

ACROSS THE POND

Issue 1

Recent European Policy Developments in Financial Services

April 19, 2011



The international nature of financial regulatory reform has left many in the U.S. and Europe with questions about the status of their counterparts' activities on either side of the Atlantic. Across the Pond is a DTCC publication designed to provide a "thumbnail" sketch of financial regulatory reform activities in the United States and European Union. Across the Pond will be updated regularly to provide current and reliable background on key policy developments in Brussels and Washington, D.C. Detailed information on any topic highlighted in Across the Pond can be requested from DTCC Government Relations in Brussels or Washington, D.C.

Background on EMIR

On 15th September, 2010, the European Commission published the draft text of the European Market Infrastructure Regulation (EMIR), a legislative proposal which covers the clearing and reporting obligations for OTC derivatives, the operational standards for Central Counterparties (CCPs) operating in any asset class, the interoperability of cash equity CCPs and the operational standards for derivative trade repositories. The European Parliament and European Council are now reviewing EMIR to formulate their respective positions before negotiating among themselves and with the European Commission on the final wording of the regulation in a process known as Trialogue. Trialogue will begin in the second half of 2011.

Regulatory update

The **Council of Ministers** (27 EU countries), under the rotating presidency of Hungary, continues to meet and discuss its views on the EMIR draft regulation. Recent developments include:

- There is deadlock on the extension of scope beyond OTC to all derivatives. It will likely be resolved politically by the EU Finance ministers (ECOFIN on 17th May).
- Cash equity CCP interoperability is likely to be part of EMIR to encourage consolidation of CCPs – there are currently 9 CCPs in the EU.
- Trade repositories regulation is largely unchanged from original draft.

The **European Parliament**, under the leadership of German Conservative MEP Werner Langen (European Peoples Party-EPP), continues to discuss its position vis-a-vis the original draft:

- 977 amendments were submitted by deadline of 16th March.
- There is broad political support for extension of scope to all derivatives (mainly clearing and reporting obligation impact).
- The Parliament's Committee on Economic and Monetary Affairs (ECON) vote on EMIR has been postponed from 20th April to 24th May due to the volume of amendments to be dealt with.

The **European Commission** continues to work on drafts of legislation expected later this year, such as MiFID 2 (Trading), CRD IV (Basel III implementation) and Crisis Resolution (failed Bank resolution).

What is 'Brussels' talking about?

- The **Nasdaq OMX/NYSE Euronext proposed merger** and the impact on Europe, especially in the light of potential job transfers to the US. According to Internal Market Commissioner Barnier, "EU should not be an outsourcer of financial services".
- The **Deutsche Boerse/NYSE Euronext merger** and the impact on Paris (job transfers to Frankfurt) and on derivatives trading and processing (excessive market share of the merged entities). Competition Commissioner Almunia has spoken out against vertical silos in a pointed reference to the Deutsche Boerse model.
- **Extraterritoriality** – Europe has grown more sensitive to perceived US extraterritorial requirements and is now coming up with some of its own. The question is do any of these requirements contribute to a safer market?
- **Scope of EMIR** – Should it be extended to cover all derivatives and not just OTC? A recent visit by Gary Gensler lent weight to the argument in favour of extending EMIR to all derivatives as he made it clear this would match the scope of U.S. regulation.
- **Exemptions from the clearing obligation** – Should there be any for participant types, e.g. pension funds, or asset classes e.g. FX. Prevailing opinions of those not in the Pension Fund or FX industry is no, but there is concern if such exemptions are granted in the US
- **MEPs paid for regulatory amendments** – 3 MEPs have resigned after it was revealed they accepted 'payment' in exchange for proposing amendments to future regulation.



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Background on Dodd-Frank

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), passed by the U.S. Congress on July 21, 2010, calls for 243 individual rulemakings related to the regulation of the U.S. financial markets, to be finalized and implemented by American regulators no later than July, 2011.

Regulatory update

To effectively implement the myriad provisions of Dodd-Frank, U.S. regulatory agencies are in the process of promulgating a number of the proposed rules, which are open to public comment before finalization. Recent developments and proposed rules include:

- The **Financial Stability Oversight Council (FSOC)** is accepting comments on its proposed rule for identifying and designating a financial market utility as systemically important. Such FMUs will be subject to heightened federal supervision and have access to the Federal Reserve Bank's discount window.
- On March 18, the **Federal Reserve Board (FRB)** completed the Comprehensive Capital Analysis and Review, examining the capital plans of the 19 largest U.S. bank holding companies. In April, the FRB will communicate its expectations to these bank holding companies, including whether to increase or restart dividend payments, buy back shares, or repay government capital.
- On April 6, the **FRB** requested comment on a proposed rule to repeal Regulation Q, which prohibits the payment of interest on demand deposits by institutions that are member banks of the Federal Reserve System.
- The **Commodities Futures Trading Commission (CFTC)** and the **Securities and Exchange Commission (SEC)** are in the process of promulgating a series of proposed rules for regulation of the swaps market. While the agencies have proposed many of the rules required by the Dodd-Frank Act, key regulatory areas have not yet been addressed, including the definition of a swap. The agencies announced they will host a roundtable in May to discuss the schedule for implementing final rules.
- The **Office of the Comptroller of the Currency (OCC)**, the **Federal Deposit Insurance Corporation (FDIC)**, and the **FRB**, together with the **SEC**, the **Federal Housing Finance Agency (FHFA)**, and the **Department of Housing and Urban Development**, have jointly published a proposed rule that would require sponsors of asset-backed securities (ABS) to retain at least 5 percent of the credit risk of the underlying assets.
- On March 30, the **federal financial regulatory agencies** (the OCC, FDIC, and FRB, together with the FHFA, SEC, Office of Thrift Supervision, and National Credit Union Administration) issued a joint proposed rule to ensure that the incentive compensation arrangements at regulated financial institutions account for risk.
- The **FRB** and **FDIC** approved a joint proposed rule which would require each nonbank financial company supervised by the FRB and each bank-holding company with assets of \$50 billion or more to report periodically to the FRB, FDIC, and FSOC on its resolution plan and the nature and extent of credit exposures to significant bank-holding companies and significant nonbank financial companies.

What is 'Washington' talking about?

- **Implementation of Dodd-Frank** – The U.S. Senate and House of Representatives continue to hold hearings related to the implementation, costs and benefits, and overall impact of Dodd-Frank on the U.S. economy, