt execution facility.¹⁶¹ However, this mandatory execution requirement does not apply if no

<http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-20817a.pdf>.

¹⁵⁹ SBSDR Proposal, available at <http://www.sec.gov/rules/proposed/2010/34-63347fr.pdf>.

¹⁶⁰ This Report will refer to DCMs and exchanges as “organized markets” and to SEFs and SBSEFs as “execution facilities”, unless otherwise indicated.

¹⁶¹ CEA Section 2(h)(8) mandates that, with respect to transactions involving swaps subject to the clearing requirement of CEA Section 2(h)(1), counterparties shall execute the transaction on a DCM or on a registered or exempt SEF. The term “swap execution facility” is defined in CEA Section 1a(50) as “a trading system or platform in which multiple participants have the ability to execute or trade swaps by accepting bids and offers made by multiple participants in the facility or system, through any means of interstate commerce, including any trading facility, that – (A) facilitates the execution of swaps between persons; and (B) is not a designated contract market.”

Exchange Act Section 3C(h) mandates that, with respect to transactions involving security-based swaps subject to the clearing requirement of Exchange Act Section 3C(a)(1), counterparties shall execute the

organized market or execution facility makes the Swap available to trade, or if the Swap is subject to the end-user exception from clearing. If a counterparty is not an ECP, however, DFA Sections 723(a)(2) and 763(e), adding CEA Section 2(e) and Exchange Act Section 6(l), respectively, require that a transaction in a Swap with or for that non-ECP counterparty must be effected on an organized market.

ii. Registration Requirements for Markets

No entity may operate a facility for the trading or processing¹⁶² of Swaps unless the entity is registered as (or exempt from registration as) an execution facility or is an organized market.¹⁶³ DFA Section 733 added CEA Section 5h, and DFA Section 763(c) added Exchange Act Section 3D, which require registration of execution facilities.¹⁶⁴ With respect to swaps, CEA Section 5h(e) states that the goal of CEA Section 5h is “to promote the trading of swaps on execution facilities and to promote pre-trade price transparency in the swaps market.”

transaction on an exchange or on a registered or exempt security-based swap execution facility (“SBSEF”). The term “security-based swap execution facility” is defined in Exchange Act Section 3(a)(77) as “a trading system or platform in which multiple participants have the ability to execute or trade security-based swaps by accepting bids and offers made by multiple participants in the facility or system, through any means of interstate commerce, including any trading facility, that – (A) facilitates the execution of security-based swaps between persons; and (B) is not a national securities exchange.”

¹⁶² See CEA Section 5h(a). Although a registered SEF may make available for trading any swap and may facilitate trade processing of any swap, a SEF may not list for trading or confirm the execution of any swap in an agricultural commodity (as defined by the CFTC), except pursuant to a CFTC regulation allowing the swap under such terms and conditions as the Commission shall prescribe. See CEA Section 5h(b); see also DFA Section 723(c) (prohibiting agricultural swaps, unless permitted by CFTC rule, regulation, or order). In July and August 2011, the CFTC promulgated final regulations in this area. See Agricultural Commodity Definition, 76 Fed. Reg. 41048 (July 13, 2011), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-17626a.pdf>; and Agricultural Swaps, 76 Fed. Reg. 49291 (August 10, 2011), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-20337a.pdf>.

See Exchange Act Section 3D(b). A registered SBSEF may make available for trading any security-based swap and may facilitate trade processing of any security-based swap.

¹⁶³ Pursuant to CEA Section 5h(c) and Exchange Act Section 3D(c), an organized market that also operates an execution facility and uses the same electronic trade execution system for listing and executing trades of Swaps must identify whether the electronic trading of such Swaps is taking place on or through the organized market or the execution facility.

¹⁶⁴ CEA Section 5h(a)(2) requires that any entity registered as a SEF shall register with the CFTC regardless of whether the entity also is registered with the SEC as a SBSEF, and Exchange Act Section 3D(a)(2) requires that any entity registered as a SBSEF shall register with the SEC regardless of whether the entity also is registered with the CFTC as a SEF.

The CFTC and SEC each have discretion to determine whether to grant an exemption from registration for a particular execution facility, but the statutory language added by the DFA for each Commission differs. CEA Section 5h(g) provides:

The [CFTC] may exempt, conditionally or unconditionally, a [SEF] from registration under this section if the [CFTC] finds that the facility is subject to comparable, comprehensive supervision and regulation on a consolidated basis by the [SEC], a prudential regulator, or the appropriate governmental authorities in the home country of the facility.

Exchange Act Section 3D(e) provides:

The [SEC] may exempt, conditionally or unconditionally, a [SBSEF] from registration under this section if the [SEC] finds that the facility is subject to comparable, comprehensive supervision and regulation on a consolidated basis by the [CFTC].¹⁶⁵

CEA Section 5h(h) and Exchange Act Section 3D(f) require the CFTC and SEC, respectively, to prescribe regulations governing the regulation of execution facilities. The CFTC proposed regulations, guidance, and acceptable practices in January 2011 regarding the registration and operational requirements for SEFs, including regulations and procedures for the listing and execution of swaps on or through SEFs.¹⁶⁶ In the proposal, the CFTC noted the similarity of certain requirements of the UK FSA and also requested comment related to the business structure of SEFs located in foreign jurisdictions. The SEC proposed regulations in February 2011 on the registration and regulation of SBSEFs.¹⁶⁷ In the release, the SEC requested comment related to access to the books and records of foreign participants and accounting requirements for foreign private issuers, as well as comment related to international information sharing agreements and the registration process for non-U.S. persons.

¹⁶⁵ The SEC also has general and broad exemptive authority under Exchange Act Section 36.

¹⁶⁶ Core Principles and Other Requirements for Swap Execution Facilities, 76 Fed. Reg. 1214 (January 7, 2011), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2010-32358a.pdf>.

¹⁶⁷ Registration and Regulation of Security-Based Swap Execution Facilities, 76 Fed. Reg. 10948 (February 28, 2011), available at <http://www.sec.gov/rules/proposed/2011/34-63825fr.pdf>.

iii. Regulatory Responsibilities for Markets

To be registered and to maintain registration as a SEF, CEA Section 5h(f)(1) requires SEFs to comply with specified core principles and any requirements the CFTC may impose by rule or regulation.¹⁶⁸ To be registered and to maintain registration as an SBSEF, Exchange Act Section 3D(d)(1) requires SBSEFs to comply with specified core principles and any requirements the SEC may impose by rule or regulation. Subject to CFTC or SEC, as applicable, rule or regulation, execution facilities have reasonable discretion in establishing their manner of compliance.

CEA Section 5h(f) and Exchange Act Section 3D(d) require execution facilities to comply with core principles related to the following areas: (1) compliance with core principles; (2) compliance with rules; (3) Swaps not readily susceptible to manipulation; (4) monitoring of trading and trade processing; (5) ability to obtain information; (6) position limits or accountability (not applicable to SBSEFs); (7) financial integrity of transactions; (8) emergency authority; (9) timely publication of trading information; (10) recordkeeping and reporting; (11) antitrust considerations; (12) conflicts of interest; (13) financial resources; (14) system safeguards; and (15) designation of chief compliance officer.

CEA Section 5h(h) and Exchange Act Section 3D(f) require the CFTC and SEC, respectively, to prescribe regulations governing the regulation of execution facilities.¹⁶⁹ As

¹⁶⁸ The DFA applied certain operational requirements and regulatory responsibilities pertaining to Swaps trading on organized markets. In addition, DFA Section 735(b) amended CEA Section 5(d) to revise existing core principles in, and add new core principles to, the existing CEA regime for DCMs.

¹⁶⁹ In addition, DFA Section 725(d) requires the CFTC to promulgate regulations mitigating conflicts of interest in connection with the conduct of business by an SD or MSP with a DCM or SEF that trades swaps in which the SD or MSP has a material debt or material equity investment. *See also* DFA Sections 726 (requiring CFTC rulemaking) and 765 (requiring SEC rulemaking); Governance and Conflicts Proposal, available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2010-31898a.pdf>; and Ownership and Governance Proposal, available at <http://www.gpo.gov/fdsys/pkg/FR-2010-10-26/pdf/2010-26315.pdf>.

described above, the CFTC proposed regulations in January 2011, and the SEC proposed regulations in February 2011.

2. Canada

Canadian provincial and territorial regulators are developing proposals for the regulation of OTC derivatives. In October 2010, the Canadian OTC Derivatives Working Group (“CDWG”)¹⁷⁰ published a discussion paper on reforming OTC derivatives markets in Canada, which included preliminary recommendations on capital requirements, standardization of contracts, clearing, reporting, and trading.¹⁷¹ In November 2010, the Canadian Securities Administrators (“CSA”)¹⁷² released a consultation document on regulation of the Canadian OTC derivatives market that addressed potential prudential requirements, clearing, reporting, trading, and enforcement.¹⁷³ The CSA Derivatives Committee (“CSA Committee”) noted that, for each of these areas, clear jurisdictional authority and specific rulemaking powers must be set out in provincial securities and derivatives legislation.¹⁷⁴ In June 2011, the CSA published a

¹⁷⁰ The inter-agency group, formed in December 2009, is chaired by the Bank of Canada and includes the Office of the Superintendent of Financial Institutions, federal Department of Finance, Ontario Securities Commission, Autorité des marchés financiers, and Alberta Securities Commission. For more information, see <http://www.bankofcanada.ca/2010/10/notices/reform-of-over-the-counter/>.

¹⁷¹ Reform of Over-the-Counter (OTC) Derivatives Markets in Canada: Discussion Paper from the Canadian OTC Derivatives Working Group (October 26, 2010), available at <http://www.bankofcanada.ca/wp-content/uploads/2010/10/reform.pdf>.

¹⁷² The CSA, an organization of Canada’s provincial and territorial securities regulators, primarily is responsible for developing a harmonized approach to securities regulation across Canada. For more information, see the CSA website, available at <http://www.securities-administrators.ca/aboutcsa.aspx?id=45&linkidentifier=id&itemid=45>.

¹⁷³ Consultation Paper 91-401 on Over-the-Counter Derivatives Regulation in Canada (CSA Derivatives Committee, November 2, 2010) (“Canada OTC Consultation”), available at http://www.osc.gov.on.ca/documents/en/Securities-Category9/csa_20101102_91-401_cp-on-derivatives.pdf; see Canadian Securities Regulators Seek Comments on Proposed Over-the-Counter Derivatives Regulation (Press Release, November 2, 2010), available at <http://www.securities-administrators.ca/aboutcsa.aspx?id=929>. The CSA stated, “The consultation paper summarizes recommendations that are intended to strengthen the regulation of Canada’s financial markets and manage specific risks related to OTC derivatives. The CSA aims to implement Canada’s G20 commitments in a manner appropriate for the Canadian markets and harmonize regulatory oversight to the extent possible with international jurisdictions.”

¹⁷⁴ *Id.* at pp. 1, 56. The CSA Committee described its work and the work of the CDWG as “aligned both from a subject matter and timetable perspective”. Canada OTC Consultation at p. 9.

consultation paper proposing a regulatory framework for reporting to a TR, which it described as the first of a series of eight papers that will build on the regulatory proposals contained in its initial November 2010 document.¹⁷⁵

a. Types of OTC Derivatives

Oversight of OTC derivatives varies among Canadian jurisdictions. In Ontario, the term “derivative” includes contracts such as swaps.¹⁷⁶ In Alberta, an OTC derivative is included under the statutory definition of a futures contract and declared a security under securities legislation, but Alberta anticipates proposing legislative amendments in 2012 that would separately define and regulate derivatives.¹⁷⁷ In a number of jurisdictions, including Manitoba, OTC derivatives are regulated under the province’s securities legislation.¹⁷⁸ In Quebec, derivatives contracts are regulated pursuant to separate legislation on derivatives.¹⁷⁹

b. Types of Market Participants

i. Registration Requirements

Currently the Investment Industry Regulatory Association of Canada (“IIROC”) oversees investment dealers that trade derivatives.¹⁸⁰ The scope of registration and regulatory requirements and the issue of the applicability of registration exemptions will be the subject of future consultations.¹⁸¹ Alberta and Ontario have indicated that derivatives market participants

¹⁷⁵ CSA Consultation Paper 91-402, Derivatives: Trade Repositories (CSA Derivatives Committee, June 23, 2011) (“Canada TR Consultation”), available at <http://www.lautorite.qc.ca/files/pdf/consultations/derives/2011juin23-91-402-cons-paper-en.pdf>; see Canadian Securities Administrators Seek Comments on Regulation of Over-the-Counter Derivatives Trade Reporting and Repositories (Press Release, June 23, 2011), available at <http://www.securities-administrators.ca/aboutcsa.aspx?id=971>.

¹⁷⁶ OSC Submission at p. 1.

¹⁷⁷ ASC Submission at pp. 1-2.

¹⁷⁸ Canada OTC Consultation at p. 8.

¹⁷⁹ *Id.*

¹⁸⁰ ASC Submission at p. 3; see also OSC Submission at p. 1.

¹⁸¹ Canada OTC Consultation at p. 12.

will be regulated through a registration process that has yet to be determined and that the new framework likely also will identify certain of such participants that are exempt from registration but recognized as such by some other means.¹⁸²

ii. Prudential and other Risk-Related Requirements

Market participants are subject to various capital requirements. Investment dealers, for example, are required to abide by capital requirements established by the IIROC.¹⁸³ Collateral obligations for OTC derivatives transactions in many cases are governed by ISDA documents.¹⁸⁴ The CSA Committee recommended that the regulation regime include comprehensive risk-based capital requirements that may include specific margin and collateral requirements.¹⁸⁵ It further recommended that capital or collateral requirements should apply to all entities acting as financial intermediaries to facilitate trading of OTC derivatives on behalf of third parties, and to end-users of OTC derivatives except where use of such transactions is restricted to hedging risks related to the end-user's business activities and does not increase systemic risk to the market.¹⁸⁶ In addition, the CSA Committee suggested that CSA staff work with staff of other regulatory agencies to assess existing regulation and suggest amendments as appropriate.¹⁸⁷

¹⁸² OSC Submission at p. 2; ASC Submission at p. 3.

¹⁸³ Canada OTC Consultation at p. 42.

¹⁸⁴ *Id.* at p. 43.

¹⁸⁵ *Id.* at pp. 44-45 (noting that OTC derivatives market participants that are subject to other satisfactory regulatory regimes should be exempt from compliance with the capital regime to be proposed for OTC derivatives market participants that are not otherwise subject to a capital regime).

¹⁸⁶ *Id.* at p. 44.

¹⁸⁷ *Id.* at pp. 44-49; *see also* p. 54 (further analysis required on whether to impose collateral segregation requirements).

c. Clearing Requirements

i. Clearing Mandate

Canadian authorities are considering a mandatory clearing requirement and expect the recently published Canada OTC Consultation to inform their regulatory efforts.¹⁸⁸ The CSA Committee recommended mandatory clearing of OTC derivatives trades determined to be appropriate for clearing and also recommended that not all participants in the Canadian OTC derivatives markets be subject to mandatory clearing.¹⁸⁹ Appropriate legislative changes would need to be made that compel the clearing of OTC derivatives, and regulators would need rulemaking authority to implement the regime.¹⁹⁰

ii. Registration Requirements for CCPs

CCP requirements vary across Canadian jurisdictions. Ontario said its regulatory framework includes requirements for a CCP that provides clearing and settlement services to Ontario entities, which either must be recognized by the OSC as a clearing agency or be exempt from such recognition.¹⁹¹ The ASC has authority to recognize a clearing agency upon filing of an application by the entity, but is proposing statutory amendments that explicitly will require that such CCPs apply for recognition by the ASC.¹⁹²

The CSA Committee recognized that regulators would need the authority to mandate clearing despite the potential non-existence of local CCPs, as well as the ability to recognize or designate a foreign CCP.¹⁹³ It raised three possible options for consideration: (1) creation and

¹⁸⁸ FSB October 2011 Report, Table 2 (provincial legislation expected by the end of 2012) and Table 6 (considering which asset classes to include, but may exempt FX swaps and forwards).

¹⁸⁹ Canada OTC Consultation at p. 27.

¹⁹⁰ *Id.* at p. 26.

¹⁹¹ OSC Submission at p. 3.

¹⁹² ASC Submission at p. 4.

¹⁹³ Canada OTC Consultation at p. 26.

use of a Canadian multi-asset CCP; (2) if there is no Canadian CCP, accessing non-Canadian single-asset and/or multi-asset CCPs, with additional collateral requirements for non-cleared trades that are not available for CCP clearing; or (3) creation and use of Canadian single-asset or multi-asset CCPs used in combination with linked non-Canadian CCPs.¹⁹⁴ Before any recommendation can be made, the CSA Committee believes further input and study is needed on a Canadian CCP solution versus accessing non-Canadian CCPs.¹⁹⁵

iii. Regulatory Requirements for CCPs

Regulatory responsibilities of CCPs are set forth by each regulator. In its comment letter, Ontario said a clearing agency must meet certain criteria based on existing CPSS-IOSCO principles, which include criteria relating to governance, fees, access, rules and rulemaking, due process, risk management, systems and technology, financial viability and reporting, operational reliability, protection of assets, outsourcing, and information sharing and regulatory cooperation. Regulations governing CCPs are being developed, but details of the requirements are yet to be determined.¹⁹⁶ In Alberta, the criteria for obtaining and maintaining recognition from the ASC has yet to be determined, but the ASC intends that the criteria adhere to the CPSS-IOSCO standards.¹⁹⁷

d. Reporting Requirements

i. Reporting Mandate

Currently no Canadian jurisdiction mandates reporting of OTC derivatives transactions or positions. Mandatory reporting is contingent on legislative changes and rules being put into

¹⁹⁴ *Id.* at p. 27.

¹⁹⁵ *Id.* at p. 28.

¹⁹⁶ OSC Submission at p. 3.

¹⁹⁷ ASC Submission at pp. 4-5.

place in various jurisdictions.¹⁹⁸ The CSA June 2011 consultation paper recommended that Canadian provincial market regulators be enabled by statutory amendments to mandate the reporting of all OTC derivatives transactions to an approved TR and that all OTC derivatives transactions entered into by a Canadian counterparty be reported to an approved TR in real time once feasible and within one business day until real-time reporting is implemented (with delayed reporting for block trades).¹⁹⁹ TRs should provide data to Canadian and acceptable foreign regulators and central banks in accordance with their regulatory duties and subject to confidentiality protection and cooperation arrangements, and should make certain data available to the public.²⁰⁰

Ontario intends to establish a regulatory framework for TRs for all derivatives.²⁰¹ Alberta said proposed statutory amendments will add a definition of the term “trade repository” and provide for the recognition of TRs, but criteria for obtaining and maintaining recognition as a TR by the ASC has yet to be determined.²⁰² Both the OSC and ASC anticipate that repositories will be required to meet standards established by international standard-setting bodies, such as CPSS and IOSCO.²⁰³

ii. Registration Requirements for Repositories

The CSA Committee recommended that any TR intending to carry on business in one or more Canadian province should be approved by the applicable provincial market regulator through a recognition or designation process, and all TRs operating in Canada should be required

¹⁹⁸ FSB October 2011 Report, Table 5 (noting that Ontario has amended its securities legislation to support reporting to TRs and regulatory access to data).

¹⁹⁹ Canada TR Consultation at pp. 3-5, 11-13, 21-23.

²⁰⁰ *Id.* at pp. 4-5, 19-21, 23-25.

²⁰¹ OSC Submission at p. 4.

²⁰² ASC Submission at p. 5.

²⁰³ OSC Submission at p. 4 and ASC Submission at p. 5.

to meet international CPSS-IOSCO standards.²⁰⁴ Reporting to a non-Canadian TR that has been approved and meets all Canadian requirements should be acceptable until a Canadian TR is operational, or if the mandating of such a TR is rejected by market regulators.²⁰⁵

e. Execution Requirements

i. Execution Mandate

Canada is reviewing whether to require the execution of OTC derivatives on an exchange or electronic trading platform, and expects to publish a consultation document on this issue.²⁰⁶

The CSA Committee discussed the costs and benefits of trading on exchanges or electronic trading platforms, supported the benefits of pre-trade transparency resulting from trading of OTC derivatives, and recommended that any legislative amendments include the regulatory authority to impose a trading requirement.²⁰⁷ However, the CSA Committee said further study in

collaboration with market participants would be necessary to determine the eventual scope of the regulatory mandate.²⁰⁸ The CSA Committee said a trading mandate could apply only to those products that have sufficient standardization and liquidity, and that pose a systemic risk.²⁰⁹

Ontario and Alberta said their regulatory frameworks include requirements for organized markets for derivatives, but that details of regulatory requirements have yet to be determined.²¹⁰

²⁰⁴ Canada TR Consultation at pp. 2-4, 7-11, 13-14.

²⁰⁵ *Id.* at pp. 4, 14-15.

²⁰⁶ FSB October 2011 Report, Table 3.

²⁰⁷ Canada OTC Consultation at pp. 35-39.

²⁰⁸ *Id.* at p. 39.

²⁰⁹ *Id.*

²¹⁰ OSC Submission at p. 2; ASC Submission at pp. 3-4.

3. Brazil

a. Types of OTC Derivatives

The Brazilian OTC derivatives markets are overseen by the Comissão de Valores Mobiliários (“CVM”).²¹¹ Brazilian law does not limit the types of OTC derivatives contracts that can be entered into by counterparties, but contracts that are traded on organized markets must be approved by the CVM.²¹²

b. Types of Market Participants

i. Registration Requirements

Commercial banks, investment firms, and brokers can enter into OTC derivatives contracts in Brazil, provided that the transactions are reported to a TR.²¹³ Contingent upon authorization by the CVM, which has the legislative authority to stipulate the legal form the market participant must take, its board composition, financial requirements, the technical qualifications of members and officers, and what fees the participant may charge, other financial entities can be authorized to enter into the market.²¹⁴

ii. Prudential and other Risk-Related Requirements

Capital requirements for non-centrally cleared derivatives contracts are higher than for centrally-cleared derivatives contracts.²¹⁵

²¹¹ Law No. 6.385 (December 1976), available at http://www.cvm.gov.br/ingl/regu/regu_6385.ASP at Article 17.

²¹² CVM Instruction 467/2008 (2008) (English summary on file with the CFTC). In Brazil, the term “organized markets of securities” is defined to include “organized over-the-counter markets”. OTC markets may be “organized” or “non-organized”. An organized market is managed by a managing entity authorized by the CVM and includes both a trading facility as well as a TR that just registers a contract. A non-organized market is not managed by a managing entity authorized by the CVM and encompasses business not transacted or registered on an organized market. *See also* discussion at p. 60.

²¹³ Res. No. 3505/2007 (2007) (English summary on file with the CFTC).

²¹⁴ Law No. 6.385 (December 1976) at Article 21(5). In addition, the Brazilian Central Bank establishes requirements for financial institutions.

²¹⁵ Brazil Survey Response to FSB Implementation Monitoring Network (September 2011), available at http://www.financialstabilityboard.org/publications/r_111104c.pdf.

iii. Business Conduct Requirements

In April 2012, a CVM rule will become effective that allows managing entities of organized markets (“MEOMs”) to strengthen minimum standards for intermediaries’ operation on organized markets.²¹⁶

c. Clearing Requirements

OTC derivatives are not required to be centrally cleared in Brazil,²¹⁷ but voluntarily may be centrally cleared if desired by the counterparties and accepted for clearing by the CCP.

d. Reporting Requirements

i. Reporting Mandate

Brazilian law requires all OTC derivatives to be reported to a TR.²¹⁸

ii. Registration Requirements for Repositories

A TR must apply for authorization from the CVM as an MEOM.²¹⁹

iii. Regulatory Requirements for Repositories

The MEOM is responsible for establishing the operational and governance rules for TRs through the adoption of bylaws.²²⁰ The entity must have a board of directors (with an audit committee),²²¹ a chief executive officer (“CEO”),²²² a self-regulation council, and a chief officer

²¹⁶ CVM Instruction 505/2011 (English summary on file with the CFTC), available at <http://www.tributosdof.com.br/index.php/content/view/22022.html>.

²¹⁷ FSB October 2011 Report, Table 2 and Table 6.

²¹⁸ FSB October 2011 Report, p. 11, Table 4 and Table 5.

²¹⁹ CVM Instruction No. 461 (October 2007), Article 109, available at <http://www.cvm.gov.br/ingl/indexing.asp>.

²²⁰ *Id.* at Article 20 (also stipulating substantive areas that the bylaws must govern).

²²¹ The audit committee has the authority to propose the appointment of independent auditors, analyze financial statements of the managing entity of organized markets, review its annual report, and assess the internal controls of the trade repository. *Id.* at Article 27.

²²² The CEO’s responsibilities include implementing risk mitigation systems, determining fees, and satisfying internal reporting requirements. *Id.* at Section IX.

for self-regulatory affairs.²²³ The MEOM also must prepare annual audited financial statements detailing the operation of internal controls and accounting procedures and the quality and safety of operating procedures.²²⁴ In addition, it must maintain transaction data for at least five years.²²⁵

e. Execution Requirements

i. Execution Mandate

Brazilian law already provides a framework for the authorization of platforms for transacting OTC derivatives, which are called “organized over-the-counter markets”.²²⁶ Brazil does not anticipate having new laws or regulations in place by end-2012 to require standardized OTC derivatives to be traded on exchanges or electronic trading platforms.²²⁷

ii. Registration Requirements for Markets

An organized OTC market must apply for authorization from the CVM as a MEOM.²²⁸ The markets must be structured, maintained, and inspected by a MEOM.²²⁹ The MEOM must be organized as an association or stock corporation and meet the requirements set forth in CVM instructions.²³⁰

iii. Regulatory Requirements for Markets

The MEOM is responsible for establishing rules that specify the procedures for admission to trade on the market, and suspension and exclusion from trading, and that define the

²²³ *Id.* at Article 19.

²²⁴ *Id.* at Section X.

²²⁵ *Id.* at Article 63.

²²⁶ *See supra* note 213 and CVM Instruction No. 461 (October 2007).

²²⁷ FSB October 2011 Report, p. 9 and Table 3.

²²⁸ *Id.* at Articles 7 and 100.

²²⁹ *Id.* at Article 9.

²³⁰ *Id.*

transactions permitted to be transacted on the market.²³¹ The MEOM must maintain records of transactions conducted on the organized market for five years.²³²

An organized OTC market can operate in three ways: (1) as a multilateral trading system that enables bids and offers from multiple parties to be exposed to the acceptance and competition by all parties authorized to participate in that market;²³³ (2) by “carrying out transactions that place firm bids and offers” on the market;²³⁴ and (3) through the registration of transactions conducted off the market.²³⁵

Organized OTC markets must have systems in place that allow for permanent, regular, adequate and efficient pricing of transactions as well as the prompt trading and registration of completed transactions.²³⁶ Further, the rules of the market must prohibit fraud and manipulation and ensure equal treatment to those with access to the platform.²³⁷

B. European Union

Significant efforts to regulate OTC derivatives are under way in the European Union. This section does not include a separate discussion for each EU member state because, although each state currently may have requirements related to OTC derivatives, efforts underway at the EU level would soon preempt most such requirements.²³⁸

²³¹ *Id.* at Article 15.

²³² *Id.* at Article 16.

²³³ *Id.* at Articles 65 and 92.

²³⁴ *Id.* at Article 92.

²³⁵ *Id.*

²³⁶ *Id.* at Article 94.

²³⁷ *Id.* at Article 97.

²³⁸ In Europe, in addition to EU member states, Switzerland has large financial institutions that are active participants in the OTC derivatives market. Switzerland has not indicated that it intends to propose any legislative or regulatory measures to regulate OTC derivatives. Switzerland, however, is working on measures that will impact OTC derivatives transactions by reducing counterparty risks for market participants that enter into OTC derivatives transactions with Swiss financial institutions, including implementation of Basel III standards, which are intended to provide incentives for central clearing of OTC derivatives.

The European Union has started the process of creating an EU-wide regulatory framework for OTC derivatives.²³⁹ The EC published proposed legislation – the European Market Infrastructure Regulation (“EMIR”) – in September 2010.²⁴⁰ EMIR is being developed as a “regulation”, as opposed to an EU directive, which means that EMIR will become effective throughout the European Union upon adoption, and will not require separate implementation by EU member states. Implementation of certain EMIR provisions will occur through technical standards proposed by the European Securities and Markets Authority (“ESMA”), along with the European Banking Authority (“EBA”), and then adopted by the EC.

EMIR’s objectives consist of increasing transparency in the OTC derivatives market and making that market safer by reducing counterparty credit and operational risks. To this end,

EMIR requires:

- Reporting of derivatives transactions to TRs and creates a new regulatory framework for TRs;
- Clearing of eligible OTC derivatives through CCPs and enhances the existing regulatory framework for CCPs; and
- Measures to reduce counterparty credit risk and operational risk for bilaterally transacted OTC derivatives.

Since the proposal’s release in 2010, the Council of the European Union (“EU Council”) and the European Parliament (“EP”) have released several revisions to EMIR. As part of the legislative procedure, the EU Council, EP, and EC are negotiating to resolve differences and to finalize EMIR, which is expected in 2012. After EMIR is approved, ESMA will have primary responsibility for implementation. Under the current draft of EMIR, draft technical standards for

²³⁹ Detailed information on EU activities related to derivatives is available at http://ec.europa.eu/internal_market/financial-markets/derivatives/index_en.htm.

²⁴⁰ Proposal for a Regulation of the European Parliament and of the Council on OTC Derivatives, Central Counterparties and Trade Repositories (September 15, 2010), available at http://ec.europa.eu/internal_market/financial-markets/docs/derivatives/20100915_proposal_en.pdf.

implementation of EMIR must be submitted by ESMA to the EC by June 30, 2012, for intended adoption by the end of 2012.

In December 2010, the EC released a public consultation on revising the Markets in Financial Instruments Directive (“MiFID”).²⁴¹ The EC’s consultation sought comment on several possible revisions to the existing Directive, including expanding its scope to cover OTC derivatives and requiring that certain OTC derivatives be traded on exchanges or electronic trading platforms.²⁴² In October 2011, the EC published two draft proposals – one for revising MiFID (“Revised MiFID”)²⁴³ and the other for creating a new regulation entitled the Markets in Financial Instruments Regulation (“MiFIR”,²⁴⁴ together with EMIR, “EU Regulations”). The Revised MiFID and MiFIR cover financial instruments broadly, and set forth requirements for derivatives generally and for OTC derivatives specifically. The Revised MiFID contains provisions on providers of investment services, investor protection, trading venues, providers of market data and other reporting services, and powers to be granted by EU member states to national competent authorities. Provisions related to OTC derivatives transactions primarily are included within MiFIR, and address:

²⁴¹ MiFID is a key component of the EC’s Financial Services Action Plan, which was launched in May 1999. It replaced and expanded the 1993 Investment Services Directive by introducing competition among different order-execution systems (regulated markets, Multilateral Trading Facilities (“MTFs”), and systematic internalizers) and setting out the legal framework for their operations. While introducing a more open framework, MiFID seeks to improve investor protection, ensure efficient and transparent markets, and enhance the means available to the competent authorities for supervising the activities of the different types of intermediaries.

²⁴² Public Consultation: Review of the Markets in Financial Instruments Directive (MiFID) (December 8, 2010), available at http://ec.europa.eu/internal_market/consultations/docs/2010/mifid/consultation_paper_en.pdf.

²⁴³ Proposal for a Directive of the European Parliament and of the Council on Markets in Financial Instruments Repealing Directive 2004/39/EC of the European Parliament and of the Council (October 20, 2011), available at http://ec.europa.eu/internal_market/securities/docs/isd/mifid/COM_2011_656_en.pdf.

²⁴⁴ Proposal for a Regulation of the European Parliament and of the Council on Markets in Financial Instruments and Amending Regulation [EMIR] on OTC Derivatives, Central Counterparties and Trade Repositories (October 20, 2011), available at http://ec.europa.eu/internal_market/securities/docs/isd/mifid/COM_2011_652_en.pdf.

- Disclosure of data on trading activity to the public and transaction data to regulators and supervisors;
- Mandatory execution of trades in OTC derivatives on trading venues;
- Removing barriers between trading venues and providers of clearing services to ensure more competition; and
- Specific supervisory actions regarding financial instruments and positions in OTC derivatives.

When finalized, the Revised MiFID and MiFIR will set the framework for trading standardized OTC derivatives on exchanges and trading facilities.

a. Types of OTC Derivatives

The proposed EU Regulations and Revised MiFID do not distinguish among OTC derivatives in a manner comparable to the DFA distinction between swaps and security-based swaps. The primary requirements of the EU Regulations, including the clearing obligation, will be applicable to all classes of derivatives, OTC or traded on a regulated market, including interest rate, credit, equity, commodity, and FX swaps. EMIR does not exclude any asset classes from the clearing obligation. ESMA will, based on a number of criteria, identify which classes of OTC derivatives are eligible for and should be subject to a mandatory clearing obligation. ESMA, therefore, has the authority to decide that FX swaps are ineligible and therefore should not be subject to central clearing requirements. In addition, all classes and types of derivatives, both OTC and those traded on exchanges or platforms, are required under EMIR to be reported to TRs, which in turn, must make the data available to certain public authorities, and, on an aggregate basis, to the public.

b. Types of Market Participants

i. Registration Requirements

The scope of market participants covered under the EU Regulations would include all types of financial institutions (such as banks, insurance companies, asset management companies, pension funds, and hedge funds) and certain non-financial institutions whose

aggregate non-hedging OTC derivatives positions exceed a certain threshold. The level of this threshold will be established in the technical standards, prepared by ESMA and approved by the EC, that implement the EU Regulations. Unlike the categories of Swaps Entities established by the DFA, the proposed EU Regulations and Revised MiFID do not create new categories of regulated entities (*e.g.*, swap dealer) that would be required to register in order to engage in certain OTC derivatives activities. EU entities engaging in OTC derivatives activities, however, may be registered under existing categories of regulated entities in the EU member states, or may fall under the category of non-financial counterparties subject to clearing and reporting obligations, if they meet certain conditions.

ii. Prudential and other Risk-Related Requirements

When finalized, EMIR will require risk management standards, including collateralization (margining), to be implemented by counterparties to bilateral OTC derivatives. Such market participants will be required to benchmark their risk management methods against defined best practices. Collateralization requirements, including the timely, accurate, and appropriate exchange of collateral, will apply to non-centrally cleared OTC derivatives transactions between financial counterparties, and non-financial counterparties above the clearing threshold.

For bilateral OTC derivatives, the exchanged collateral must be adequately segregated. For centrally cleared derivatives, collateral held by CCPs also will have to be segregated, and clearing members must offer individual client segregation to their clients.²⁴⁵

In July 2011, the EC released a proposal that would replace two Capital Requirements Directives with a new directive and regulation (“CRD IV”), which would transpose Basel III²⁴⁶

²⁴⁵ EU Council version of EMIR Article 37 (October 4, 2011) (“EU Council version of EMIR”).

²⁴⁶ *See* International Regulatory Framework for Banks (“Basel III”), available on the BIS website at <http://www.bis.org/bcbs/basel3.htm>. Basel III implementation will require the holding of additional capital

standards into EU and national law. CRD IV governs access to deposit-taking activities, and covers enhanced governance, sanctions, capital buffers, and enhanced supervision.²⁴⁷ The regulation contains detailed prudential requirements for credit institutions and investment firms with respect to capital, liquidity, leverage, and counterparty credit risk.²⁴⁸ For example, capital requirements for non-centrally cleared OTC derivatives would be higher than the requirements for centrally-cleared OTC derivatives. As with EMIR and MiFIR, the regulation is directly applicable to EU member states and does not require separate implementation by each state.

iii. Business Conduct Requirements

Under EMIR, as proposed, financial institutions, and non-financial institutions that enter into non-cleared OTC derivatives transactions above a certain threshold must ensure that appropriate procedures and arrangements are in place to measure, monitor, and mitigate operational and credit risk. This would include, among other requirements: (1) the timely confirmation of the terms of the OTC derivatives where possible by electronic means; and (2) robust, resilient, and auditable processes for reconciliation of portfolios of OTC derivatives, management of associated risks, early identification and resolution of disputes between parties, and monitoring the value of outstanding OTC derivatives. Under MiFIR, trading venues are

for non-centrally cleared derivatives contracts compared to the capital held for those contracts that are centrally cleared.

²⁴⁷ Proposal for a Directive of the European Parliament and of the Council on the Access to the Activity of Credit Institutions and the Prudential Supervision of Credit Institutions and Investment Firms and Amending Directive 2002/87/EC of the European Parliament and of the Council on the Supplementary Supervision of Credit Institutions, Insurance Undertakings and Investment Firms in a Financial Conglomerate (July 20, 2011), available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0453:FIN:EN:PDF>.

²⁴⁸ Proposal for a Regulation of the European Parliament and of the Council on Prudential Requirements for Credit Institutions and Investment Firms (July 20, 2011), available in three parts at http://ec.europa.eu/internal_market/bank/docs/regcapital/CRD4_reform/20110720_regulation_proposal_part1_en.pdf; http://ec.europa.eu/internal_market/bank/docs/regcapital/CRD4_reform/20110720_regulation_proposal_part2_en.pdf; and http://ec.europa.eu/internal_market/bank/docs/regcapital/CRD4_reform/20110720_regulation_proposal_part3_en.pdf.

subject to conduct of business rules, best execution requirements, and client order handling obligations in connection with the transactions concluded on an OTF that is operated by an investment firm or a market operator. The Revised MiFID will strengthen the conduct of business rules for investment firms, which generally under MiFID are subject to requirements regarding corporate governance, organizational structure, recordkeeping, safekeeping of client funds, conflicts of interest, providing information to clients, suitability, and the obligation to execute orders on the terms most favorable to the client. Finally, the revisions to the Market Abuse Directive and the newly proposed Market Abuse Regulation, which are currently underway, will ensure regulation keeps pace with market developments, strengthen the fight against market abuse across commodity and related derivative markets, reinforce the investigative and sanctioning powers of regulators, and reduce administrative burdens on small and medium-sized issuers.²⁴⁹

c. Clearing Requirements

i. Clearing Mandate

Under EMIR, as proposed, and technical standards to be proposed thereunder, all OTC derivatives that have been declared subject to the clearing obligation would be required to be cleared through an authorized or recognized CCP.²⁵⁰ The European Union would use top-down and bottom-up approaches to determine which OTC derivatives would be subject to the

²⁴⁹ For further information, *see generally*, the Market Abuse webpage of the EC at http://ec.europa.eu/internal_market/securities/abuse/index_en.htm.

²⁵⁰ EMIR Article 3 (October 4, 2011); *see* FSB October 2011 Report, p. 7 and Table 2. There is some debate as to whether clearing of certain OTC derivatives, primarily denominated in Euro, must take place on a CCP established in the EU. The ECB has indicated that it favors such a policy. *See* ECB, The Eurosystem's Policy Line with Regard to Consolidation in Central Counterparty Clearing (September 2001), available at <http://www.ecb.int/paym/pdf/market/secmar/centralcounterpartyclearing.pdf>, referenced in Eurosystem Oversight Policy Framework (July 2011), available at <http://www.ecb.int/pub/pdf/other/eurosystemoversightpolicyframework2011en.pdf?5c43739067ca2ee42b4fd338304217c4>. However, the UK Treasury opposes this policy, and has challenged the legality of ECB's policy before the European Court of Justice (United Kingdom v. ECB, Case T-496/11 (filed September 15, 2011), available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2011:340:0029:0030:EN:PDF>).

mandatory clearing requirement. Under a top-down approach, ESMA, in consultation with the European Systemic Risk Board, would identify classes of OTC derivatives that should be required to be cleared, but for which no CCP has yet been authorized to clear them. ESMA would then notify the EC of the classes of contracts that should be subject to the clearing obligation and may publish a call for development of proposals for the clearing of these contracts.²⁵¹ Before reaching a decision, ESMA would conduct a public consultation and, where appropriate, may consult with the competent authorities of third countries. Under a bottom-up approach, a CCP would identify OTC derivatives for clearing and apply for authorization to the competent authority of the member state where it is established. Upon authorization, the authority would immediately notify ESMA of that authorization. ESMA then would, within six months, develop and submit to the EC for endorsement draft implementing technical standards. EMIR would not subject OTC derivatives that are traded on exchanges to a mandatory central clearing requirement; however, MiFIR would require that those transactions be centrally cleared.²⁵²

The clearing requirement would apply to transactions between financial institutions, as well as between financial and non-financial institutions to the extent the value of the non-financial institutions' OTC derivatives transactions exceed a certain clearing threshold (the exact terms of such threshold to be defined in technical standards).²⁵³ If a non-financial institution exceeds that threshold for 30 days over a three-month period, it would be required to clear all of

²⁵¹ Eligible OTC derivatives (*i.e.*, those subject to mandatory clearing) would be identified by ESMA based on a number of criteria, still subject to discussion by the EU Council and EP, and technical standards to be drafted by ESMA. Among EMIR drafts, there is agreement that ESMA should at least consider the liquidity of OTC derivatives and the availability of fair, reliable, and generally accepted pricing information in the relevant class of OTC derivatives. In addition, the EU Council suggests that ESMA also take into account the degree of standardization of contractual terms and operational processes. EU Council version of EMIR Article 4.3.

²⁵² MiFIR Article 25.

²⁵³ In determining whether the non-financial institution exceeded the relevant threshold, any transactions entered into by the non-financial institution for hedging purposes would not be counted.

its new OTC derivatives contracts (whether such contracts were entered into for hedging or non-hedging purposes) within three months of becoming subject to the clearing requirement. In addition, the EU Council and EP have proposed a temporary exemption for pension funds from central clearing.²⁵⁴

OTC derivatives transactions between certain legal entities within a group structure (*i.e.*, intra-group transactions) likely will not be subject to clearing requirements in the European Union. Current versions of EMIR also include an exception from margin requirements for certain types of intra-group transactions.²⁵⁵

Clearing requirements in the European Union likely will specify how market participants should treat cross-border OTC derivatives transactions, *i.e.*, transactions where one counterparty is located outside of the European Union and/or the CCP is located outside of the European Union. EMIR would apply the clearing obligation to trades conducted between EU and non-EU entities, unless the trade or the entity is exempt from clearing. The EU entity subject to the clearing obligation would be required to clear the transaction with a CCP authorized or recognized by ESMA.²⁵⁶

ii. Registration Requirements for CCPs

Under EMIR, CCPs in the European Union, including those clearing OTC derivatives, would be subject to supervision and oversight by the national competent authority of the EU member state in which the CCP is established. Under EMIR, a CCP with clearing transactions involving counterparties in more than one EU member state would be overseen by a college of competent authorities of the relevant EU member states. The exact role of ESMA and the

²⁵⁴ See EP version of EMIR Article 71(2a) (June 7, 2011) and EU Council version of EMIR Article 71.0; see also FSB October 2011 Report at Table 6.

²⁵⁵ EU Council version of EMIR Article 3.1(a).

²⁵⁶ EMIR Article 23.1

college of such authorities in the authorization and supervision of CCPs is still under consideration. In addition, EMIR would establish a recognition regime for CCPs located outside of the European Union whose legal and supervisory frameworks have been recognized as equivalent to EMIR.

iii. Regulatory Requirements for CCPs

EMIR would require CCPs to comply with detailed prudential, business conduct, and organizational requirements,²⁵⁷ which would be supplemented by technical standards. EMIR provides that a CCP must mitigate its counterparty credit risk exposure through a number of mechanisms, including stringent but non-discriminatory participation requirements, financial resources, and other guarantees.²⁵⁸ EMIR also would require a minimum amount of capital for authorization of a CCP and require a CCP to have a mutualized default fund to which members of the CCP will have to contribute their proportionate share. In addition, a CCP would be required to implement adequate internal control mechanisms, including sound administrative and accounting procedures, and appropriate governance arrangements. Finally, EMIR would require the CCP to maintain a minimum amount of capital to be used in a default procedure before the mutualization of losses among non-defaulting clearing members.

d. Reporting Requirements

i. Reporting Mandate

Under EMIR, all derivatives²⁵⁹ – whether centrally cleared or otherwise – would be reported by financial and non-financial counterparties²⁶⁰ no later than one business day following

²⁵⁷ EMIR Title IV, Chapter 1.

²⁵⁸ EMIR Title IV, Chapter 2.

²⁵⁹ The EC September proposal required OTC derivatives to be reported to TRs, but the latest proposal dated October 4, 2011, by the EU Council and the EP version of June 7, 2011, require all derivatives transactions to be reported to TRs. See Articles 7.1 and 6.1, respectively.

²⁶⁰ See EMIR Article 9.1; see also FSB October 2011 Report, p. 11 and Table 5.

completion of the transaction to TRs or, alternatively, to ESMA if there is no TR for a particular asset class.²⁶¹ MiFIR, in addition, requires that investment firms report transaction data to competent authorities by close of business following the conclusion of the transaction.²⁶² EMIR also would require regular publication of aggregate data by TRs or by third parties.²⁶³ Once EMIR is finalized, ESMA will produce draft technical standards on: (1) content and format of the information to be reported to TRs or ESMA as the case may be; (2) information and data that TRs will make public; and (3) data that TRs shall make available to ESMA, market regulators, prudential supervisors, and central banks of the European System of Central Banks.

The MiFIR proposal also would create a post-trade transparency/public-dissemination mechanism, under which regulated markets, MTFs, and OTFs²⁶⁴ must make transactions data available to the public as close to real time as is technically possible.²⁶⁵ Further, regulated markets, MTFs, and OTFs would be required to publish aggregate positions of commodity derivatives or emissions allowances or derivatives thereof on a weekly basis,²⁶⁶ and TRs must publish aggregate by class of derivatives on the contracts reported to it.²⁶⁷

ii. Registration Requirements for Repositories

Draft versions of EMIR propose to give ESMA the power to register and supervise TRs, but EU member state authorities would have access to TR data.²⁶⁸ In order to be registered by ESMA, a TR would be required to be established in the European Union. EMIR would not

²⁶¹ The reporting requirement in the EMIR proposal overrides privacy and confidentiality law concerns and requires that all relevant data be reported. *See id.* at p. 19.

²⁶² MiFIR Article 23.1.

²⁶³ EMIR Article 67.

²⁶⁴ Regulated market refers to an exchange; MTFs and OTFs are electronic trading platforms.

²⁶⁵ MiFIR Article 9.

²⁶⁶ MiFID II Article 60.

²⁶⁷ EMIR Article 67.1.

²⁶⁸ EMIR Article 67.2(b).

require data to be reported to a TR located in the European Union, but a non-EU repository would be required to be recognized by ESMA in order for the reporting requirement to be satisfied. A recognition regime for non-EU TRs is set out in EMIR for those TRs whose legal and supervisory frameworks have been recognized as equivalent to EMIR and whose countries have entered into an international agreement with the European Union.²⁶⁹

iii. Regulatory Requirements for Repositories

EMIR would require registered TRs to comply with detailed requirements to ensure that the information they maintain is reliable, secure, and protected.²⁷⁰

e. Execution Requirements

i. Execution Mandate

The MiFIR proposal provides requirements for moving trading in certain eligible OTC derivatives across all major asset classes to exchanges or other types of trading venues, including a regulated market, an MTF, or an organized trading facility (“OTF”).²⁷¹ The EC predicts that final regulation will be in effect by the end of 2013. Exchanges and electronic trading platforms would be required to provide multi-dealer functionality (*i.e.*, the capability of enabling multiple third-party buying and selling interests to interact).²⁷² All OTC derivatives subject to mandatory clearing pursuant to EMIR, which are sufficiently liquid as determined by ESMA, would be

²⁶⁹ EMIR Article 63. ESMA would recognize a TR from a third country, where the TR is authorized in and is subject to effective surveillance in that third country; the EC has determined that the legal and supervisory arrangements of the third country ensure that the TR authorized in that third country comply with requirements equivalent to EU requirements; the European Union has entered into an international agreement with that third country; and cooperation arrangements have been established to ensure that EU authorities have immediate and continuous access to all the necessary information.

²⁷⁰ EMIR Articles 65-66.

²⁷¹ An OTF is a new type of trading venue that is defined as any system or facility, which is not a regulated market or MTF, operated by an investment firm or a market operator, in which multiple third-party buying and selling interests in financial instruments are able to interact in the system in a way that results in a contract in accordance with the provisions of the Revised MiFID. See MiFIR Article 2.1(7).

²⁷² See MiFIR Article 2.1(5)-(7) (defining regulated markets, MTFs, and OTFs). Each definition requires that the entity “[bring] together multiple third-party buying and selling interests.” See also FSB October 2011 Report, at Table 3-4.

required to trade on one of three types of trading venues. This obligation would be imposed on both financial and non-exempt non-financial counterparties.

ii. Registration Requirements for Markets

MiFIR is designed to require that all OTC derivatives trading is conducted on trading venues. MiFIR would establish a recognition regime for non-EU trading venues whose legal and supervisory frameworks have been recognized as equivalent.

iii. Regulatory Requirements for Markets

MiFIR sets forth specific regulatory requirements for trading venues. EMIR and MiFIR would require pre- and post-trade price and volume transparency for all derivatives transactions, whether OTC or traded on an organized venue. Some exceptions, exemptions, or waivers of pre- or post-trade price or volume transparency requirements would be permitted for trades of a certain size (*e.g.*, block trades). Pre- and post-trade price and volume transparency requirements would be identical across the three types of trading venues, but would be calibrated according to the instruments traded.²⁷³ In addition, post-trade transparency requirements identical to those applicable to trades executed on organized venues are proposed to apply to transactions in products that are clearing-eligible but not traded on an organized venue and to products that are not required to be cleared and only are reported to a TR, including trades where a counterparty is a European dealer (*i.e.*, an investment firm acting as a systematic internalizer).²⁷⁴

²⁷³ National regulators of EU member states where a venue is located may grant a waiver, based on the market model, the specific characteristics of trading activity in a product and, in certain cases, the liquidity, from the pre-trade transparency requirements pursuant to specified criteria, including the market model or the type and size of orders. However, ESMA would be required to issue an opinion on the legality of the waiver. For post-trade transparency, the proposal provides for the possibility of deferred publication in certain cases, depending on the size or type of transactions. The scope of and requirements for these exceptions would be established by implementing rules. MiFIR Article 8.

²⁷⁴ MiFIR Article 13. A systematic internalizer is an investment firm that, on an organized, frequent, and systematic basis, “deals on own account” by executing client orders outside a regulated market or an MTF or an OTF. MiFIR Article 2.1(3).

The organizational and market surveillance requirements applicable to the three venues are nearly identical. Regulated markets and MTFs would execute transactions on a non-discretionary basis, but the operator of an OTF would have a degree of discretion over how a transaction is executed.²⁷⁵ Consequently, the OTF operator would be subject to investor protection, business conduct, and best execution requirements, and prohibited from trading against its own proprietary capital.

C. Asia

1. Japan

The Japanese legislature passed the Amendment to the Financial Instruments and Exchange Act (“FIEA”) in May 2010.²⁷⁶ This amendment gave the Japanese financial regulator, the JFSA, the authority to regulate OTC derivatives.²⁷⁷ The JFSA expects the implementing cabinet ordinance (“Cabinet Ordinance”) and other measures to be finalized by November 2012.²⁷⁸

a. Types of OTC Derivatives

The FIEA covers financial products such as equity swaps, interest rate swaps (“IRS”), CDS, and FX, but not commodity derivatives. Under the domestic legislative framework, there are no provisions prohibiting a particular class of financial derivatives. Japan has separate definitions for “exchange traded derivatives”, “OTC derivatives”, and “foreign exchange-traded

²⁷⁵ Non-discretionary execution indicates that transactions will be executed according to predetermined rules. By contrast, discretionary execution of a trade indicates that the market has some degree of flexibility in choosing the methodology used to execute the trade.

²⁷⁶ See Outline of the Bill for Amendment of the Financial Instruments and Exchange Act, available on the JFSA website at <http://www.fsa.go.jp/en/refer/diet/174/01.pdf>.

²⁷⁷ In addition, industrial commodity derivatives are regulated and supervised by the Ministry of Economy, Trade and Industry, and agricultural commodity derivatives are regulated and supervised by the Ministry of Agriculture, Forest and Fisheries. JFSA Submission (September 27, 2011) at p. 4.

²⁷⁸ JFSA Presentation at p.8; FSB October 2011 Report, Table 1 and Table 6.

derivatives.”²⁷⁹ A derivatives transaction where one counterparty is a financial instruments business operator (“FIBO”) or a registered financial institution (“RFI”) under FIEA is subject to the Japanese domestic regulatory framework.²⁸⁰

b. Types of Market Participants

i. Registration Requirements

There is no separate licensing requirement for derivatives dealers. The FIEA requires that entities that market transactions in derivatives or act as intermediaries or brokers register as FIBOs.²⁸¹ Financial institutions such as commercial banks may engage in certain derivatives business by registering as RFIs.²⁸² Foreign corporate FIBOs and foreign securities traders may obtain the approval of the Prime Minister to trade derivatives at a Japanese financial instruments exchange.²⁸³

ii. Prudential and other Risk-Related Requirements

Japan has implemented Basel II for banks, including banks registered as RFIs. Japan will apply Basel 2.5’s enhanced measurements of risks related to securitization and trading book exposures by December 31, 2011.²⁸⁴ Japan intends to release a public consultation on Basel III in early 2012 with publication of final rule text by the end of March 2012. These rules will be implemented by the end of March 2013.²⁸⁵ Type I Japanese FIBOs, which often are called securities companies, are required to keep their capital-to-risk ratio at no less than 120%. This

²⁷⁹ JFSA Submission at p. 1.

²⁸⁰ *Id.* at p. 3.

²⁸¹ FIEA Article 28.

²⁸² FIEA Article 33-2; *see also* JFSA Submission at p. 2.

²⁸³ *Id.* at p. 8 (citing FIEA Article 60(I)).

²⁸⁴ BCBS Progress Report on Basel III Implementation (October 2011), pp. 10-12, available at <http://www.bis.org/publ/bcbs203.pdf>.

²⁸⁵ *Id.*

ratio is defined as the ratio of capital after the deduction of total fixed assets relative to the total amount of risk, including market risk, counterparty risk, and operational risk.²⁸⁶ In terms of liquidity and risk management, FIBOs that engage in OTC derivatives transactions are required to manage their liquidity risks according to JFSA supervisory guidelines.²⁸⁷ FIBOs and RFIs that enter into FX derivatives or securities-related OTC derivatives with retail customers are required to have customers post margin for those transactions.²⁸⁸ The FIEA requires that FIBOs and RFIs segregate customer assets from their own assets.²⁸⁹

iii. Business Conduct Requirements

All FIBOs are required to comply with the business conduct rules under FIEA.²⁹⁰ Business conduct requirements applicable to FIBOs generally include basic operating requirements placed on financial institutions, such as proper disclosure, reporting to regulators, appropriate internal control systems to avoid conflicts of interest, and adherence to fiduciary duty obligations.²⁹¹

c. Clearing Requirements

i. Clearing Mandate

Under the FIEA, clearing through a CCP will be mandatory for specific OTC derivatives transactions where the reduction of settlement risk through central clearing would be deemed necessary for the stability of the Japanese market.²⁹² The exact products included within the

²⁸⁶ JFSA Submission at p. 6.

²⁸⁷ *Id.* at p. 6; *see also* Comprehensive Guidelines for Supervision of Financial Instruments and Business Operators, etc. (June 2010), available at <http://www.fsa.go.jp/en/refer/guide/instruments.pdf>.

²⁸⁸ JFSA Submission at p. 6 (citing FIEA Article 38, item 7, and Cabinet Ordinance Article 117, ¶ 1, item 27).

²⁸⁹ *Id.* at p. 7 (citing FIEA Articles 43-2 and 43-3).

²⁹⁰ *Id.* at p. 2.

²⁹¹ *Id.* at p. 8.

²⁹² JFSA Presentation at p.3; *see also* FSB October 2011 Report, p. 7, Table 2 and Table 6; and Progress since the Washington Summit in the Implementation of the G20 Recommendations for Strengthening Financial

central clearing requirement will be specified by Cabinet Ordinance. Mandatory clearing is required for trades “that are significant in volume and would reduce settlement risks in the domestic market”.²⁹³

The FIEA requires central clearing for high-volume OTC derivatives.²⁹⁴ Clearing must occur on a Japanese CCP for those OTC derivatives where clearing criteria relates closely to corporate bankruptcy criteria under Japanese law²⁹⁵ such as the iTraxx Japan CDX index.²⁹⁶ For all other products, the JFSA would allow entities that it regulates to clear on domestically-licensed CCPs, foreign-licensed CCPs, or foreign CCPs that have an interoperability arrangement with a domestically-authorized CCP.²⁹⁷

ii. Registration Requirements for CCPs

CCPs are required to have a license when they offer central clearing services to domestic FIBOs or RFIs.²⁹⁸ CCPs must have capital in excess of 1 billion yen and JFSA-authorized internal operating rules, expertise in clearing transactions in financial instruments within their human resources, and adequate infrastructure to ensure timely collateral calls for the settlement of liability.²⁹⁹ Additionally, authorization is required for shareholders that intend to hold more than 20% of the voting rights of a domestic CCP.³⁰⁰

Stability: Report of the Financial Stability Board to G20 Leaders (November 8, 2010) (“FSB November 2010 Report”) at p. 14, available at http://www.financialstabilityboard.org/publications/r_101111b.pdf.

²⁹³ FSB October 2011 Report, Table 2.

²⁹⁴ See OTC Derivatives Regulation in Japan: Improving the Stability and Transparency of OTC Derivatives Markets (October 17, 2011) (“JFSA Presentation”), available at <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=49926&SearchText=>.

²⁹⁵ JFSA Presentation; FSB October 2011 Report, Table 7.

²⁹⁶ JFSA Submission at p. 3; see also FSB October 2011 Report, Table 2 and Table 7.

²⁹⁷ JFSA Presentation; see also JFSA Submission at pp.15-16.

²⁹⁸ JFSA Submission at p. 12 (citing FIEA Article 156-2).

²⁹⁹ *Id.* at pp. 12- 14.

³⁰⁰ JFSA Presentation.

The requirements of the authorization regime that are applied to CCPs organized under Japanese law also are largely applied to CCPs organized under foreign laws. Certain requirements, however, such as minimum capital requirements and major shareholder requirements, will not be applied to foreign CCPs.³⁰¹ Foreign CCPs that are clearing transactions executed by domestic FIBOs must obtain a CCP license from JFSA.³⁰² However, where the impact of assuming clearing liabilities is deemed insignificant to the domestic market, the Commissioner of JFSA may publish a notification that a specific foreign CCP may not be required to obtain a license to conduct certain clearing activities.³⁰³

iii. Regulatory Requirements for CCPs

CCPs must prepare and keep documents relating to their operations and submit them to the JFSA.³⁰⁴

d. Reporting Requirements

i. Reporting Mandate

The FIEA establishes a mandatory OTC derivatives reporting requirement for financial institutions, under which FIBOs and RFIs are required to store and report OTC derivatives trade information to JFSA, unless they provide such trade information to a TR. Trade data will be reported to a designated TR, and trade data that the TR does not accept will be reported to the JFSA.³⁰⁵ The JFSA currently is considering whether all trade information should be subject to the trade reporting obligation.³⁰⁶

³⁰¹ *Id.*

³⁰² JFSA Submission at p. 15 (citing FIEA Article 156-2).

³⁰³ *Id.* at p.15 (citing FIEA 2XX VIII, Order for Enforcement of FIEA 1-18-2, Article 1-19(2)).

³⁰⁴ *Id.* at pp. 14-15 (citing FIEA Article 156-3).

³⁰⁵ FSB October 2011 Report, p. 11 and Table 5.

³⁰⁶ JFSA Submission at p. 3.

ii. Registration Requirements for Repositories

TRs must be designated for a regulatory purpose by the Prime Minister, before domestic FIBOs can report their trades to them.³⁰⁷ In order for a TR to be designated, it must have adequate financial resources to maintain operations and knowledgeable staff with the skills to undertake operations adequately, and must not have directors that are deemed inappropriate for such a role.³⁰⁸

Foreign TRs whose regulator has an international cooperative oversight framework with JFSA and has an adequate regime for reporting to JFSA are expected to be designated for regulatory purposes by the Prime Minister.³⁰⁹

iii. Regulatory Requirements for Repositories

The JFSA currently is in the process of determining the details relating to recordkeeping and reporting of trade information. It is expected to publish a draft Cabinet Ordinance in Spring 2012 for public consultation, in order to allow for time to implement trade reporting before the G-20 end-of-2012 deadline.³¹⁰

e. Execution Requirements

i. Execution Mandate

The FIEA does not include an obligation for OTC derivatives to be exchange traded. The JFSA recently published a draft regulatory framework to require certain OTC derivatives to be executed on electronic trading platforms.³¹¹

³⁰⁷ *Id.* at p. 16 (citing FIEA Article 156-64).

³⁰⁸ *Id.* at pp. 16-17 (citing FIEA Article 165-67).

³⁰⁹ *Id.* at pp. 18-19 (citing FIEA Article 156-64).

³¹⁰ *Id.* at p.18

³¹¹ *Id.* at p. 2; FSB October 2011 Report, Table 3. The JFSA undertook a review panel in late 2011 and published a draft regulatory framework in December 2011. It anticipates establishing the framework without delay. *See* Issues Discussed at the OTC Derivatives Regulation Review Panel (Executive

ii. Registration Requirements for Markets

In order to obtain a license, a financial instruments exchange must meet minimum capital requirements of 1 billion yen and must be a juridical person with a board of directors and a board or committee of auditors.³¹² Only an authorized financial instrument firm association, authorized by the Prime Minister, can establish a financial exchange without a separate license.³¹³

iii. Regulatory Requirements for Markets

Financial instruments exchanges must prepare and keep documents relating to their operations and submit them to the Commissioner of JFSA.³¹⁴ Financial instruments exchanges must conduct self-regulatory services or may, with authorization of the Prime Minister, outsource such services to a separate self-regulatory organization.³¹⁵ Self-regulatory organizations are supervised by the JFSA.

2. China

a. Types of OTC Derivatives

China indicates that there is increased standardization of OTC derivatives products.³¹⁶ It has stated that it is reviewing whether all asset classes will be covered.³¹⁷

b. Types of Market Participants

In order to enter into OTC derivatives transactions in China, institutions use agreements developed by the National Association of Financial Market Institutional Investors

Summary) (“Japan Review Panel”), available at <http://www.fsa.go.jp/en/news/2012/20120106-1.pdf>.

³¹² *Id.* at p.9 (citing FIEA Article 83-2).

³¹³ *Id.* at p.10 (citing FIEA Article 67).

³¹⁴ *See* FIEA Article 188 and Cabinet Ordinance Concerning Financial Instruments Exchange Article 112.

³¹⁵ *Id.* at p.11 (citing FIEA Article 85).

³¹⁶ FSB October 2011 Report, Table 1.

³¹⁷ *Id.* at Table 6.

(“NAFMII”).³¹⁸ At this time, it is unclear what statutory or regulatory requirements may be imposed on participants in the OTC derivatives market.

c. Clearing Requirements

China is considering what type of legislation and clearing requirements would be suitable for its markets.³¹⁹ The People’s Bank of China (“PBOC”), China’s central bank, is making efforts to have the Shanghai Clearing House (“SCH”)³²⁰ establish a framework for central clearing.³²¹

d. Reporting Requirements

There will be regulation in force by the end of 2012 requiring all OTC derivatives transactions to be reported to TRs.³²² Under current requirements, all OTC interest rate, FX, and certain credit risk mitigation tools (the Chinese term for CDS) can be traded on the China Foreign Exchange Trade System (“CFETS”) trading platform.³²³ Executing on the CFETS platform fulfills the trade reporting requirement. Interest rate trades executed outside of the CFETS platform must be reported to CFETS, and credit risk mitigation trades should be reported to the NAFMII.³²⁴ China currently is considering details of its requirements, including the frequency and contents of reporting and which institutions will play the role of TRs.³²⁵

³¹⁸ The NAFMII is a self-regulatory organization in China that has developed a documentation standard for OTC derivatives in China. See Promoting Market Innovation, National Association of Financial Market Institutional Investors, available at, <http://www.nafmii.org.cn/Channel/349969>

³¹⁹ FSB October 2011 Report, Table 2 and Table 6.

³²⁰ SCH is owned by a number of other infrastructures, CFETS, China Central Depository & Clearing Co., China Banknote Printing and Minting Corporation, and China Gold Coin Incorporation, and it is regulated by the PBOC.

³²¹ FSB October 2011 Report, Table 2.

³²² *Id.* at Table 5.

³²³ FSB October 2011 Report, p. 11 and Table 5.

³²⁴ *Id.*

³²⁵ *Id.*

e. Execution Requirements

China is reviewing what trading requirements to impose on OTC derivatives.³²⁶

However, Chinese regulators have said their eventual system will have multi-dealer functionality and will provide pre-trade price and volume transparency for all electronically traded OTC derivatives.³²⁷ Any interest rate transactions that take place off of an electronic trading platform will be reported to the CFETS platform.³²⁸

3. Hong Kong

a. Types of OTC Derivatives

The Hong Kong Monetary Authority (“HKMA”) and Hong Kong Securities and Futures Commission (“SFC”, together with the HKMA, the “Hong Kong Authorities”) released a consultation paper on their proposed OTC regulatory regime in October 2011.³²⁹ The Hong Kong Authorities propose amending the Securities and Futures Ordinance (“SFO”) to set out a general framework for the regulation of the OTC derivatives market, which includes providing relevant rulemaking powers to the HKMA and SFC. The Hong Kong Authorities will conduct a public consultation on proposed regulations in the first quarter of 2012.³³⁰ The amendments to the SFO and the proposed regulations must be approved by Hong Kong’s Legislative Council. Hong Kong is working to adopt these regulations by the end of 2012. In order to provide for flexibility given the evolving global developments related to derivatives regulation, the Hong Kong Authorities propose setting out the main regulatory obligations in the SFO, and including

³²⁶ *Id.* at Table 3.

³²⁷ *Id.* at Table 4.

³²⁸ *Id.* at Table 3.

³²⁹ Consultation Paper on the Proposed Regulatory Regime for the Over-the-Counter Derivatives Market in Hong Kong (October 2011) (“Hong Kong Consultation”), available at <https://www.sfc.hk/sfcConsultation/EN/sfcConsultFileServlet?name=otcreg&type=1&docno=1>.

³³⁰ *Id.* at p.5.

the details (*e.g.*, scope of mandatory obligations) in the regulations to be made under the SFO.³³¹ The legislation will include a power to allow specific transactions to be included in or excluded from the definition of “OTC derivatives”.³³²

Hong Kong intends to implement certain requirements for clearing of and reporting on certain types of IRS and non-deliverable forwards by the end of 2012.³³³ Transactions subject to mandatory reporting and clearing obligations are referred to as “reportable transactions” and “clearing eligible transactions” respectively.³³⁴ The Hong Kong Authorities selected these asset classes for regulation before other classes because they represent a much larger percentage of OTC derivatives trading in Hong Kong than equity swaps, CDS, and commodities.³³⁵ After market consultation, the Hong Kong Authorities will expand the clearing and reporting obligations, in phases, to cover other interest rate and foreign exchange derivatives, as well as other asset classes such as equity derivatives and, for mandatory clearing, will propose both a top-down and bottom-up approach.³³⁶ While OTC equity derivatives represent a small percentage of the derivatives market in Hong Kong, they propose to focus on this category next to assist in monitoring systemic risk in Hong Kong’s stock market.³³⁷

³³¹ *Id.* at p. 2.

³³² *Id.* at p. 11.

³³³ *Id.* at pp. 3 and 12.

³³⁴ *Id.* at p. 3.

³³⁵ *Id.* at p. 14 (citing a 2009 market study on the Hong Kong OTC derivatives market).

³³⁶ *Id.* at p. 3.

³³⁷ *Id.* at p. 15.

b. Types of Market Participants

i. Registration Requirements

Hong Kong has proposed regulation of major participants in its OTC derivatives market, in particular authorized institutions (“AIs”),³³⁸ licensed corporations (“LCs”),³³⁹ and large participants whose positions may pose a systemic risk. AIs and LCs that already are registered would not need a separate registration. AIs represent most of the major participants in the Hong Kong derivatives market and would be regulated by the HKMA because, for many AIs, their OTC derivatives business forms a core part of their banking business, which is regulated by the HKMA.³⁴⁰ As for the other participants in the market, many of them are international investment houses that conduct OTC derivatives business in Hong Kong either through unregulated entities within the group or through entities that already are licensed by the SFC with respect to their securities and futures business.³⁴¹ Currently unlicensed entities that carry on a business of dealing in or advising on OTC derivatives would be required to be licensed under the proposal.³⁴² The SFC also would have a degree of regulatory oversight with respect to large participants in the OTC derivatives market that are not otherwise regulated by the SFC or HKMA as intermediaries, but that have positions that raise systemic risk concerns.³⁴³

ii. Prudential and other Risk-Related Requirements

The HKMA is beginning to incorporate the capital regime for banks and the revised counterparty credit risk framework under Basel III for implementation in accordance with the

³³⁸ The AI category is the registration class for deposit-taking institutions and licensed banks.

³³⁹ The LC category is the registration class for entities that deal in securities, futures contracts, or leveraged foreign exchange trading; advise on securities or futures contracts; or act as asset managers.

³⁴⁰ *Id.* at p. 10

³⁴¹ *Id.*

³⁴² *Id.*

³⁴³ *Id.* at pp. 4-5.

2013 international timeline.³⁴⁴ The Hong Kong Authorities are considering imposing capital requirements for OTC derivatives transactions not cleared through a CCP that are based on international standards. The Hong Kong Authorities also are participating in international work by international standard setters on margin requirements for non-centrally cleared OTC derivatives transactions and will consider the appropriate regime for Hong Kong entities in light of the outcome of this international work.³⁴⁵

iii. Business Conduct Requirements

The Hong Kong Authorities have not yet specified what business conduct rules they propose to adopt for OTC derivatives market participants. In developing their requirements, the Hong Kong Authorities will take into account the standards being developed by the IOSCO Task Force.³⁴⁶

c. Clearing Requirements

i. Clearing Mandate

Mandatory clearing is expected to cover certain IRS and non-deliverable forwards initially, with subsequent consideration of extending the requirement to other types of products.³⁴⁷ The scope of mandatory clearing is under review, but Hong Kong currently plans to cover institutions holding positions that may pose systemic risk to the financial system.³⁴⁸ The Hong Kong Authorities propose that a mandatory clearing obligation apply if both counterparties (including AIs and LCs) exceed a specified threshold and if an AI, LC, or Hong Kong person is a

³⁴⁴ FSB October 2011 Report, Table 1.

³⁴⁵ Hong Kong Consultation at p. 35.

³⁴⁶ *Id.* at pp. 36-38.

³⁴⁷ FSB October 2011 Report, Table 6.

³⁴⁸ *Id.*

counterparty to the transaction or an AI or LC has originated or executed the transaction.³⁴⁹ The clearing threshold would be set in absolute dollar terms, on a per product class basis and would be calculated using the average notional value of a person's month-end positions for the preceding six months.³⁵⁰

In some cases, locally incorporated AIs would be required to centrally clear transactions at both an entity level and a group basis (*e.g.*, clearing the transactions of its subsidiaries) to assist the HKMA's consolidated supervision of the AIs' activities.³⁵¹ Clearing would be required on a group basis when positions of the AI and its subsidiaries, as specified by the HKMA, together have exceeded the clearing threshold. If an AI is required to centrally clear transactions on a group basis, then its obligation will be to procure the clearing of the transactions entered into by its subsidiaries, rather than clearing the transaction itself, because it is not the counterparty of those transactions.

The specified threshold calculation would include all transactions in a product class, not only clearing eligible transactions.³⁵² When an entity first exceeds the clearing threshold, it would have a three-month grace period to set up a clearing relationship with a designated CCP or clearing agent and to establish the necessary infrastructure to clear. The Hong Kong Authorities have not set threshold amounts for the clearing obligation, but are in the process of collecting data on derivatives activities in the Hong Kong market to determine the threshold levels.³⁵³

³⁴⁹ Hong Kong Consultation at pp. 3-4. It is intended that the term "originated or executed" shall have the same meaning for mandatory reporting and clearing. *See* Hong Kong Consultation at pp. 25-27; *see also* FSB October 2011 Report, Table 2 ("much also depends on the timing of global consensus on key issues and completing the legislative process in time"); Hong Kong Consultation at p. 26.

³⁵⁰ *Id.* at p.22 and 28.

³⁵¹ *Id.* at p. 16.

³⁵² *Id.* at p. 28.

³⁵³ *Id.* at p. 28.

Overseas persons (including overseas incorporated AIs with transactions not conducted through their Hong Kong branches) may be affected by the mandatory clearing requirement if they transact clearing-eligible transactions with an AI, LC, or Hong Kong person and both have exceeded the clearing threshold. The Hong Kong Authorities have proposed that there will be an exemption where both counterparties to the transaction are overseas persons and the transaction is either: (1) subject to mandatory clearing under the laws of an acceptable overseas jurisdiction; or (2) exempted from mandatory clearing under those laws.³⁵⁴ In addition, the Hong Kong Authorities have suggested that overseas entities should be allowed to become clearing members at local CCPs and have requested comment on this issue.³⁵⁵

ii. Registration Requirements for CCPs

The Hong Kong Authorities have proposed that only a recognized clearing house³⁵⁶ or an authorized automated trading services provider³⁵⁷ should be eligible to be designated as a CCP. They are considering whether to require clearing by local CCPs of certain products that are considered systemically important to the Hong Kong financial market.³⁵⁸

iii. Regulatory Requirements for CCPs

The SFC intends to adopt international standards consistent with CPSS-IOSCO for the regulation of CCPs before recognizing an entity as a recognized clearing house or authorized

³⁵⁴ *Id.*

³⁵⁵ *Id.* at p. 34.

³⁵⁶ A recognized clearing house is a company recognized by the SFC that ensures orderly, fair and expeditious clearing and settlement arrangements for transactions cleared or settled through its facilities and that risks associated with its business and operations are managed prudently. *See* Securities and Futures Ordinance Chapter 571 Section 37-38.

³⁵⁷ Automated trading services providers are entities, other than recognized exchanges companies or recognized clearing houses, that provide automated trading services (as well as clearing and settlement) through electronic facilities whereby offers to sell or purchase securities or futures contracts are made. *See* Guidelines for the Regulation of Automated Trading Services, Securities and Futures Commission (February 2002), available at <http://www.sfc.hk/sfcRegulatoryHandbook/EN/displayFileArchServlet?docno=H061>; *see also* Securities and Futures Ordinance Chapter 571 Section 95.

³⁵⁸ Hong Kong Consultation at p. 33.

automated trading services provider for OTC derivatives.³⁵⁹ These international standards include standards relating to governance structures, financial resources, membership criteria, risk management policies and procedures, margining requirements, and default procedures.

d. Reporting Requirements

i. Reporting Mandate

The Hong Kong Authorities have proposed a mandatory reporting obligation where specified OTC derivatives transactions (*i.e.*, reportable transactions) are required to be reported to a TR to be operated by the HKMA.³⁶⁰ However, the TR will meet international standards consistent with CPSS-IOSCO on reporting and data format, which will facilitate the aggregation of global data.³⁶¹ LCs and locally incorporated AIs would be required to report all reportable OTC derivatives transactions that they are counterparty to, or that they have originated or executed,³⁶² to the HKMA TR.³⁶³ If and as required by the HKMA, locally incorporated AIs also would be required to ensure that the positions of subsidiaries are reported to the TR.³⁶⁴

Overseas incorporated AIs would be required to report their reportable transactions to the HKMA TR if they originated or executed the transaction through, or became a counterparty via,

³⁵⁹ *Id.*

³⁶⁰ FSB October 2011 Report at p. 18.

³⁶¹ *Id.* at pp. 18-19.

³⁶² *Id.* at p. 17 (“By ‘originated and executed’ we mean that the AI or LC has negotiated, arranged, confirmed or committed to a transaction on behalf of itself or any counterparty to the transaction, and in the case of an overseas-incorporated AI, that this has been done through its Hong Kong branch. It would therefore include the functions of a relevant sales desk or trading desk involved in the transaction.”). The Hong Kong Authorities propose including transactions “originated or executed” because most OTC derivatives activity conducted by AIs and LCs in Hong Kong is not booked in Hong Kong, so the AIs and LCs in Hong Kong are not counterparties to the transaction. Therefore, the Hong Kong Authorities believe that, in order to be effective, the mandatory reporting obligation would include transactions “originated or executed” by LCs, locally incorporated AIs, and the Hong Kong branch of overseas incorporated AIs. *Id.*

³⁶³ Since the scope of Hong Kong regulation initially will be IRS and non-deliverable forwards, these are the “reportable” categories. Hong Kong Consultation at p. 16; *see also* FSB October 2011 Report, Table 5 (implementation “depends on timing of global consensus on key issues and completing the legislative process in time; intention to take a phased approach, beginning with [IRS] and non-deliverable forwards”).

³⁶⁴ Hong Kong Consultation at p.16.

their Hong Kong branch or if a transaction where the overseas incorporated AI is a counterparty has a Hong Kong nexus.³⁶⁵ A transaction with a Hong Kong nexus may have an impact on the monetary and financial stability of Hong Kong.³⁶⁶ Hong Kong persons³⁶⁷ are required to report reportable transactions to the HKMA TR if they are a counterparty to the transaction, they have exceeded the specified reporting threshold, and no AI or LC is also subject to a reporting obligation for that transaction.³⁶⁸ Overseas persons who are not AIs, LCs, or Hong Kong persons would not be subject to the mandatory reporting requirement.

In all cases where the mandatory reporting obligation applies, the Hong Kong Authorities have proposed that such reporting must be complied with by the end of the next business day.³⁶⁹

³⁶⁵ A Hong Kong nexus exists where the underlying entity or reference entity for an equity derivative or a credit derivative is established, incorporated, or listed in Hong Kong or under Hong Kong law, or where, for other derivatives, the underlying asset, currency, or rate is denominated in Hong Kong dollars. Hong Kong Consultation at pp. 16 and 18; *see also* FSB October 2011 Report, Table 5 (“Transactions that meet HK nexus condition to be reported to local TR to be developed by HKMA”).

³⁶⁶ Hong Kong Consultation at p.17.

³⁶⁷ *Id.* at p. 19 (“The reference to ‘Hong Kong persons’ is essentially intended to cover persons (other than AIs and LCs) who operate from Hong Kong, or who otherwise have a connection with Hong Kong. Accordingly, we propose that the term should refer to the following – (1) individuals who are Hong Kong residents, (2) the owners of any sole proprietorship or partnership that is based in, operated from, or registered in Hong Kong, (3) companies that are incorporated or registered in Hong Kong, (4) funds that are managed in or from Hong Kong (irrespective of whether they are established as a company or a trust), and (5) any other entity that is established or registered under Hong Kong law.”). The Hong Kong Authorities anticipate that the definition of Hong Kong persons will cover “non-AI and non-LC financial institutions, commercial entities and high net worth individuals based in Hong Kong, as well as funds managed from Hong Kong, and irrespective of whether they enter into OTC derivatives transactions to hedge their commercial activities or as part of an investment portfolio.” *Id.*

³⁶⁸ *Id.* at pp. 16 and 21. The Hong Kong Authorities propose setting the reporting threshold in absolute dollar terms and based on the average notional value of a person’s month-end positions from the preceding six months. The specific threshold for each product class has yet to be determined. Thresholds would be set on a per product class basis – they would apply separately and independently to different product classes, and thresholds may be different for different product classes (each product class may include one or more product type). The HKMA and SFC are collecting data on OTC derivatives activities in Hong Kong’s market that will be used to determine the specified threshold levels. Reporting thresholds (like clearing thresholds) would be reviewed every three years and amended as appropriate to reflect market developments and changes. All transactions in a specified product class would be included for purposes of calculating the reporting threshold, including transactions that fall outside of the definition of reportable transactions as well as transactions that are exempt from the reporting obligation.

³⁶⁹ *Id.* at p. 16.

ii. Registration Requirements for Repositories

As explained above, the HKMA has proposed the creation of a government-operated TR that would act as the repository for all transactions required to be reported.

e. Execution Requirements

i. Execution Mandate

Legislative changes to give regulators power to impose trading requirements are anticipated to be completed in early 2012, but the timing of implementation remains under consideration and will be guided by development of international standards.³⁷⁰ The Hong Kong Authorities will examine local market conditions after the introduction of mandatory reporting and clearing requirements and advise on how best to implement a mandatory trading obligation.³⁷¹ While the Hong Kong Authorities propose not imposing a mandatory trading obligation at the outset, the SFO will be amended to permit a trading requirement in the future.³⁷²

4. Singapore

a. Types of OTC Derivatives

The Monetary Authority of Singapore (“MAS”) intends to issue a public consultation in early 2012 on a proposed framework for OTC derivatives, with relevant legislation to be introduced by the end of 2012.³⁷³

b. Clearing Requirements

In considering implementation of a clearing requirement for OTC derivatives, Singapore is taking into account systemic risk to the local market and the degree of standardization in the

³⁷⁰ FSB October 2011 Report, Table 5.

³⁷¹ Hong Kong Consultation at p.32.

³⁷² *Id.* at p. 4.

³⁷³ FSB October 2011 Report, Table 1.

local market.³⁷⁴ As explained above, Singapore intends to pass legislative amendments to require mandatory clearing of such derivatives by the end of 2012.³⁷⁵

c. Reporting Requirements

MAS intends to publish a public consultation on reporting to TRs in the near future, and to introduce legislation by the end of 2012.³⁷⁶

d. Execution Requirements

i. Execution Mandate

MAS intends to publish a public consultation on trading requirements for OTC derivatives in the near future, and legislation is to be introduced by the end of 2012.³⁷⁷

5. Australia

a. Types of OTC Derivatives

The Australian Council of Financial Regulators (“ACFR”) issued a discussion paper in June 2011 on issues surrounding the central clearing of OTC derivatives.³⁷⁸ The Australia Discussion Paper examines the range of instruments in the Australian OTC derivatives markets, with FX and interest rate derivatives being the most actively traded by domestic market

³⁷⁴ *Id.* at Table 6.

³⁷⁵ *Id.* at Table 1; *see also* November 2010 FSB October 2011 Report at p. 15. The MAS currently regulates the Singapore Exchange Derivatives Clearing Limited (“SGX-DC”), which uses its AsiaClear system to clear OTC derivatives. SGX-DC clears OTC commodity derivatives and recently has expanded to OTC financial derivatives. This clearing activity currently is voluntary.

³⁷⁶ FSB October 2011 Report, Table 5.

³⁷⁷ *Id.* at Table 3.

³⁷⁸ Central Clearing of OTC Derivatives in Australia (Discussion Paper, June 2011) (“Australia Discussion Paper”), available at <http://www.rba.gov.au/publications/consultations/201106-otc-derivatives/pdf/201106-otc-derivatives.pdf>. ACFR membership includes senior representatives of the Australian Prudential Regulation Authority (“APRA”), Australian Securities and Investment Commission (“ASIC”), Reserve Bank of Australia, and Treasury of Australia.

participants.³⁷⁹ The ACFR requested comment on a range of issues and has not set forth a detailed proposal.

b. Types of Market Participants

i. Registration Requirements

Under the Corporations Act of 2011, firms or persons that carry out financial services in Australia are required to have an ASIC-issued Australian Financial Services License (“AFSL”) that authorizes the firm or person to deal in derivatives.³⁸⁰ If ASIC considers an overseas financial services provider to be subject to equivalent regulation in its home jurisdiction, that financial services provider is exempt from the requirement to hold an AFSL.³⁸¹

In order to receive and maintain an AFSL, entities need to demonstrate that they satisfy certain business conduct, governance, risk control, and financial requirements.³⁸² The specific requirements will depend on the scale of an entity’s business and the type of counterparties with whom it is dealing.³⁸³ Higher requirements typically will apply where an entity’s business is more complex or its counterparties are less sophisticated.³⁸⁴

ii. Prudential and other Risk-Related Requirements

The AFSL licensing regime requires that an AFSL holder entering into (both on- and off-exchange) derivatives transactions as a principal must meet minimum financial requirements imposed by ASIC.³⁸⁵ Banks undertaking on- and off-exchange derivatives transactions in Australia are regulated by APRA, which intends to implement Basel III requirements related to

³⁷⁹ FSB October 2011 Report, Table 1; Australia Discussion Paper at p. 1.

³⁸⁰ *Id.* at p. 42.

³⁸¹ *Id.*

³⁸² *Id.*

³⁸³ *Id.*

³⁸⁴ *Id.*

³⁸⁵ *Id.* at p. 43.

counterparty credit risk that would include higher capital charges for non-centrally cleared OTC derivatives.³⁸⁶

iii. Business Conduct Requirements

AFSL holders must conduct their business in such a way to ensure that markets remain “fair, orderly and transparent”.³⁸⁷ The AFSL holder also must have arrangements in place to handle conflicts between its commercial interests and the requirement to maintain a fair, orderly, and transparent market.³⁸⁸ It also must monitor and enforce compliance with the market’s operating rules and have sufficient resources (*i.e.*, financial, technological, and human resources) to operate the market properly.³⁸⁹ In addition, the AFSL holder is prohibited from engaging in activity that is misleading or deceptive.³⁹⁰ Finally, it must provide the ASIC with an annual report detailing the extent to which it complied, over the previous year, with its obligations under Australian law.³⁹¹

Client funds must be kept in client money accounts that cannot be used to meet other clients’ obligations.³⁹² AFSL holders may make payment out of a client money account if the client has provided the AFSL holder with written authorization for the transaction.³⁹³ If the AFSL holder becomes insolvent, its clients are entitled to the funds in the client money accounts

³⁸⁶ Australia Survey Response to FSB Implementation Monitoring Network (September 2011), available at http://www.financialstabilityboard.org/publications/r_111104b.pdf.

³⁸⁷ Corporations Act, Article 792A (2001), available at http://www.austlii.edu.au/au/legis/cth/consol_act/ca2001172/.

³⁸⁸ *Id.*

³⁸⁹ *Id.*

³⁹⁰ *See* Corporations Act, Section 1041H; Australian Securities and Investments Commission Act, Section 12DA (2001), available at http://www.austlii.edu.au/au/legis/cth/consol_act/asaica2001529/.

³⁹¹ Corporations Act, Section 792F.

³⁹² Handling and Use of Client Money in Relation to Over-the-Counter Derivatives Transactions (Discussion Paper, November 2011), p. 2, available at http://www.treasury.gov.au/documents/2231/PDF/DP_Client_Monies_OTC.pdf.

³⁹³ *Id.* at p. 5.

in priority over other creditors.³⁹⁴ The Australian government is soliciting comments through a consultation paper to review whether current client money account provisions provide adequate protection for investors.³⁹⁵

c. Clearing Requirements

i. Clearing Mandate

Australia currently does not require OTC derivatives to be centrally cleared and has not yet proposed legislation mandating central clearing of OTC derivatives.³⁹⁶ Australia has indicated that it is likely to harmonize its clearing requirements with those of other major jurisdictions,³⁹⁷ and is considering the requirement that Australian dollar-denominated interest rate derivatives be centrally cleared domestically.³⁹⁸

As discussed above, the Australia Discussion Paper addresses issues surrounding the central clearing of OTC derivatives. The ACFR anticipates that this paper will facilitate the development of a formal regulatory framework on the issue of central clearing.³⁹⁹ The Australia Discussion Paper raised the possibility that Australian dollar-denominated IRS be centrally cleared through an Australian-domiciled CCP. The ACFR currently is developing recommendations for consideration by the Australian government.

³⁹⁴ *Id.* at p. 8.

³⁹⁵ *Id.* at pp. 16-18.

³⁹⁶ Australia Discussion Paper at p. 2; *see also* FSB October 2011 Report, Table 2 (“TBD” whether legal requirements will be in force by the end of 2012 to require all standardized OTC derivatives to be cleared through CCPs).

³⁹⁷ FSB October 2011 Report, Table 6 (“*e.g.*, exemption of some classes of FX derivatives likely”; “coverage of credit and equity classes under review”; “likely that smaller financial entities would be exempt”).

³⁹⁸ Australia Discussion Paper at p. 3.

³⁹⁹ *Id.* at p. 1.

d. Reporting Requirements

i. Reporting Mandate

Australia expects to consult with industry participants and to consider what types of reporting requirements to implement for OTC derivatives.⁴⁰⁰ Australia expects to have regulations in place to require mandatory reporting of OTC derivatives data to TRs by the end of 2012.⁴⁰¹

e. Execution Requirements

i. Execution Mandate

Review of a market licensing regime for electronic trading platforms and exchanges is under way.⁴⁰² Currently Australia does not require OTC derivatives to be traded on an exchange or electronic trading platform.

6. Republic of Korea

The Financial Investment Services and Capital Markets Act (“FSCMA”) came into effect in February 2009 and includes OTC derivatives within its scope.⁴⁰³ As explained below, Korean regulators took an initial step by proposing an amendment to the FSCMA that would provide for the clearing of OTC derivatives.

a. Types of OTC Derivatives

The KFSS said the FSCMA defines the term “derivative” to include IRS and other swap contracts.⁴⁰⁴ The FSCMA defines the term “over-the-counter derivatives” to mean derivatives

⁴⁰⁰ FSB October 2011 Report, Table 5.

⁴⁰¹ *Id.* (Australia will review at end-2011 whether it is still on track to meet this requirement).

⁴⁰² *Id.* at Table 3.

⁴⁰³ KFSS Submission at p. 1.

⁴⁰⁴ *Id.* at p. 1 (quoting FSCMA Article 5-1-iii). Any type of counterparty may enter into a swap, but an ordinary investor may enter into a swap only for the purpose of hedging risk associated with the investor’s assets or debt. The term “ordinary investor” includes those without a sophisticated knowledge of derivatives and means an investor other than a professional investor. *Id.* at pp. 1-2. When financial

that are not exchange-traded derivatives.⁴⁰⁵ The Financial Services Commission (“KFSC”) and KFSS may determine the scope of regulated derivatives.⁴⁰⁶ In addition, when dealers sell a new “exotic” derivative, they must submit documents to the KFSS that explain the details of the new product.⁴⁰⁷

b. Types of Market Participants

i. Registration Requirements

Entities engaging in financial investment business must obtain authorization or registration from the regulators under the FSCMA.⁴⁰⁸ Such entities must satisfy several requirements, such as those related to capital, a feasible and sound business plan, human resources, information technology facilities, sound governance, and mechanisms to prevent conflicts of interest.⁴⁰⁹

The FSCMA applies to every OTC derivatives transaction that involves a domestic counterparty.⁴¹⁰ Therefore, although certain exceptions may apply, a foreign financial investment business entity intending to enter into such a transaction with a domestic client generally must register with Korea’s financial regulators.⁴¹¹

investment companies sell a new OTC derivative to ordinary investors, they must undergo prior review by the Korea Financial Investment Association (“KFIA”). *Id.* at p. 2 (quoting FSCMA Article 166(2)-1-i).

⁴⁰⁵ FSCMA Article 5(3), available at <http://www.fsc.go.kr/downManager?bbsid=BBS0085&no=78267>.

⁴⁰⁶ KFSS Submission at p. 2 (explaining that the KFSC formulates financial policies and supervises financial markets, and the KFSS primarily examines and supervises financial services firms).

⁴⁰⁷ *Id.* at p. 6.

⁴⁰⁸ FSCMA Article 12.

⁴⁰⁹ KFSS Submission at p. 4.

⁴¹⁰ *Id.* at p. 3.

⁴¹¹ *Id.* at pp. 3-4 (quoting FSCMA Enforcement Decree Article 7 on the Exclusion of Financial Investment Business from Application, available at <http://www.fsc.go.kr/downManager?bbsid=BBS0085&no=78276>).

ii. Prudential and other Risk-Related Requirements

The Korean government adopted the Basel II capital framework in January 2008.⁴¹²

iii. Business Conduct Requirements

Entities engaging in financial investment business must comply with the principle of suitability and must inform their customers of the details of a financial investment product and other relevant information pursuant to the FSCMA.⁴¹³ After an OTC derivatives transaction is executed, the entity must inform the counterparty of the value of the contract on a monthly or quarterly basis.⁴¹⁴ In addition, the entity is required to examine and assess the likelihood of conflicts of interest and, if unable to reduce the likelihood to a reasonable level, must not enter into the transaction.⁴¹⁵

c. Clearing Requirements

i. Clearing Mandate

Although Korea has no specific regulation on clearing swaps through a CCP, the KFSS noted that the Korean regulators proposed amendments to the FSCMA to create a legal basis for the creation of a CCP in Korea and then to determine which swaps will be required to be cleared through a CCP.⁴¹⁶ The Korean government anticipates that, by the end of 2012, legislation will

⁴¹² FSB Monitoring Progress – Korea (September 2011), available at http://www.financialstabilityboard.org/publications/r_111104m.pdf.

⁴¹³ KFSS Submission at pp. 4-5 (noting that the KFIA also has formulated its own business conduct rules and procedures, and quoting FSCMA Article 46 on the Principle of Suitability, etc., and Article 47 on the Duty to Explain).

⁴¹⁴ *Id.* at p. 5.

⁴¹⁵ *Id.*

⁴¹⁶ *Id.* at p. 3; *see also* Revision Bill of the Financial Investment Services and Capital Market Act (KFSC Press Release, July 26, 2011) at pp. 2-4, available at <http://www.fsc.go.kr/downManager?bbsid=BBS0085&no=78276>. The press release states that OTC derivatives transactions that can significantly affect markets if defaulted will be mandatorily cleared through clearinghouses.

be in place mandating the centralized clearing of OTC derivatives.⁴¹⁷ Following this, regulations would need to be passed, followed by the establishment and pilot-testing of a domestic CCP.⁴¹⁸

ii. Registration Requirements for CCPs

As described above, Korea plans to establish a framework for authorizing a CCP to clear OTC derivatives.⁴¹⁹

d. Reporting Requirements

i. Reporting Mandate

Entities engaging in financial investment business are required to report OTC derivatives transaction data to the KFSS on a monthly basis.⁴²⁰ This reporting requirement includes trading volumes and outstanding notional amounts by type of underlying asset, *i.e.*, interest rate, currency, equity, credit, commodity, etc.⁴²¹

ii. Registration Requirements for Repositories

Korea does not have authorization requirements for repositories and instead, as explained above, requires reporting directly to the KFSS.⁴²²

e. Execution Requirements

i. Execution Mandate

Korea does not have organized markets or electronic execution facilities for OTC derivatives, and does not require trading of OTC derivatives on organized markets or electronic

⁴¹⁷ FSB October 2011 Report, Table 2.

⁴¹⁸ *Id.*

⁴¹⁹ KFSS Submission at pp. 3, 6.

⁴²⁰ *Id.* at pp. 3 and 6; *see also* FSB October 2011 Report, Table 5 (plan to enhance some parts of the reporting system).

⁴²¹ KFSS Submission at pp. 3, 6.

⁴²² *Id.* at p. 6.

trading platforms.⁴²³ Currently a review of policy options is under way.⁴²⁴ The Korean government is exploring trading requirements and is considering multi-dealer functionality of markets.⁴²⁵

III. Regulatory Comparison

Major OTC derivatives jurisdictions have coalesced around a unified set of goals with the G-20 Leaders' committing to central clearing, trading on exchanges and electronic trading platforms, reporting to TRs, standardization, and capital requirements. However, differences in the details among regulatory frameworks and in the timing of regulatory initiatives have raised concerns. This Study found similarities and differences among jurisdictions with respect to regulation of market participants, clearing, reporting, and trading of OTC derivatives. However, among the jurisdictions with major OTC derivatives markets, only the United States and Japan have adopted recent legislation in this area, although the European Union is nearing adoption of such legislation.⁴²⁶ In addition, a few jurisdictions require some reporting of OTC derivatives transactions, and several jurisdictions have released consultations related to the regulation of OTC derivatives. This section of the Report sets forth potential issues for further monitoring,⁴²⁷ summarizes commenters' views on harmonization among various regimes, and describes the Commissions' efforts to fulfill the DFA's mandate to work toward developing consistent international standards in the regulation of Swaps.

⁴²³ *Id.*

⁴²⁴ FSB October 2011 Report, Table 3.

⁴²⁵ *Id.* at Table 4.

⁴²⁶ See FSB October 2011 Report at p. 21 ("The European Union and United States, the jurisdictions with authority over the largest and most developed OTC derivatives markets, are well into the process of establishing legislative and regulatory frameworks. Many jurisdictions have indicated that final decisions on domestic legislative frameworks will look to the international baseline established once EU and US legislation and implementing regulations are in place and international standards are finalized.").

⁴²⁷ For further information, see the tables in Appendix I below.

A. Open Issues

1. Market Participant Issues

Registration and Regulation. The DFA created four new categories of market participants and generally requires registration of market participants that fall within the definitions of the terms SD, SBSB, MSP, and MSBSP. The DFA also requires compliance with detailed regulatory requirements for these registrants. Pursuant to the DFA, the CFTC and SEC have released proposed or final regulations that further define these terms, set forth registration requirements, and establish compliance requirements. No other jurisdiction has yet proposed to similarly register and regulate entities as a result of the types of activities that require registration pursuant to the DFA. However, entities engaged in similar OTC derivatives activity may be otherwise regulated in their respective jurisdictions under existing law.

Prudential and other Risk Related Requirements. The DFA includes requirements related to capital, margin, risk management, segregation, and liquidity. Swaps Entities will be required to comply with minimum capital and minimum initial and variation margin requirements. The CFTC has proposed regulations in this area, and the SEC plans to propose regulations in 2012. Other jurisdictions are proposing their own regulations in this area, incorporating elements of Basel II or III. However, participants in the OTC derivatives markets will need to monitor the minimum required capital requirements that are ultimately adopted by each jurisdiction, as well as the scope of entities that are captured by these requirements, in order to determine the amount of capital they are required to hold. Given the importance of margin requirements to the overall reform of the derivatives markets and the current lack of uniform treatment of margin across jurisdictions, authorities are working together to establish consistent standards for margin for non-centrally cleared OTC derivatives transactions, with a draft consultation paper expected by June 2012.

Banks and Their Branches. The DFA includes the Push-Out Rule, which substantially limits non-hedging use of Swaps by depository institutions, and the Volcker Rule, which significantly limits the ability of banking entities to engage in proprietary trading, other than for hedging and other specified exceptions. Foreign regulators, other than in the United Kingdom, have not proposed rules similar to the Push-Out and Volcker Rules.⁴²⁸

2. Clearing Issues

The United States, European Union, and Japan will require certain OTC derivatives to be cleared through a CCP.⁴²⁹ However, this Study has identified some differences with respect to requirements for mandatory clearing, segregation and portability, CCP ownership and governance, and CCP location.⁴³⁰

Clearing Requirement. The scope of transactions potentially subject to mandatory clearing may differ between the United States and the European Union. The U.S. Treasury has proposed an exemption from DFA clearing and trading requirements for FX swaps and forwards (although such transactions would remain subject to reporting and other requirements). The EMIR proposal does not provide an explicit exemption for FX, but instead proposes that ESMA would have the authority to exempt FX transactions from the clearing requirement. In addition, EMIR likely will include exemptions for intra-group trades and central bank transactions, and a

⁴²⁸ The United Kingdom recently has suggested imposing limits on trading and OTC derivatives activities of ring-fenced retail banking entities, although not on members of the same corporate group as such entities. Independent Commission on Banking, Final Report, Recommendations, p. 51, available at <http://bankingcommission.s3.amazonaws.com/wp-content/uploads/2010/07/ICB-Final-Report.pdf>.

⁴²⁹ See FSB October 2011 Report at p. 1 (“Some jurisdictions have indicated that they are waiting for the US and EU regulatory frameworks to be finalised before acting. Consistency in implementation across jurisdictions is critical, and it is understandable that small markets want to see what frameworks the United States and European Union put in place when developing their own frameworks.”); see also *id.* at p. 8 (“the pace at which various jurisdictions are implementing central clearing mandates and actual levels of central clearing currently seen do not support a conclusion that progress is on track to fully meet the G-20 commitment, which calls for central clearing of *all* standardised OTC derivatives by end-2012”) and JFSA Presentation.

⁴³⁰ See also FSB October 2011 Report at pp. 14-18.

temporary exemption for pension funds.⁴³¹

End-Users. Both U.S. and EU legislation include a carve-out for end users that use OTC derivatives to hedge risk. The DFA provides non-financial entities that use Swaps to hedge their commercial risks with an exception from the clearing requirement, subject to certain conditions. In addition, the CFTC and SEC are required to consider whether certain small financial institutions (with assets of \$10 billion or less) may be permitted to use the end-user exception. In the European Union, EMIR, as currently proposed, would establish a clearing threshold under which a non-financial entity would not be required to clear its OTC derivatives transactions. However, until ESMA sets this threshold, it is not possible to assess whether the scope of relief is consistent with the DFA.

Segregation of Client Collateral at CCPs. In the United States, the CFTC has adopted a segregation model that provides for legal segregation with operational commingling for collateral related to cleared swaps. Under this model, FCMs and DCOs would be permitted to operationally commingle collateral but to account for such collateral individually. The SEC has not published a proposal addressing segregation of client assets at CCPs. As currently proposed, the EU Council version of EMIR requires a CCP to offer customers of clearing members a choice between individual client segregation and omnibus client segregation for both listed and OTC swaps. However the EP version of EMIR requires full segregation of customer assets by the CCP unless the client requests its funds to be held in an omnibus account. Until EMIR is finalized and ESMA provides technical standards, an assessment on consistency cannot be provided.

CCP Location. Neither the DFA nor current versions of EMIR would require OTC derivatives to be cleared in CCPs located in any particular jurisdiction. However, Japanese law

⁴³¹ See *id.* at p. 16.

requires certain OTC derivatives on Japanese underlying assets to be cleared on a CCP located in Japan. This locational requirement will be further specified through Cabinet Ordinance.

CCP Recognition. The DFA provides that the CFTC and the SEC may grant a conditional or unconditional exemption from registration for a CCP that is subject to “comparable, comprehensive supervision and regulation” by appropriate government authorities in its home country. The CFTC has not yet determined whether or the extent to which it may use this authority. Because foreign jurisdictions, such as the European Union, are still in the process of establishing their own legislative approaches to derivatives clearing and have not yet moved forward on regulations adopting such legislative approaches, and because the SEC has not yet completed its rulemaking process, the SEC would, for some time, not be in a position to perform a comparability assessment regarding clearing agency regulation. In the European Union, ESMA and the EC will be responsible for recognizing third-country CCPs. The recognition will require that the EC ascertain the legal and supervisory framework of that third country as equivalent to the EU framework, that the CCP is authorized and subject to effective supervision in that third country, and that ESMA has established cooperation arrangements with the third-country competent authorities. In Japan, the FIEA allows foreign CCPs to obtain a license, but a foreign CCP may provide clearing services in Japan without obtaining a license if it has an approved interoperability arrangement with a Japanese CCP.

3. Reporting Issues⁴³²

Reporting Requirement. Reporting to TRs will be required for all Swaps transactions under the DFA and for all derivatives transactions under EMIR, as proposed. The United States and the European Union are prescribing data elements that need to be reported and timeframes

⁴³² *See id.* at p. 2 (“there are a number of implementation issues that need to be resolved around ensuring the suitability of the data collected in TRs for meeting different regulatory mandates (including financial stability) and authorities’ effective access to data stored in TRs relevant to their respective mandates”); *see also id.* at pp. 18-19.

within which data needs to be reported. These requirements should be monitored to evaluate potential differences in required reporting elements (extent and format) and in the timing of reporting, with DFA requiring real-time reporting, EMIR requiring reporting of uncleared and OTC cleared trades to the TR no later than the working day after the transaction takes place, and MiFIR requiring reporting of trades taking place on exchanges as quickly as possible and no later than the close of the following business day.

Regulatory Access to Data. The DFA requires that foreign authorities provide a written agreement to indemnify a Swaps data repository and the CFTC or SEC, as applicable, for any litigation expenses as a condition to obtaining Swaps data maintained by the Swaps data repository. This requirement has caused concern among foreign regulators, some of which have expressed unwillingness to register or recognize an SDR unless able to have direct access to necessary information. Some regulators also are considering the imposition of a similar requirement that would restrict the CFTC's and SEC's access to information at TRs abroad. The CFTC and SEC are working to develop solutions that provide access to foreign regulators in a manner consistent with the DFA and to ensure access to foreign-based information. Congress may determine that a legislative amendment to the indemnification provision is appropriate.

Public Dissemination. The United States requires, and the European Union has proposed, transparency and public disclosure of data. However, it is likely that there will be significant differences in the timing of the dissemination of data, as well as in the nature of the data released. The DFA and MiFIR require real-time public reporting of transactional data, with the possibility of exemptions for large notional transactions (block trades), whereas EMIR, as currently proposed, requires weekly publication of aggregate data.

4. Execution Issues

Execution Requirement. The DFA requires that any swap subject to the clearing

requirement must be executed on a DCM or SEF and any security-based swap must be executed on a securities exchange or SBSEF, unless no such venue makes the swap or security-based swap available for trading. As noted above, EMIR does not include an execution requirement. The EC has proposed in MiFIR that ESMA assess and decide when an OTC derivatives contract that is eligible for clearing is sufficiently liquid to be traded exclusively on the various organized venues (a regulated market, MTF, or OTF). Under this model, there could be a class of clearing-eligible contracts in the European Union that will not be required to be traded on an organized venue. Additionally, given where MiFIR is in the adoption process, there also is likely to be a timing gap between DFA implementation and MiFIR implementation. Japan published a draft regulatory framework requiring certain OTC derivatives to be executed on electronic trading platforms.⁴³³

Issues Related to Trading Venues. The DFA defines SEFs and SBSEFs as entities that provide the ability for multiple participants to execute or trade Swaps by accepting bids and offers made by multiple participants in the facility or system. Therefore, the CFTC and SEC have proposed regulations that would not permit single-dealer platforms to be registered as SEFs or SBSEFs. As currently contemplated, OTFs are similar systems where multiple third-party buying and selling interests interact, and the execution of client orders against the proprietary capital of the OTF operator is not permitted. In addition, MiFIR would subject OTFs to pre-trade and post-trade transparency requirements. OTFs, however, could exercise discretion in processing the trades (*i.e.*, the OTFs do not need to execute the transactions according to predetermined rules). In contrast, U.S. requirements provide for execution pursuant to predetermined rules.

⁴³³ See Japan Review Panel at p. 1; *but see* FSB October 2011 Report at p. 1 (“The establishment of legislative and regulatory frameworks to implement the commitment to trading standardised derivatives on exchanges and electronic platforms, where appropriate, is markedly behind the progress made toward other commitments.”); *see also id.* at pp. 9-10, 18.

B. Harmonization Efforts

Many of the 33 commenters that filed public submissions took into account the differences and similarities in regulatory approaches for the OTC derivatives market and provided their views on various aspects of harmonization.

Consistency vs. Market-Specific Regulation. The Request for Comment asked, “[i]n viewing the existing laws, institutions, and enforcement mechanisms of each respective jurisdiction as a whole, are ... similarities and differences appropriate and desirable for regulatory purposes, or do certain aspects of a particular jurisdiction’s Swap market warrant a different regulatory approach?”⁴³⁴ Many of those commenting on this issue supported consistency in regulation.⁴³⁵ Some acknowledged that full harmonization would be difficult to achieve, if desirable at all, but said decisions on equivalency of similar regimes could resolve minor inconsistencies once sufficiently convergent frameworks were adopted.⁴³⁶

Some commenters pointed out that the use of OTC derivatives contracts, the methods of OTC trading, and the overall business structures of market participants are very similar among the G-20 countries and, therefore, there is little need for specific tailoring of requirements to specific aspects of the domestic regime.⁴³⁷ More specifically, the vast majority of cross-border business occurs among the United States, Europe, and Japan, each of which has broadly the same regulatory concerns.⁴³⁸

⁴³⁴ Request for Comment at p. 44511.

⁴³⁵ See, e.g., ISDA Submission at 12; AIMA Submission at 2.

⁴³⁶ See, e.g., AIMA Submission at p. 9.

⁴³⁷ *Id.* at 11.

⁴³⁸ *Id.*

On the other hand, some commenters supported variation among individual regimes in order to take into account market differences.⁴³⁹ Also, some commenters stated that there may be important differences in banking, custody, and insolvency law across jurisdictions, which require development of varied customer solutions at clearinghouses, such as requirements on customer asset protection, in order to provide the optimal level of protection.⁴⁴⁰ Some said regulators should be flexible when confronted with differences in non-domestic financial, legal, and regulatory infrastructures.⁴⁴¹ Moreover, some degree of regulatory flexibility will encourage various trading venues and clearinghouses to develop superior solutions that are responsive to customer demand.⁴⁴²

Costs of Inconsistency and Benefits of Consistency. The Request for Comment inquired about “the potential costs and benefits (in terms of investor protection, market efficiency, competition, or other factors) that may arise from further consistency/harmonization of regulations across borders”.⁴⁴³ Some commenters stated that, because the regulation of OTC derivatives markets was in a state of flux, it would be difficult to assess the costs and benefits of new requirements or of harmonization with accuracy.⁴⁴⁴

Commenters provided input on both the costs of inconsistent requirements and the benefits of consistent requirements. Comments on the consequences of inconsistent requirements include:

- Increase in costs to market participants who seek to manage risks through OTC derivatives;

⁴³⁹ See, e.g., Eurex Submission at 7.

⁴⁴⁰ *Id.*

⁴⁴¹ *Id.*

⁴⁴² *Id.*

⁴⁴³ Request for Comment at p. 44511.

⁴⁴⁴ See, e.g., ISDA Submission at p. 12.

- Increased burdens for entities subject to supervision and inspection by multiple regulators, especially if regulators are imposing different requirements;
- Reduction of cross-border business, customer choice, and competition;
- Distortions in competition because market participants will select their counterparties on the basis of regulatory rather than economic factors; and
- New inefficiencies and risks to financial stability because firms will have more difficulty in integrating risk management and more fragmented markets will make regulatory oversight more difficult.⁴⁴⁵

Comments on the benefits of consistent requirements include:

- Creating a level playing field among jurisdictions and avoiding regulatory arbitrage and a “race to the bottom”;
- Reducing the burden on entities seeking to comply with different regimes and allowing for the implementation of common monitoring and compliance solutions;
- Coordinated monitoring and mitigation of systemic risks;
- Permitting benefits of enhanced efficiencies to be passed on to investors, including institutional investors such as pension funds; and
- Enabling regulators of one jurisdiction to recognize the regime of another jurisdiction as being equivalent.⁴⁴⁶

However, convergence also may bring with it additional costs or negative consequences where, in the interests of finding a convergent position, policymakers agree to a position which is suboptimal or even disruptive for the markets.⁴⁴⁷

Measurement of Consistency. The Request for Comment asked how consistency in regulation across jurisdictions should be measured and whether there are factors other than regulatory text that should be taken into consideration in assessing the degree to which cross-border regulatory harmonization has been implemented in practice.⁴⁴⁸ One commenter stated that harmonization should not be measured simply in terms of similar texts.⁴⁴⁹ The commenter went on to state that regulatory harmonization also should be measured by compatibility, *i.e.*,

⁴⁴⁵ *Id.*, at 12-13.

⁴⁴⁶ *See, e.g.*, AIMA Submission at p. 6.

⁴⁴⁷ AIMA Submission at p. 10.

⁴⁴⁸ Request for Comment at p. 44511.

⁴⁴⁹ ISDA Submission at p. 13.

whether regulations allow cross-border transactions and international competition among dealers to continue in an economically meaningful way.⁴⁵⁰

In addition to textual similarity, the commenter stated that other factors that could enhance harmonization include:

- *Recognition/Exemption of Entities Regulated by Other Jurisdictions:* There should be mutual recognition between jurisdictions and/or exemptions granted to cross-border entities.⁴⁵¹
- *Consistency and Non-Duplicative Reporting:* The same transactions should not have to be reported twice. Internationally compatible reporting systems should be used for cross-border trades.
- *Similarity in Implementation and Regulatory Approach:* Even if regulatory requirements are similar, they could have different outcomes because of differences in implementation and supervisory approach.⁴⁵² This should be avoided.
- *Avoiding Excessive Costs:* There are additional costs and burdens for firms that are subject to supervision and inspection by multiple regulators. Also, if different technical standards are required in different jurisdictions, costs potentially will be significant.
- *Minimizing the Impact of Timing Differences:* Differences in the timing of regulatory implementation among jurisdictions could lead to regulatory arbitrage. If such timing gaps are significant, they could affect the balance of competition.⁴⁵³

Another commenter stated that reaching truly harmonized legislation is likely to be nearly impossible and, therefore, it would be difficult to measure exactly the extent to which two regulatory frameworks are consistent.⁴⁵⁴ The commenter proposed that consistency could be judged by examining the effect of the legislation and comparing the outcomes, or by determining

⁴⁵⁰ *Id.*

⁴⁵¹ For example, CCPs and execution facilities that are registered outside the United States should be recognized as eligible for clearing and executing transactions without requiring registration in the United States, and non-U.S. regulators also should recognize U.S.-registered entities. Similarly, U.S. regulators should recognize dealers that are registered outside the United States and that meet relevant prudential requirements without requiring U.S. registration, and non-U.S. regulators should recognize U.S.-registered dealers. *Id.*

⁴⁵² For example, margin regulations that are similar could lead to different results if different standards are implemented for the models that calculate initial margin or if some supervisors take a principles-based approach while others are more specific in their requirements. *Id.*

⁴⁵³ *Id.*

⁴⁵⁴ AIMA Submission at p. 10.

whether the frameworks in question comply with international standards or principles. Another measure could be whether standardized industry documentation can be produced to cover the scope of the regimes' requirements.⁴⁵⁵

Legislative Harmonization. The Request for Comment inquired what steps should or could be taken to better harmonize DFA statutory requirements with statutory requirements implemented in other jurisdictions.⁴⁵⁶ Commenters encouraged the CFTC and SEC to engage in constructive dialogue with policymakers and regulators at all levels in other key jurisdictions in order both to encourage them to align their requirements with those in the United States and to reach agreement over where U.S. regulations may be adapted to meet sensible positions adopted elsewhere.⁴⁵⁷

Regulatory Harmonization. The Request for Comment also asked “what steps could be taken to harmonize CFTC or SEC regulations with regulations promulgated by authorities in other jurisdictions”.⁴⁵⁸ One commenter responded that the Commissions should conduct a thorough “gap analysis” of U.S. and other regimes, which could serve as a basis for dialogues with other jurisdictions about their requirements.⁴⁵⁹ According to this commenter, such dialogue must include both senior-level discussions on key decisions (*e.g.*, the timing of implementation) and technical-level discussions to reduce burdens on international firms and allow recognition of non-U.S. firms trading in the United States or with U.S. counterparties (or for U.S. investors).⁴⁶⁰

C. Recommendations

This Report provides a snapshot of current efforts to regulate OTC derivatives in the

⁴⁵⁵ *Id.*

⁴⁵⁶ Request for Comment at p. 44511.

⁴⁵⁷ *See, e.g.*, AIMA Submission at p. 13.

⁴⁵⁸ Request for Comment at p. 44511.

⁴⁵⁹ AIMA Submission at p. 11.

⁴⁶⁰ *Id.*

Americas, Europe, and Asia. It is a timely complement to ongoing efforts at the CFTC and the SEC to monitor similarities and, more importantly, differences among regulatory proposals. However, regulatory developments will continue for the foreseeable future, and the Commissions will continue to address issues arising from regulatory divergence.

As discussed above, DFA Section 752(a) – entitled International Harmonization – requires the CFTC and the SEC, as appropriate, to “consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards” for regulating Swaps and Swaps Entities to “promote effective and consistent global regulation”. The Commissions have been, and will continue to be, actively involved in several international initiatives and in various international fora that are focused on the regulation of OTC derivatives.

Consistent with the DFA’s mandate, the Commissions have directed staff to participate in international workstreams that are developing standards for OTC derivatives regulation, as well as in fora for additional consultation and coordination. These projects include work through CPSS, IOSCO, and the IOSCO Task Force, and participation in the ODWG and ODRF. For more information about the activities of each of these workstreams, see Appendix III to this Report.

In addition, CFTC and SEC staff has been engaged in a regulatory dialogue with the EC and ESMA concerning differences between Title VII and EMIR and MiFID/MiFIR. Senior officials have met in Brussels and in Washington, DC, and have held numerous conference calls to understand and resolve differences. Similar dialogues are under way with regulators from Japan, Hong Kong, Singapore, and Canada. Senior officials met on December 8, 2011, in Paris, to discuss cross-border regulation of OTC derivatives and continue to hold numerous conference calls to understand and resolve differences.

This Report provides the following recommendations for ongoing compliance with DFA

Section 752(a):

- CFTC and SEC staff should continue to monitor developments at the national level across jurisdictions and should communicate with fellow regulators involved in efforts to regulate OTC derivatives.
- CFTC and SEC staff should continue to participate in international fora and actively contribute to initiatives that are designed to develop and establish global standards for OTC derivatives regulation.
- CFTC and SEC staff should continue to engage in bilateral dialogues with regulatory staff in the European Union, Japan, Hong Kong, Singapore, and Canada and should consider dialogues with additional jurisdictions, as appropriate.

These recommendations provide a roadmap for successful consultation and coordination with non-U.S. authorities to promote effective and consistent international standards in the regulation of OTC derivatives.

IV. Conclusion

Regulation of OTC derivatives has just begun. These markets are in transition – and our efforts to regulate them are evolving. Consistent and comprehensive OTC derivatives regulatory reform is important to ensure global financial stability. The 2009 G-20 Leaders’ commitments that all standardized derivatives be cleared through CCPs and traded on exchanges or electronic trading platforms, where appropriate, by end-2012; that all OTC derivatives contracts be reported to TRs; and that non-centrally cleared trades be subject to higher capital requirements were the first global commitments regarding OTC derivatives regulatory reform. As described in this Report, progress varies across jurisdictions in meeting the 2009 G-20 Leaders’ commitments.

The G-20 leaders have agreed to the OTC derivatives commitments, but it is still too early to determine precisely where there is alignment internationally and where there may be gaps or inconsistencies. In the interim, the CFTC and SEC are working with other domestic and foreign regulators to analyze requirements and to coordinate regulatory proposals to the greatest

extent possible. The Commissions will continue to monitor global reforms and are committed to working closely with their international counterparts in this effort.

Appendix I

Swap Market Information

The BIS gathers and reports information on the size and structure of derivatives markets in major jurisdictions. It has estimated that, as of June 2011, the total notional value of outstanding OTC derivatives was \$708 trillion.⁴⁶¹

A. Major Dealers

DFA Section 719(c)(2) provides that this Report should include: “(A) identification of the major exchanges and their regulator in each geographic area for the trading of swaps and security-based swaps including a listing of the major contracts and their trading volumes and notional values as well as identification of the major swap dealers participating in such markets”.⁴⁶² However, as discussed above, no major jurisdiction in the Americas, Europe, or Asia to date has established and implemented a regime for identifying and regulating such dealers. Moreover, no major exchange in the Americas, Europe, or Asia currently provides for the trading of Swaps or other OTC derivatives by entities defined and regulated as dealers. Accordingly, this Report cannot identify “major swap dealers” participating in “major exchanges ... in each geographic area for the trading of swaps and security-based swaps”.

The DFA is the only law in a major jurisdiction to bring entities that deal in, or make a market in, OTC derivatives within comprehensive regulation with respect to those activities. As explained above, enactment of the DFA established a registration and compliance regime for persons falling within the statutory definitions of “swap dealer” or “security-based swap dealer”

⁴⁶¹ OTC Derivatives Market Activity in the First Half of 2011, BIS Monetary and Economic Department (November 2011), available at http://www.bis.org/publ/otc_hy1111.pdf; *see also* Semiannual OTC Derivatives Statistics at End-June 2011 (explaining gathering of information from G-10 countries and Switzerland), available at <http://www.bis.org/statistics/derstats.htm>.

⁴⁶² Emphasis added.

(as those definitions are further defined by the CFTC and the SEC).⁴⁶³ Such dealers are subject to specific enumerated requirements with respect to, *e.g.*, capital and margin, reporting and recordkeeping, business conduct, documentation, and employment of a chief compliance officer. However, as of this writing, the CFTC and SEC have not promulgated final regulations on further defining the dealer definitions. In addition, following adoption of final regulations regarding the dealer registration process, such process will be implemented over a period of time. Accordingly, it is not possible at this point to determine precisely which entities are “swap dealers” or “security-based swap dealers” under the DFA. Moreover, if CFTC or SEC staff attempted to identify certain entities as dealers, this Report could give the appearance of an official determination that such entities fell within the DFA’s statutory definitions.

Outside the United States, dealers may be subject to regulation covering financial market participants generally, and not specifically as dealers in Swaps or other OTC derivatives. Regulatory authority over entities dealing in these instruments may be vested in one or more authorities, *e.g.*, a financial regulator, a central bank, an agency with multinational responsibilities, an agency regulating commercial industries, or a combination of these. In many instances, as jurisdictions are examining the appropriate scope for regulating OTC derivatives, lines of responsibility are yet to be determined.

Large financial entities in the Americas, Europe, and Asia that deal or make markets in OTC derivatives currently cannot be identified as “major swap dealers” – either pursuant to the DFA or otherwise. Until other regulators have the statutory authority to define and regulate such entities as dealers in OTC derivatives, CFTC and SEC staff cannot definitively identify “major

⁴⁶³ As discussed above, the DFA requires the CFTC and the SEC to further define, in consultation with the Federal Reserve Board, the terms “swap dealer” and “security-based swap dealer.”

swap dealers” in each geographic area. For this reason, it would be premature to attempt to include a listing that purports to identify such dealers.

However, this Report notes that certain entities active within the U.S. OTC derivatives market have acknowledged that they are – generally – dealers.⁴⁶⁴ Moreover, observers of the market recognize that most of the total notional value is concentrated in and accounted for by a relatively small number of large firms. According to an ISDA survey, the fourteen most active international derivatives dealers (“G-14 Dealers”)⁴⁶⁵ reported a cumulative notional amount of \$383.8 trillion at the end of June 2010 after adjusting for double counting of inter-dealer transactions. This amount represented 82 percent of the total amount reported by survey respondents.⁴⁶⁶ ISDA found that the global nature of the market is such that the G-14 Dealers are based in five different countries, and only six are based in the United States.⁴⁶⁷

⁴⁶⁴ Further information about the OTC derivatives market will be provided in the semiannual and annual reports for the CFTC and SEC under CEA Section 2(a)(14) and Exchange Act Section 13(m)(2) to make available to the public information relating to the trading and clearing in the major Swap categories and the market participants and developments in new products.

⁴⁶⁵ Bank of America-Merrill Lynch, Barclays Capital, BNP Paribas, Citigroup, Credit Suisse, Deutsche Bank AG, Goldman Sachs & Co., HSBC, J.P. Morgan, Morgan Stanley, The Royal Bank of Scotland Group, Société Générale, UBS AG, and Wells Fargo Bank, N.A. The term “G-14” relates back to the convening by the New York Fed in September 2005 of 14 major market participants and their domestic and international supervisors to form the ODSG. The composition of the group of participants has varied somewhat over time (*e.g.*, original member Merrill Lynch & Co., Inc. was merged with Bank of America; Lehman Brothers, Inc. entered bankruptcy). See ODSG Meeting on Credit Derivatives, List of Attendees, Industry Participants (September 15, 2005), available at http://newyorkfed.org/newsevents/news_archive/markets/2005/an050915.html; ISDA Research Notes: Concentration of OTC Derivatives Among Major Dealers (Issue 4, 2010) (released October 25, 2010) (“Mid-Year 2010 Market Survey”), available at http://www.isda.org/researchnotes/pdf/ConcentrationRN_4-10.pdf; and Cross-Asset Class Roadmap, Commitment Letter at p. 3 (March 31, 2011), available at <http://newyorkfed.org/newsevents/news/markets/2011/SCL0331.pdf>.

⁴⁶⁶ See Mid-Year 2010 Market Survey; see also FSB October 2011 Report at p. 6 (“While G-14 dealers are understood to dominate trading in credit derivatives and interest rate derivatives for the four most-traded currencies, a broader group of market participants are understood to represent a greater proportion of trading volume in the commodity and foreign exchange derivatives asset classes, as well as interest rate derivatives in other currencies.”).

⁴⁶⁷ Mid-Year 2010 Market Survey at pp. 2, 5. ISDA does not identify the G-14 Dealers by jurisdiction.

B. Major Markets and Regulators

DFA Section 719(c)(2)(A) provides that this Report should include: “identification of the major exchanges and their regulator in each geographic area for the trading of swaps and security-based swaps including a listing of the major contracts and their trading volumes and notional values”⁴⁶⁸

As discussed in the Report, the trading of Swaps or other OTC derivatives is not currently required to occur on organized markets or execution facilities. However, since the enactment of the DFA, various entities have expressed an expectation to seek licenses as organized markets or execution facilities in order to provide venues for the trading of Swaps.⁴⁶⁹

With respect to regulators of exchanges trading Swaps, in the United States, the DFA provided the CFTC and SEC with oversight authority for organized markets and execution facilities on which Swaps trading may occur. As explained above, the DFA imposed clearing and trade execution requirements for Swaps, created a new type of regulated marketplace for counterparties to satisfy their trade execution requirement obligations, and established a comprehensive regulatory framework for such marketplaces. In other jurisdictions, the scope and makeup of relevant regulatory authority is being examined.⁴⁷⁰

Regarding the reference in DFA Section 719(c)(2) to the listing of major contracts and related trading data for exchanges trading Swaps, no exchange currently provides for the trading of Swaps and submissions received in response to the Request for Comment generally did not

⁴⁶⁸ Emphasis added.

⁴⁶⁹ The following entities publicly have expressed an expectation to establish and register as SEFs with the CFTC: BGC Partners, Inc.; Bloomberg L.P. (“Bloomberg”); FXall; GFI Group Inc.; ICAP North America Inc.; MarketAxess Corp.; Nodal Exchange, LLC; Phoenix Partners Group LP; Thomson Reuters; Tradeweb Markets LLC (“Tradeweb”); Tradition (North America) Inc.; Tullett Prebon Ltd.; and State Street. Many have filed comment letters in connection with proposed CFTC regulations for SEFs, which are available at: <http://comments.cftc.gov/PublicComments/CommentList.aspx?id=955>. Other entities have expressed an expectation to establish and register as SEFs during meetings with CFTC staff.

⁴⁷⁰ As discussed in the section on Brazil, that jurisdiction already provides a legal framework for the authorization of platforms for transacting OTC derivatives.

include related data. Lack of sufficient data notwithstanding, public sources do provide some information regarding Swaps trading in the global OTC derivatives market and related data regarding exchange-traded derivatives. As of December 2010, approximately 90% of derivatives contracts were transacted OTC.⁴⁷¹ While the number of OTC derivatives contracts that are executed on organized markets has grown since 2009, the bilateral portion of the market continues to dominate. These markets can be measured by notional turnover, notional outstanding, and number of contracts. When measured by either notional turnover or notional outstanding, interest rate derivatives are the largest category – representing approximately three-quarters of total derivatives notional outstanding and traded.⁴⁷²

BIS has estimated that total OTC derivatives outstanding as of December 2010 was \$601 trillion, of which 77.4% was interest rate derivatives, 9.6% was FX derivatives, 5% was credit derivatives, 0.9% was equity derivatives, 0.5% was commodity derivatives, and 6.6% was other or unknown.⁴⁷³

C. Major Clearinghouses and Regulators

DFA Section 719(c)(2) provides that this Report should include information on major clearinghouses and their regulators; the clearinghouses' major contracts, clearing volumes, notional values, and major clearing members; a description of methods of clearing swaps; and a description of various systems used for establishing margin. The clearinghouses described below serve as CCPs for credit default, interest rate, and energy swaps. Each of these clearinghouses intermediates swap contracts by becoming a buyer to every seller and *vice versa*. The clearinghouse establishes membership requirements for its direct members. These firms are

⁴⁷¹ BIS Quarterly Review September 2011 – Detailed Tables – Statistical Annex, A131-A136, available at http://www.bis.org/publ/qtrpdf/r_qt1109.htm.

⁴⁷² *Id.* at A131.

⁴⁷³ *Id.* at A131.

usually multinational financial institutions or subsidiaries thereof. A clearing member may submit a swap to the clearinghouse on behalf of its own account or on behalf of a customer. Using statistical risk models, the clearinghouse determines the amount of initial margin the clearing member must deposit with the clearinghouse so that there is sufficient collateral to support a swap position. A clearing member also may have to make daily payments as a result of any adverse marks-to-market of all open positions held by it. This is variously known as “variation margin” or “variation settlement.” In most clearinghouses, a clearing member also must contribute to a default fund that the clearinghouse can draw upon to remedy losses in the event of a clearing member default.

Americas			
United States			
	<p>CME Clearing (“CME”)⁴⁷⁴</p> <p><u>Regulators:</u></p> <p>As a registered DCO, CME’s clearing activities related to IRS, commodity-based swaps, and broad-based CDS index products are overseen by the CFTC.</p> <p>As a registered clearing agency (“CA”), CME’s clearing activities related to single-name CDS products⁴⁷⁵ and narrow-based CDS index products are overseen by the SEC.</p> <p><u>Swap Product Classes:</u></p> <ul style="list-style-type: none"> • IRS⁴⁷⁶ • CDS index and single-name products⁴⁷⁷ • Commodity-based Swaps <p><u>Clearing Volume & Outstanding Notional Values⁴⁷⁸:</u></p> <table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 50%; text-align: center;">Clearing Volume</td> <td style="width: 50%; text-align: center;">As of September 30, 2011</td> </tr> </table>	Clearing Volume	As of September 30, 2011
Clearing Volume	As of September 30, 2011		

⁴⁷⁴ Sources: CME Group submission (October 25, 2011); and CME website, available at: <http://www.cmegroup.com/trading/interest-rates/cleared-otc-interest-rate-swaps-overview.html>.

⁴⁷⁵ CME currently does not clear single-name CDS contracts but plans to begin clearing them in early FY 2012.

⁴⁷⁶ Source: Information from CME’s website, available at: <http://www.cmegroup.com/trading/interest-rates/cleared-otc-interest-rate-swaps-overview.html>.

⁴⁷⁷ Source: Information from CME’s website, available at: <http://www.cmegroup.com/trading/cds/index.html>.

⁴⁷⁸ Information on the volume of cleared agricultural commodity swaps is available on CME’s website at: [http://www.cmegroup.com/trading/otc/product-slate.html#sortKey=9&sortOrder=descending&SortType=number&FilterOn=//lcpcProductTO\[cpcproduct/product_group%20+%20'Agricultural'%20and%20cpcproduct/cleared_as%20+%20'Cleared%20Swaps'\]&PageStart=1&vertindex=0](http://www.cmegroup.com/trading/otc/product-slate.html#sortKey=9&sortOrder=descending&SortType=number&FilterOn=//lcpcProductTO[cpcproduct/product_group%20+%20'Agricultural'%20and%20cpcproduct/cleared_as%20+%20'Cleared%20Swaps']&PageStart=1&vertindex=0).

IRS	\$38.7 billion
CDS Indices	\$7.0 billion
Corn Calendar Swaps	215,683 contracts (as of December 7, 2011)
Soybean Calendar Swaps	3,317 contracts (as of December 7, 2011)
Fertilizer Swaps	120 contracts (as of December 7, 2011)
Wheat Calendar Swaps	6,235 contracts (as of December 7, 2011)
Outstanding Notional	
	As of September 30, 2011
IRS	\$34.2 billion
CDS Indices	\$5.9 billion
Corn Calendar, Soybean Calendar, Fertilizer, and Wheat Calendar Swaps	No information available.

Clearing Method: Generally, CME’s clearing model includes financial safeguards, daily margining, and position nettings. CME’s cleared products can be negotiated, executed, and submitted through multiple venues or clearing platforms, including Bloomberg, MarkitSERV, ClearPort, TradeWeb, CME’s Migration Utility, and other third party platforms.

Margining System:

IRS:

Initial margin is calculated according to the Standard Portfolio Analysis of Risk (“SPAN”) system, using a historical Value at Risk (“VaR”) model. CME regularly tests its margin methodology to determine whether market data requires it to be adjusted.

The margin methodology is based on a 99% confidence level of a five-day move using five years of historical data and utilizes appropriate yield curve scenarios to capture potential losses based on filtered historical simulations. All positions in each currency are valued under a series of cross-portfolio yield curve scenarios to estimate the highest forecast loss. CME continuously reviews the scenarios in light of

	<p>market conditions. Variation margin is calculated daily based on zero-coupon yield curves.</p> <p><u>CDS:</u></p> <p>Initial margin is calculated in a manner designed to capture the risks inherent to a CDS portfolio rather than individual CDS positions. The margining methodology takes into account various factors, including systemic risk, curve risk, spread convergence/divergence risk, sector risk, idiosyncratic risk, liquidity risk, and other characteristics that may be relevant should CME need to liquidate or hedge a clearing member’s portfolio following a default. The margin requirements are determined using a series of scenarios. Margin requirements are designed to cover a five-day move with a 99% confidence level.⁴⁷⁹</p> <p>For CDS clearing, CME requires members to post initial margin as collateral for any newly established positions, while all open positions are subject to minimum maintenance margin requirements. CME also computes a twice daily mark-to-market calculation in which members’ open positions are marked to current market prices and losses must be paid in cash. These intraday marks may result in additional margin collections (<i>i.e.</i>, variation margin requirements).⁴⁸⁰</p> <p>Agricultural Swaps:</p> <p>Margin calculated according to the SPAN system.</p> <p><u>Clearing Members:</u> 14 IRS clearing firms, 11 CDS clearing firms, and 64 agricultural swap clearing firms.⁴⁸¹</p>
	<p>ICE Clear Credit (“ICE”)⁴⁸²</p>
	<p><u>Regulators:</u> As a registered DCO, ICE’s clearing activities related to broad-based CDS index products are overseen by the CFTC.</p> <p>As a registered CA, ICE’s clearing activities related to narrow-based CDS index products and single-</p>

⁴⁷⁹ Source: CME Presentation on CMDX Clearing Trading Platform, available at: http://www.adsatis.com/docs/isdareview/cme_response.pdf.

⁴⁸⁰ *Id.*

⁴⁸¹ Lists of CME’s IRS, CDS, and agricultural swap clearing firms are available on CME’s website at: <http://www.cmegroup.com/trading/cds/files/cds-clearing-members.pdf>; <http://www.cmegroup.com/trading/interest-rates/files/Cleared-OTC-IRS-Clearing-Firm-Contacts.pdf>; and <http://www.cmegroup.com/tools-information/clearing-firms.html>.

⁴⁸² Sources: ICE submission (October 21, 2011); and ICE’s website, available at: https://www.theice.com/clear_credit.jhtml.

name CDS products are overseen by the SEC.

Swap Product Classes:

- CDS index and single-name products⁴⁸³

Clearing Volume & Outstanding Notional Values:

Clearing Volume	As of October 28, 2011
CDS Indices	\$429 billion
CDS Single-names	\$369 billion

Outstanding Notional	As of October 28, 2011
CDS Indices	\$13.1 trillion
CDS Single-names	\$1.2 trillion

Clearing Method: ICE serves as a CCP for CDS, both single name and index contracts, by establishing a daily settlement price for each CDS instrument. Clearing members must submit prices to the clearinghouse daily, and the clearinghouse conducts a daily auction process resulting in periodic trade executions between clearing members. This process determines daily settlement prices, which are validated by ICE's Chief Risk Officer and used for daily mark-to-market valuations.

Margining System: ICE's CDS risk management systems were developed internally based on a proprietary risk assessment methodology designed specifically for the CDS market. ICE's risk management framework uses its daily settlement pricing process to determine initial and variation margin requirements, guaranty fund requirements, and official daily settlement prices.⁴⁸⁴

- A) Daily Settlement Pricing: ICE establishes a daily settlement price for all cleared CDS instruments using a pricing process where clearing members are required to submit prices on a daily basis. ICE then conducts a daily auction process resulting in periodic trade executions between clearing members to ensure the prices submitted are appropriate. ICE uses these daily settlement prices to

⁴⁸³ A complete listing of CDS products is also available on ICE's website at: https://www.theice.com/clear_credit.jhtml.

⁴⁸⁴ Source: ICE CDS Clearing: Leading Risk Management Services for Credit Derivatives, available at: https://www.theice.com/publicdocs/globalmarketfacts/docs/factsheets/ICE_CDS_Fact_Sheet.pdf.

determine the initial margin, mark-to-market and variation margin calculations, and guaranty fund contributions.

- B) **Margin Requirements:** ICE’s initial margin requirements are set to cover five days of adverse price/credit spread movements for cleared portfolios with a confidence level of 99%. ICE’s initial margin methodology is a scenario-based framework that incorporates concepts and techniques used in Monte Carlo simulations. ICE’s margin model is designed to capture risks unique to CDS products, such as systematic risk (*i.e.*, spread dynamics), jump-to-default risk, liquidity risk, basis risk, and concentration risk. Using its dynamic margin model, ICE also may collect additional margin (*i.e.*, variation margin requirements) for significant fluctuations in the end-of-day market prices.
- C) **Guaranty Fund Requirements:** ICE also collects guaranty fund contributions for the mutualization of losses under extreme but plausible market scenarios. ICE’s total guaranty fund is sized to achieve protection against two clearing members entering a state of default and is designed to protect ICE from the extreme jump-to-default risk associated with large protection sellers. ICE’s guaranty fund model also is a scenario-based framework that incorporates concepts and techniques used in Monte Carlo simulations.

Clearing Members: 26 clearing firms.⁴⁸⁵

KCBT Clearing Corporation (“KCC”)⁴⁸⁶

Regulator: As a registered DCO, KCC’s clearing activities are overseen by the CFTC.

Swap Product Class: Wheat calendar swaps (“WCS”)

Clearing Method:

KCC performs daily mark-to-market valuations of swaps. The daily settlement price for a WCS contract month prior to the last month of trading for such contract is the daily settlement price of the corresponding futures contract (also cleared by KCC). The daily settlement price for a WCS contract month during the last month of trading for such contract is the cumulative average of the daily settlement prices of the corresponding KCC wheat futures month for each trading day during the last month of

⁴⁸⁵ A list of ICE’s clearing members is available on ICE’s website at: https://www.theice.com/publicdocs/clear_credit/ICE_Clear_Credit_Participant_List.pdf.

⁴⁸⁶ Source: KCBT submission (September 26, 2011).

trading. At the close of business on the last trading day of a particular WCS contract month, the cumulative average settlement price becomes the final settlement price used to cash settle any open WCS contracts in such contract month.

Margining System:

The initial margining system is the same as that used for KCC wheat futures: 95% comfort level (1.96 standard deviations) in analyzing day-to-day price changes covering the most recent 30-day sample period. When the 95% comfort level is exceeded, the KCC Executive Committee discusses the most recent day-to-day changes to determine if the market move is the result of a one-off occurrence or a more sustained period of volatility and determines whether to adjust margins.

Clearing Volume	As of September 26, 2011
WCS	1,861 contracts
Outstanding Notional	As of September 26, 2011
WCS	\$0 because all WCS have been converted into futures

Clearing Members: 13 clearing members.⁴⁸⁷

Canada

Natural Gas Exchange Inc. (“NGX”)⁴⁸⁸

Regulators: As a registered DCO, NGX’s clearing activities are overseen by the CFTC.

As a recognized clearing agency, NGX’s clearing activities also are overseen by the ASC.

Swap Product Classes: NGX has not yet determined which of the natural gas and electricity contracts it clears are “swaps” as opposed to “futures”, “options”, or “forwards”.⁴⁸⁹ The following information about NGX’s clearing and margining methods applies to NGX, generally.

⁴⁸⁷ A list of clearing members is available on KCC’s website at: http://www.kcbot.com/membership_5.html.

⁴⁸⁸ Source: NGX website, available at: http://ngx.com/overview_cas.html.

	<p><u>Clearing Method:</u> Unlike the other clearinghouses described in this chart, each NGX trading participant must serve as its own clearing member. Moreover, whereas other clearinghouses “mutualize risk among clearing members” by requiring them to deposit funds into a common guarantee fund, NGX does not reserve the right to draw on funds deposited by one clearing member to remedy another clearing member’s default.</p> <p><u>Margining System:</u> Initial margin is calculated by taking into account different liquidation periods and historical price volatility. Initial margins are established to cover commodity price movements during a liquidation event and are currently calculated using 2.7 standard deviations (a 99.5% confidence interval) from the last mark-to-market price (calculated using historical volatility data) over a minimum of a two-day hold (liquidation) period. NGX periodically conducts stress tests to insure initial margins are adequate. Variation margin reflects the daily mark-to-market value of the relevant positions and is calculated using a real-time risk monitoring system.</p> <p><u>Volume and Outstanding Notional:</u> Information is available on NGX’s website.⁴⁹⁰ As explained above, NGX is not yet certain which of its contracts are “swaps”.</p> <p><u>Clearing Members:</u> There are over 150 clearing members.</p>
Brazil	
	<p>BM&FBOVESPA (“BM&F”)⁴⁹¹</p> <p><u>Regulator:</u> The Brazilian CVM regulates BM&F.</p> <p><u>Swap Product Classes:</u></p> <ul style="list-style-type: none"> • IRS • Currency swaps • Equity index swaps

⁴⁸⁹ Conversation between CFTC and NGX staff (November 2011).

⁴⁹⁰ <http://www.ngx.com/yearlyvolgraph.html>.

⁴⁹¹ Sources: BM&F submission (September 26, 2011); and BM&F’s Swap Contracts Specifications, available on BM&F’s website at: <http://www.bmf.com.br/bmfbovespa/pages/contratos2/pdf/SwapContracts.pdf>.

- Inflation swaps

Clearing Method: Clearing members submit swaps to BM&F and decide on the type of service they wish BM&F to provide, *i.e.*, whether BM&F will “guarantee” the swap by serving as a CCP (the guarantee feature) or only provide services related to registration, “position control and value update”, and information concerning cash settlement values.

Margining System: BM&F’s Swap Margin Calculation Criteria applies only to those counterparties who have opted to clear pursuant to the clearinghouse’s guarantee feature, described above.

Pursuant to the Swap Margin Calculation Criteria, the margin of a swap portfolio must suffice to cover the future settlement values of all the positions in the portfolio. The methodology to calculate the margin for a swap portfolio is based on the calculation, under stress scenarios, of the portfolio’s cash flow at present value and the margin value derived from the scenario resulting in the greatest risk. The portfolio risk is then measured pursuant to the cash flow accumulated value.

If counterparties opt into BM&F’s guarantee system, then the clearinghouse may approve a variety of assets to be used as collateral, upon the request of the counterparties.

Clearing Volume	As of August 31, 2011
IRS, currency, equity index, and inflation swaps	\$62 billion
Outstanding Notional	As of August 31, 2011
IRS, currency, equity index, and inflation swaps	\$80 billion (almost 90% of this is attributable to IRS)

Clearing Members: More than 70 clearing members.⁴⁹²

Europe

⁴⁹² A list of clearing members is available on BM&F’s website, at: <http://www.bmfbovespa.com.br/shared/iframe.aspx?altura=1100&idioma=en-us&url=www2.bmf.com.br/pages/portal/bmfbovespa/associados2/associadosPesquisa2.asp>.

United Kingdom	
	<p data-bbox="436 272 1073 313">CME Clearing Europe Ltd. (“CME Europe”)⁴⁹³</p> <p data-bbox="436 347 1711 435"><u>Regulators:</u> As a registered DCO, CME Europe’s clearing activities are overseen by the CFTC. As a recognized clearinghouse, CME Europe’s clearing activities are also overseen by the UK FSA.</p> <p data-bbox="436 456 730 488"><u>Swap Product Classes:</u></p> <ul data-bbox="485 509 772 651" style="list-style-type: none"> <li data-bbox="485 509 709 542">• Energy swaps <li data-bbox="485 565 772 597">• Agricultural swaps <li data-bbox="485 618 743 651">• Freight swaps⁴⁹⁴ <p data-bbox="436 672 1774 743"><u>Clearing Method:</u> Transactions may be submitted to the CME Europe clearing system from other broker or trade negotiation platforms (such as an unaffiliated DCM or SEF) or directly from clearing members.</p> <p data-bbox="436 764 1774 938"><u>Margining System:</u> Initial margin is calculated according to the SPAN model. SPAN simulates the effects of changing market conditions and uses tailored options pricing models to determine a portfolio’s overall risk. SPAN constructs scenarios of price and volatility changes to estimate the potential loss arising if an entire portfolio must be closed out over a one-day time horizon. The resulting margin requirement is designed to cover this potential loss at a 99% confidence level.</p> <p data-bbox="436 959 1346 992">CME Europe performs mark-to-market calculations at least twice daily.</p> <p data-bbox="436 1013 1774 1138">A customer of a clearing member can choose whether a clearing member holds its margin money in an omnibus account, <i>i.e.</i>, together with other customers, or in an individual account. With respect to a clearing member’s omnibus account, CME Europe calculates the clearing member’s margin requirement on a net basis, such that long and short positions of customers will offset one another.</p> <p data-bbox="436 1159 1087 1192"><u>Clearing Volume and Outstanding Notional Value:</u></p>

⁴⁹³ Source: CME Europe’s DCO application, available on the CFTC’s website at: <http://sirt.cftc.gov/sirt/sirt.aspx?Topic=ClearingOrganizations>; and CME Europe’s website, available at: <http://www.cmeclearingeuropa.com/>.

⁴⁹⁴ Details of the swap contracts cleared by CME Europe are available on CME Europe’s website at: <http://www.cmeclearingeuropa.com/products-and-market-data/index.html>.

		Clearing Volume	YTD
		Energy, agricultural, and freight swaps	Not public. ⁴⁹⁵
		Outstanding Notional	As of August 31, 2011
		Energy, agricultural, and freight swaps	Not public. ⁴⁹⁶
	<u>Clearing Members:</u> 15 clearing members. ⁴⁹⁷		
	ICE Clear Europe Ltd. (“ICE Europe”) ⁴⁹⁸		
	<p><u>Regulators:</u></p> <p>As a registered DCO, ICE Europe’s clearing activities related to broad-based CDS index products and energy swaps are overseen by the CFTC.</p> <p>As a registered CA, ICE Europe’s clearing activities related to narrow-based CDS products and single-name CDS products are overseen by the SEC.</p> <p>As a recognized clearinghouse, ICE Europe’s clearing activities also are overseen by the UK FSA.</p> <p><u>Swap Product Classes:</u></p> <ul style="list-style-type: none"> • CDS Index products • Single-name CDS products • Energy swaps 		

⁴⁹⁵ E-mail from CME Europe staff to CFTC staff (November 8, 2011).

⁴⁹⁶ E-mail from CME Europe to CFTC staff (November 8, 2011).

⁴⁹⁷ A list of clearing members is available on CME Europe’s website at: <http://www.cmeclearingeuropa.com/membership/index.html>.

⁴⁹⁸ Sources: ICE submission (October 21, 2011); ICE Europe’s website, available at: https://www.theice.com/clear_europe.jhtml and https://www.theice.com/clear_credit.jhtml; and ICE Europe’s DCO application, available on the CFTC’s website at <http://sirt.cftc.gov/sirt/sirt.aspx?Topic=ClearingOrganizations>.

- Freight swaps

Clearing Volume and Outstanding Notional Value:

Clearing Volume	YTD
Energy and freight swaps	Over 593 million lots ⁴⁹⁹ of gas, natural gas liquids, electricity, oil, physical environmental, and wet freight swaps (as of September 2011)
CDS index products	175 billion Euro (open interest as of October 28, 2011)
CDS single-name products	393 billion Euro (open interest as of October 28, 2011)

Outstanding Notional	YTD
Energy and freight swaps	Over 283 million cleared lots of gas, natural gas liquids, electricity, oil, physical environmental, and wet freight swaps (as of September 2011)
CDS index products	6.4 trillion Euro (as of October 28, 2011)
CDS single-name products	1.1 trillion Euro (as of October 28, 2011)

Clearing Method: ICE Europe’s clearing method for CDS is similar to ICE Clear Credit’s method (see description of ICE Clear Credit, above). Open positions are marked to market daily using prices taken

⁴⁹⁹ The term “lot” refers to one standardized contract. Not all lots are equivalent. For example, Henry Hub [natural gas] trades in 2,500 million British thermal units per lot, power trades at 800 megawatts (peak) per lot, and oil trades in 1,000 barrels per lot.

from relevant markets and are validated by ICE Europe.

Margining System:

CDS: ICE Europe's margining system for CDS is similar to ICE Clear Credit's system (see description of ICE Clear Credit, above).

Energy and freight swaps: Initial margin is calculated according to the SPAN model. ICE Europe sets SPAN parameters (*e.g.*, the price scan range and the volatility scan range) as follows:

- statistical analysis used to determine an appropriate modeled range for the SPAN parameter being set;
- results of statistical analysis reviewed to determine whether the standard modeled outcome is appropriate; and
- parametric VaR employed to calculate the scanning range and inter-month spread charges.

In general, parameters are set to cover a confidence interval of 99% over a one- or two-day holding period, the worst case of the two being taken as the basis for the margin parameter. The model observes, as available, 60-, 250-, and 1,000-day price histories. Typically, emphasis is given to the 60-day price history in setting margin parameters. However, longer price history or relevant price periods may be used, *e.g.*, for seasonal products.

Variation margin is collected and paid based on the difference between the settlement price on such day of each traded contract in the account and the price at which each such contract was bought or sold or, in the case of open positions, the price at which the position is recorded on the clearinghouse's books. The clearinghouse also may require that a clearing member reduce or increase positions or post additional initial margin if it determines that market integrity requires it.

In addition to ordinary initial and variation margin requirements, the clearinghouse may, at its discretion, make settlements-to-market on a routine or *ad hoc* basis. Generally, the clearinghouse considers making discretionary calls if a contract price exceeds 66% of its scanning range.

Clearing Members:

CDS: 16 clearing members.

Energy/freight swaps: 40 clearing members.⁵⁰⁰

⁵⁰⁰

A list of clearing members for both CDS and energy/freight is available on ICE Europe's website at: https://www.theice.com/publicdocs/clear_europe/ICE_Clear_Europe_Clearing_Member_List.pdf.

LCH.Clearnet Ltd. (“LCH Ltd.”)⁵⁰¹

Regulators: As a DCO, LCH Ltd.’s clearing activities are overseen by the CFTC.

As a recognized clearinghouse, LCH Ltd.’s clearing activities also are overseen by the UK FSA.

Swap Product Class: IRS (various contracts in 17 currencies)

Clearing Volume and Outstanding Notional Value:

Clearing Volume	As of September 30, 2011
IRS	\$25 trillion cleared during September 2011

Outstanding Notional	As of September 30, 2011
IRS	\$300 trillion

Clearing Method: To submit a trade for clearing, a customer and its executing broker will affirm the trade. The trade subsequently will be “given up” by both sides to the client’s chosen SwapClear clearing member who will clear the trade through LCH Ltd.

Margining System: Customers deliver collateral to the SwapClear clearing member under modified ISDA documentation. The customer and the clearing member will agree on the amount of collateral to be delivered to the clearing member.

Customers are offered options as to how their initial margin is held and posted by their SwapClear clearing member at LCH Ltd., depending on each individual customer’s priorities (such as position or margin portability). This initial margin can be held either on a gross or net basis:

- gross margining: initial margin will be held in an individual segregated client account; and
- net margining: initial margin will be held in an omnibus net segregated client account.

Initial margin is calculated according to the historical VaR method with implicit currency and maturity correlation offsets, as follows:

⁵⁰¹ Sources: LCH submission (October 3, 2011); LCH website, available at: http://www.lchclearnet.com/swaps/swapclear_for_clearing_members/; IRS Clearing at LCH.Clearnet: An Overview, by Daniel Maguire, Head of LCH.Clearnet OTC Derivatives, Risk, and Operations, Futures Industry magazine (November 2011), pp. 36-38; follow-up e-mails of October and November 2011 between CFTC and LCH staff.

	<p>-backtesting including the worst case losses (100% confidence interval) based on historical scenarios from the past five years; and -a seven- day holding period for calculating margin for customers of clearing members and a five-day holding period for (the period required for the hedging/transfer/closeout of a clearing member’s portfolio should that clearing member default; by contrast, for futures, the typical holding period is two days).</p> <p><u>Clearing Members</u>: 60 clearing members.⁵⁰²</p>								
France									
	<p>LCH.Clearnet SA (“LCH SA”)⁵⁰³</p> <p><u>Regulators</u>: LCH SA is regulated by the French Autorité des marchés financiers, Autorité de contrôle prudentiel, and Banque de France.</p> <p><u>Swap Product Class</u>: CDS Index and Single-Name Products.</p> <p><u>Clearing Volume and Outstanding Notional Value</u>:</p> <table border="1" style="margin-left: auto; margin-right: auto;"> <tr> <td style="text-align: center;">Clearing Volume</td> <td style="text-align: center;">Between March 29, 2010 and December 2011</td> </tr> <tr> <td style="text-align: center;">CDS (both indices and single-names)</td> <td style="text-align: center;">4,639,818,140 Euro (open interest)</td> </tr> <tr> <td style="text-align: center;">Outstanding Notional</td> <td style="text-align: center;">Between March 29, 2010 and December 2011</td> </tr> <tr> <td style="text-align: center;">CDS (both indices and single-names)</td> <td style="text-align: center;">49,369,965,955 Euro</td> </tr> </table> <p><u>Clearing Method</u>: There is a default fund dedicated to CDS. No further information is available at this</p>	Clearing Volume	Between March 29, 2010 and December 2011	CDS (both indices and single-names)	4,639,818,140 Euro (open interest)	Outstanding Notional	Between March 29, 2010 and December 2011	CDS (both indices and single-names)	49,369,965,955 Euro
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Outstanding Notional	Between March 29, 2010 and December 2011								
CDS (both indices and single-names)	49,369,965,955 Euro								

⁵⁰² A list of clearing members is available on LCH Ltd.’s website, at: http://www.lchclearnet.com/membership/ltd/current_membership.asp.

⁵⁰³ Source: LCH SA’s website, available at: <http://www.lchclearnet.com/cds>.

	<p>time.</p> <p><u>Margining System</u>: Margin requirements are calculated daily. No further information is available at this time.</p> <p><u>Clearing Members</u>: No information available at this time.</p>												
Germany													
	<p>Eurex Clearing AG (“Eurex”)⁵⁰⁴</p> <p><u>Regulators</u>: Eurex is overseen by the German Bundesanstalt für Finanzdienstleistungsaufsicht and Deutsche Bundesbank. As of November 2011, it has a DCO application pending with the CFTC, which would supervise its clearing of index CDS.</p> <p><u>Swap Classes</u>:</p> <ul style="list-style-type: none"> • Index CDS • Single-name CDS (only one such contract) <p><u>Clearing Volume and Outstanding Notional Value</u>:</p> <table border="1" style="margin-left: auto; margin-right: auto;"> <thead> <tr> <th style="text-align: center;">Clearing Volume</th> <th style="text-align: center;">As of September 2011</th> </tr> </thead> <tbody> <tr> <td style="text-align: center;">Index CDS</td> <td style="text-align: center;">0</td> </tr> <tr> <td style="text-align: center;">Single-name CDS</td> <td style="text-align: center;">0</td> </tr> </tbody> </table> <table border="1" style="margin-left: auto; margin-right: auto;"> <thead> <tr> <th style="text-align: center;">Outstanding Notional</th> <th style="text-align: center;">As of September 2011</th> </tr> </thead> <tbody> <tr> <td style="text-align: center;">Index CDS</td> <td style="text-align: center;">85 million Euro</td> </tr> <tr> <td style="text-align: center;">Single-name CDS</td> <td style="text-align: center;">10 million Euro</td> </tr> </tbody> </table> <p><u>Clearing Method</u>: Eurex uses a risk model specific to CDS. A clearing member must obtain a special license from Eurex to clear CDS. Eurex also has established a default fund dedicated to CDS. Both a protection seller and a protection buyer must comply with various margin requirements: mark-to-market,</p>	Clearing Volume	As of September 2011	Index CDS	0	Single-name CDS	0	Outstanding Notional	As of September 2011	Index CDS	85 million Euro	Single-name CDS	10 million Euro
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Single-name CDS	10 million Euro												

⁵⁰⁴ Source: Eurex submission (September 26, 2011).

	<p>next day, and liquidity. In addition, a protection seller has a credit event margin requirement, and a protection buyer has an accrued premium margin requirement.</p> <p>Eurex currently is developing systems to clear swaps other than CDS, which it plans to launch in early 2012.</p> <p><u>Margining System:</u></p> <ul style="list-style-type: none"> -mark-to-market margin defined as the difference between present values, based on pre-agreed, and the most recently observed, market spreads; -next-day margin defined as VaR based on historical simulation with expected shortfall; -liquidity margin defined as covering an extended liquidation period for less liquid contracts; -credit event margin (protection seller only) defined as the net exposure to the <i>n</i> reference entities bearing the greatest risk in a clearing member's portfolio; and -accrued premium margin (protection buyer only), requested daily, for each CDS cleared. <p><u>Clearing Members:</u> Two firms are licensed to clear CDS through Eurex.</p>				
Spain					
	<p>Mercado Español de Futuros Financieros (“MEFF”)⁵⁰⁵</p> <p><u>Regulator:</u> The Spanish Comisión Nacional del Mercado de Valores oversees MEFF.</p> <p><u>Swap Class:</u> Energy swaps</p> <p><u>Clearing Volume and Outstanding Notional Value:</u></p> <table border="1" data-bbox="793 1045 1430 1286"> <thead> <tr> <th data-bbox="793 1045 1127 1127">Clearing Volume</th> <th data-bbox="1127 1045 1430 1127">YTD (as of November 28, 2011)⁵⁰⁶</th> </tr> </thead> <tbody> <tr> <td data-bbox="793 1127 1127 1286">Electricity swaps</td> <td data-bbox="1127 1127 1430 1286">3,204,062 megawatts per hour consisting of 10,331 contracts, and having an aggregate value of approximately</td> </tr> </tbody> </table>	Clearing Volume	YTD (as of November 28, 2011)⁵⁰⁶	Electricity swaps	3,204,062 megawatts per hour consisting of 10,331 contracts, and having an aggregate value of approximately
Clearing Volume	YTD (as of November 28, 2011)⁵⁰⁶				
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⁵⁰⁵ Source: CNMV submission (November 10, 2011) and MEFF website, available at: <http://www.meff.es>.

⁵⁰⁶ Source: Volume information is available on MEFF's website. These figures, as well as those for Outstanding Notional, were compiled by CNMV staff.

			160,203,100 Euro
		Outstanding Notional	YTD (November 28, 2011)
		Electricity swaps	1,312,523 megawatts per hour in open interest, consisting of 689 contracts, and having an aggregate value of approximately 65,626,150 Euro
<p><u>Clearing Method</u>: Clearing members contribute to a default fund, which is separated between electricity swaps and financial derivatives that are not classified as swaps.</p> <p><u>Margining System</u>: Various methods are used to calculate initial margin based on length of contracts and time remaining until expiration. MEFF offsets certain contracts in order to calculate a clearing member's initial margin. Clearing members also are subject to variation margin requirements.</p> <p><u>Clearing Members</u>: 17 clearing members.</p>			

Asia	
Japan	
	Japan Securities Clearing Corporation (“JSCC”) ⁵⁰⁷
	<p><u>Regulator</u>: The JFSA regulates the JSCC.</p> <p><u>Swap Class</u>: Index CDS</p> <p>Plans to clear IRS by late 2012.</p>

⁵⁰⁷ Source: JSCC submission (September 26, 2011); and JSCC website, available at: http://www.jscc.co.jp/en/data/documents/cds/cds_statistics_201109.pdf and http://www.jscc.co.jp/en/news/2011/3/Outline%20of%20Credit%20Default%20Swaps%20Clearing_Revised%20Edition_.pdf.

	<p><u>Clearing Volume and Outstanding Notional Value:</u></p> <table border="1" data-bbox="800 245 1423 342"> <tr> <td>Clearing Volume</td> <td>As of September 2011</td> </tr> <tr> <td>Index CDS</td> <td>101.7 billion Yen</td> </tr> </table> <table border="1" data-bbox="800 370 1423 467"> <tr> <td>Outstanding Notional</td> <td>As of September 2011</td> </tr> <tr> <td>Index CDS</td> <td>72.7 billion Yen</td> </tr> </table> <p><u>Clearing System:</u> Clearing members are subject to initial and variation margin requirements. Clearing members must contribute to a default fund.</p> <p><u>Margining System:</u> Initial margin is the estimated loss that could occur due to price fluctuations while a defaulting clearing member’s portfolio is managed. Variation margin is calculated according to daily settlement prices, which are determined by quotes that clearing members submit to the clearinghouse. Parameters used for the variation margin calculation: 750-day price history, five-day holding period, and 99% confidence level.</p> <p><u>Clearing Members:</u> Five clearing members clearing CDS.</p>	Clearing Volume	As of September 2011	Index CDS	101.7 billion Yen	Outstanding Notional	As of September 2011	Index CDS	72.7 billion Yen
Clearing Volume	As of September 2011								
Index CDS	101.7 billion Yen								
Outstanding Notional	As of September 2011								
Index CDS	72.7 billion Yen								
China									
	<p>Shanghai Clearing House (“SCH”)⁵⁰⁸</p> <p><u>Regulators:</u> The Chinese Ministry of Finance, PBOC, and China Securities Regulatory Commission oversee the SCH.</p> <p><u>Swap Class:</u> SCH clears “credit risk mitigation warrants” (“CRMW”). In China, CRMWs differ from CDS in several ways: protection seller requires approval from NAFMII prior to selling CRMW; NAFMII controls the number of CRMWs that can be sold; CRMW can only be based on the debt of one company; CRMW is structured around a one-time payment; CRMW can be traded on the secondary market; a CRMW’s credit event is defined more narrowly; and CRMW is not settled with an auction.</p>								

⁵⁰⁸ Source: SCH submission (December 7, 2011) (unofficial English translation by CFTC staff) and SCH website, available at: <http://www.shclearing.com/English/ShowClass.asp?ClassID=62>.

	<p><u>Clearing Volume and Outstanding Notional Value</u>: No information is available at this time.</p> <p><u>Clearing and Margining System</u>: No information is available at this time.</p> <p><u>Clearing Members</u>: 32 clearing members clear CRMW.⁵⁰⁹</p>			
Hong Kong				
	Hong Exchanges and Clearing Limited (“HKEx”) ⁵¹⁰			
	<p><u>Regulators</u>: The SFC and HKMA oversee the HKEx.</p> <p><u>Swap Class</u>: HKEx proposes to clear IRS by the end of 2012.</p>			
Singapore				
	Singapore Exchange Derivatives Clearing Limited (“SGX-DC”) ⁵¹¹			
	<p><u>Regulator</u>: The Singapore MAS regulates SGX-DC.</p> <p><u>Swap Classes</u>:</p> <ul style="list-style-type: none"> • IRS • Energy swaps • Forward freight agreement swaps • Bulk commodity swaps <p><u>Clearing Volume and Outstanding Notional Value</u>:</p> <table border="1" style="margin-left: auto; margin-right: auto;"> <tr> <td style="text-align: center;">Clearing Volume</td> <td style="text-align: center;">As of August 31, 2011</td> </tr> </table>		Clearing Volume	As of August 31, 2011
Clearing Volume	As of August 31, 2011			

⁵⁰⁹ A list of clearing members is available on SCH’s website at: <http://www.shclearing.com/insider/showinfo.asp?InfoID=652> (in Chinese only).

⁵¹⁰ Sources: HKEx website pages, available at: <http://www.hkex.com.hk/eng/newsconsul/hkexnews/2010/1012103news.htm> and http://www.hkex.com.hk/eng/newsconsul/hkexnews/2010/documents/203_otc%20clearing_e.pdf.

⁵¹¹ Source: SGX-DC Submission.

		IRS (Singapore dollar only)	160 billion Singapore dollars
		Energy swaps	8,470 lots
		Forward freight agreement swaps	61,620 lots
		Bulk commodity swaps	45,370 lots
		Outstanding Notional	As of August 31, 2011
		IRS (Singapore dollar only)	139 billion Singapore dollars
		Energy swaps	620 lots ⁵¹²
		Forward freight agreement swaps	17,820 lots
		Bulk commodity swaps	8,670 lots
	<p><u>Clearing Method:</u> Clearing members deposit initial margin with SGX-DC and also are subject to variation margin requirements, determined by mark-to-market valuations.</p> <p>Each clearing member chooses a settlement bank to execute the settlement of margin obligations. Settlement payments are subject to the terms of a contract pursuant to which SGX-DC has the authority to instruct a settlement bank to transfer a payment from the clearing member's bank account to SGX-DC.</p> <p><u>Margining System:</u> The following methods are used:</p> <p><u>IRS:</u></p> <p>Initial margin for IRS is calculated according to the Historical Simulation VaR methodology. Margin for each clearing member's positions is calculated on a portfolio basis, at the 99th percentile confidence level, based on rolling five years of daily historical price data, and assuming a five-day holding period. The five-day holding period is deemed necessary to account for the period of time from the point of</p>		

⁵¹² The term "lot" refers to one standardized contract. Not all lots are equivalent because each type of contract, e.g., bulk commodity or energy, might refer to different units of energy.

default to the neutralization of risks in the portfolio, including hedging.

Energy/forward freight/bulk commodity swaps:

Margin for energy swaps, forward freight agreements, and bulk commodity swaps is calculated according to the SPAN loss-estimation methodology. This evaluates overall portfolio risk through a scenario approach, with a loss/gain attached to each scenario, corresponding to a particular combination of price change, volatility change, and decrease in time to expiration. The margin requirement represents the worst loss of all the scenarios. Confidence intervals are within 95% to 99% to apply across all contracts and products clearing, based on historical price volatility studies of different time periods up to a maximum of 12 months. The holding period would cover the expected time to liquidate the product in the event of default.

Mark-to-market valuations are calculated three times a day for IRS and four times a day for energy swaps.

Semiannually, SGX-DC reviews the appropriateness of its margin methodologies and stress testing. Reports are sent to the MAS for approval.

Clearing Members:

IRS: 11 clearing members.

Commodity swaps (energy, forward freight, bulk commodity): 23 clearing members.⁵¹³

⁵¹³ A list of clearing members of SGX-DC is available on SGX-DC's website, but the list does not distinguish among those firms clearing IRS and those clearing commodity swaps: http://www.sgx.com/wps/wcm/connect/sgx_en/Misc/regulations/directory+of+members/.

Appendix II

Tables Summarizing Regulatory Approaches in Studied Jurisdictions⁵¹⁴

Table 1: Legal and Regulatory Framework for Regulation of OTC Derivatives

Table 2: Application of Central Clearing Requirements

Table 3: Transparency and Trading Requirements

⁵¹⁴ The information in these tables has been extracted from the FSB October 2011 Report, Appendix VIII, and updated to reflect the latest information regarding release of proposals or the expected date of such release.

Table 1
Legal and Regulatory Framework for Regulation of OTC Derivatives

Jurisdiction	Laws and Regulations that Affect Standardization	Laws and Regulations to Require Central Clearing	Laws and Regulations to Require Trading	Laws and Regulations to Require Reporting
Australia	No	Legislation not yet proposed; ACFR discussion paper published June 2011; ACFR consultation period open until August 5, 2011, after which ACFR to develop recommendation for Australian government consideration	Legislation not yet proposed; review of market licensing regime for electronic trading platforms and exchanges under way	Expected by end-2012 (timing to be reviewed at end-2011) Expect to consult with industry participants; to be reviewed later in 2011
Brazil	No	Pre-existing legislation in place requires all exchange-traded derivatives to be centrally cleared; non-exchange traded derivatives may be bilaterally risk managed or centrally cleared at the option of counterparties Mandatory clearing requirement applies only to exchange-traded derivatives	Capital incentives for use of exchange-traded derivatives	Pre-existing rules enacted by the Central Bank and CVM require all OTC derivatives trades to be reported to a TR
Canada	New capital standards; regulatory steps with regard to TRs	Under review; provincial legislation expected by end-2012 with rulemaking contingent on international harmonization efforts Legislation in place in provinces where the majority of OTC derivatives trades are booked but further work required to harmonize across all provinces Upcoming consultation on clearing will inform rulemaking;	Under review; consultation paper to be published late 2011	Contingent on legislative changes and rules being put in place across multiple jurisdictions and international reporting standards CSA published a consultation paper on TRs; most jurisdictions are assessing what legislative changes may be required; Ontario has amended its Securities Act to support reporting to TRs and regulatory access to data

Jurisdiction	Laws and Regulations that Affect Standardization	Laws and Regulations to Require Central Clearing	Laws and Regulations to Require Trading	Laws and Regulations to Require Reporting
		potential legislative changes that may be needed to support clearing are under review		Decision to be made to require reporting to a domestic TR or rely on reporting to a global TR. Anticipated that a very small number of trades may not be accepted by TRs that could be reported to securities regulators
China	Improved Master Agreement and Definition Document; developed electronic trading platform	Legislation not yet proposed; PBOC efforts to encourage SCH to establish detailed schemes for central clearing of OTC derivatives	Legislation not yet proposed; interest rate transactions executed outside of the organized platform need to be reported to the CFETS platform	Under current rules, all OTC interest rate, FX, and credit risk mitigation tools (other than credit risk mitigation agreements) can be traded on the CFETS electronic platform; interest rate trades executed outside the CFETS platform should be reported to CFETS; credit risk mitigation trades should be reported to NAFMII Additional steps include consideration of details including frequency and contents of reporting and which institutions will play the role of TRs
European Union	EMIR, CRD IV, MiFID, MiFIR, technical standards implementing EMIR	EMIR; Legislation not yet adopted; to be adopted in early 2012; technical rules to be drafted by ESMA, EBA, and EIOPA	MiFIR, proposed in October 2011, requires trading of all OTC derivatives subject to an obligation of central clearing (pursuant to EMIR) and which are sufficiently liquid, as determined by ESMA, to take place on one of three regulated venues: regulated	Legislation (EMIR) has not yet been adopted; EMIR has been proposed and is expected to be adopted in early 2012; ESMA to develop technical standards Reporting will be to ESMA where a TR is not able to record the details of an OTC derivative

Jurisdiction	Laws and Regulations that Affect Standardization	Laws and Regulations to Require Central Clearing	Laws and Regulations to Require Trading	Laws and Regulations to Require Reporting
			markets, MTFs, and the future OTFs; final rules subject to agreement by the European Parliament and Council expected in 2012	
Hong Kong	HKMA to begin legislative process for incorporating Basel III framework in its capital regime for banks for implementation in 2013	Much also depends on the timing of global consensus on key issues and completing the legislative process in time Legislation not yet proposed; regulators have commenced work on required amendments to legislation for regulatory regime for OTC derivatives Legislation must be adopted; regulators released consultation in Q4 2011	Legislative changes to give regulators the power to impose a trading requirement is targeted to be completed in 2012, although the timing of implementation is under consideration and will be guided by the development of international standards Legislation not yet proposed; regulators have commenced work on required amendments to legislation to build the regulatory regime for OTC derivatives Regulators released a consultation in Q4 2011	Legislation depends on timing of global consensus on key issues and completing the legislative process in time; intention to take a phased approach, beginning with IRS and non-deliverable forwards Regulators have commenced work on required amendments to legislation to build the regulatory regime for OTC derivatives Regulators released a consultation on the proposed regime in Q4 2011 Transactions that meet HK nexus condition to be reported to local TR to be developed by HKMA
Japan	FIEA; JFSA expects Cabinet Ordinance and other measures to be finalized by November 2012	Initially the requirements will apply only to Yen IRS and CDS (iTraxx Japan indices) FIEA amended May 2010 Cabinet Ordinance to be amended to include requirement for CCP clearing of trades “that are significant in volume and would reduce settlement risks in the domestic market”	Legislation not yet proposed; TBD what legislative or regulatory steps will be taken (FIEA May 2010 does not address trading); Awaiting conclusions of IOSCO and other countries’ work Draft regulatory framework published	In general, trade data will be reported to a TR and trade data that the TR does not accept will be reported to JFSA FIEA amended May 2010 to introduce the legislative framework for reporting of OTC derivatives transactions to TRs Cabinet Ordinance to be completed November 2012

Jurisdiction	Laws and Regulations that Affect Standardization	Laws and Regulations to Require Central Clearing	Laws and Regulations to Require Trading	Laws and Regulations to Require Reporting
				Trade data reported to JFSA will be limited to information not accepted by a TR, such as exotic OTC derivatives trades
Republic of Korea	July 2011 preliminary announcement on the revision of FSCMA, including standardization of OTC derivatives Revision of the FSCMA to be submitted to the National Assembly by the end of 2011; detailed provisions of enforcement ordinances and supervisory regulations required after legislation is adopted	Legislation not yet proposed; July 2011 preliminary announcement on the revision of FSCMA to be submitted to the National Assembly by end-2011 FSCMA amendments to be adopted; detailed provisions of enforcement ordinances and supervisory regulations required after passage of legislation, as well as establishment and pilot-testing of domestic CCP	Legislation not yet proposed; review of policy options under way	FSCMA and the Foreign Exchange Transactions Act require reporting of all OTC derivatives transactions to authorities Necessary to improve some parts of the reporting system to meet international standards
Singapore	Legislation to be introduced by end-2012; public consultation by end-2011	Legislation not yet proposed Public consultation to be issued by end-2011; legislation to be introduced by end-2012	Legislation to be introduced by end-2012 Public consultation on proposed policies for implementation in legislation by end-2011	Legislation to be introduced by end-2012 Public consultation by end-2011
United States	DFA enacted July 2010; CFTC and SEC proposed implementing	DFA enacted July 2010 CFTC regulations finalized; SEC implementing regulations to be finalized	DFA requires any swap or security-based swap that is subject to a clearing requirement to be traded on a registered trading	DFA enacted July 2010; CFTC and SEC have proposed implementing regulations; CFTC and SEC final regulations must be

Jurisdiction	Laws and Regulations that Affect Standardization	Laws and Regulations to Require Central Clearing	Laws and Regulations to Require Trading	Laws and Regulations to Require Reporting
	regulations that should promote standardization; CFTC and SEC final regulations beginning to be promulgated		platform, <i>i.e.</i> , a contract market designated by the CFTC or SEF registered with the CFTC or an exchange or SBSEF registered with the SEC, if such swap or security-based swap is made “available to trade” on a trading platform. The CFTC and SEC have proposed regulations pertaining to the registration and operation of trading platforms CFTC and SEC must promulgate final implementing regulations	promulgated Reporting to the CFTC or SEC if there is no TR available; should be limited in scope

Table 2
Application of Central Clearing Requirements

Jurisdiction	Coverage of All Asset Classes	Coverage of All Types of Financial Entities	Intra-group Transactions	CCP Location Requirement
Australia	No; likely to harmonize with requirements in major jurisdictions (<i>e.g.</i> , exemption of some classes of FX derivatives likely); coverage of credit and equity classes under review	No (likely that smaller financial entities would be exempt)	Under review	Under review
Brazil	No; central clearing requirement pertains only to exchange-traded derivatives (not OTC)	No	No	No
Canada	Under review; FX swaps and forwards may be exempted with a view to harmonizing rules with other jurisdictions; other asset classes TBD	Under review; consideration being given to systemic risk concerns and harmonization with other jurisdictions	Under review	TBD (appropriate measures to encourage onshore clearing of Canadian-dollar denominated interest rate derivatives under consideration)
China	Under review	Yes	NA	Yes (SCH)
European Union	Yes (EMIR)	Yes (EMIR, however, exemption of certain pension arrangements for a limited period under consideration by Council and Parliament)	No (both Council and Parliament have proposed an exemption for intra-group trades in EMIR)	No
Hong Kong	Yes; mandatory clearing expected to cover standardized IRS and non-deliverable forwards initially, extending this to other types of products will be considered after the initial roll out	Yes; scope of coverage of mandatory clearing under review; “HK’s current plan is to cover institutions holding positions that may pose systemic risk to the financial system”	No; “HK will however keep in view global developments in this regard”	No
Japan	TBD (Cabinet Ordinance expected)	Yes (applicable to all “financial	TBD (Cabinet	Yes (domestic CCP

Jurisdiction	Coverage of All Asset Classes	Coverage of All Types of Financial Entities	Intra-group Transactions	CCP Location Requirement
	November 2012)	intermediaries”)	Ordinance expected November 2012)	clearing to be mandated for those derivatives required “to be aligned with the domestic bankruptcy regime”; iTraxx Japan series of CDS index trades anticipated to be included)
Republic of Korea	Yes	Yes		No
Singapore	Yes (taking into account systemic risk to the local market and degree of standardization in the local market)	Under review	Under review	No (however, this is under review)
United States	Yes (although US Treasury has proposed exempting FX swaps and forwards from mandatory clearing requirements)	Yes	TBD (under consideration by CFTC and SEC)	No

Table 3
Transparency and Trading Requirements

Jurisdictions	Multi-dealer Functionality Required to Fulfill Trading Requirement or Single-dealer Functionality Permitted	Pre-trade Price and Volume Transparency Required for All Exchange- or Electronic Platform-Traded and OTC Derivatives	Post-trade Price and Volume Transparency Required for All Exchange- or Electronic Platform-Traded and OTC Derivatives
Australia	TBD (under the current market licensing regime – which is under review – a single-dealer platform is not required to be regulated as a market)	TBD (under review)	TBD (under review)
Brazil	Multi-dealer functionality required	No (pre-trade price and volume transparency required for the 90% of the derivatives market that is exchange-traded; no pre-trade requirements for the 10% of the market that is OTC)	Yes (all derivatives, including OTC, must be reported to a TR)
Canada	TBD (will seek to harmonize with international community)	TBD	TBD (supportive of improved price transparency, although this needs to be carefully defined, and further work needs to be undertaken to weigh potential costs and benefits)
China	Multi-dealer functionality required	Yes	Yes
European Union	Multi-dealer functionality (proposed in MiFIR)	Yes (proposed in MiFIR)	Yes (proposed in MiFIR)
Hong Kong	Under consideration (with global developments in view)	Under consideration (with global developments in view)	Under consideration (with global developments in view)
Japan	Single-dealer functionality permitted	TBD	TBD
Republic of Korea	Multi-dealer functionality required	Yes	Yes
Singapore	NA (note that US and EU have proposed different rules; useful for IOSCO to provide guidance on the use of single-dealer platforms)	To be consulted on (taking into consideration IOSCO report on trading)	To be consulted on (taking into consideration IOSCO report on trading)

Jurisdictions	Multi-dealer Functionality Required to Fulfill Trading Requirement or Single-dealer Functionality Permitted	Pre-trade Price and Volume Transparency Required for All Exchange- or Electronic Platform-Traded and OTC Derivatives	Post-trade Price and Volume Transparency Required for All Exchange- or Electronic Platform-Traded and OTC Derivatives
United States	Multi-dealer functionality required	TBD (DFA requires that market participants have the ability to execute or trade swaps or security-based swaps subject to clearing and trading mandates by accepting bids and offers made by multiple participants on a DCM or SEF (for swaps) and on an exchange of SBSEF (for security-based swaps) CFTC and SEC have proposed regulations to implement this requirement	Yes

Appendix III

International Initiatives Involved in Developing Policy for OTC Derivatives Regulation⁵¹⁵

Commitment(s)	Action	Group	Status
Central clearing	Report on the macro-financial implications of alternative configurations for access to CCP in OTC derivatives markets	CGFS ⁵¹⁶	Consultative report published November 2011
Central clearing	Revision of the BCBS supervisory guidance for managing settlement risk in foreign exchange transactions (2000)	BCBS and CPSS	Consultative report in 2012
Central clearing	Report on international standards to address coordination of central clearing requirements with respect to products and participants (and any exemptions from clearing requirements)	IOSCO (working with other authorities as appropriate)	Report to be published in February 2012
Central clearing, Reporting to trade repositories	Principles for financial market infrastructures (“FMIs”), including derivatives CCPs and TRs Results of follow-up work being conducted during the consultation period may be incorporated into the final report on principles for FMIs. Follow-up work to cover: (1) access and links; (2) resolution; and (3) development of standards/principles for effective cooperation and coordination on oversight arrangements and information sharing among the relevant authorities for FMIs (including TRs and CCPs)	CPSS and IOSCO (working with other authorities as appropriate)	Consultative report published March 2011 Final report by early 2012

⁵¹⁵ The information in these tables has been extracted from the FSB October 2011 Report, Appendix I.

⁵¹⁶ The CGFS monitors developments in global financial markets for central bank governors. Information on the CGFS is available on the BIS website at <http://www.bis.org/cgfs/index.htm>.

Commitment(s)	Action	Group	Status
Central clearing	International standards on margining for non-centrally cleared derivatives	BCBS, IOSCO, Working Group	Consultative report by June 2012
Exchange and electronic platform trading	Report on trading of OTC derivatives	IOSCO	Final report published February 2011
Exchange and electronic platform trading	Stock-taking on use of multi-dealer and single-dealer trading platforms for OTC derivatives	IOSCO	January 2012
Reporting to trade repositories	Report on OTC derivatives data reporting and aggregation requirements	CPSS and IOSCO	Final report published January 2012
Reporting to trade repositories, central clearing	Development and implementation of frameworks for effective cooperation and coordination on oversight arrangements and information sharing among the relevant authorities for individual TRs and systemically important OTC derivatives CCPs	ODRF and CPSS-IOSCO	No timetable set (ongoing)
Capital requirements	Regulatory capital adequacy rules for capitalization of both trade and default fund exposures to CCPs	BCBS	Consultative report published November 2011
Standardization, Central clearing	Roadmap of industry initiatives and commitments along four thematic objectives: (1) increasing standardisation, (2) expanding central clearing, (3) enhancing bilateral risk management, and (4) increasing transparency	ODSG	Strategic roadmap published March 2011 Specific milestones starting from April 30, 2011, through early 2012
Commodity derivatives	Report on principles for the regulation and supervision of commodity derivatives markets	IOSCO	Final report published September 2011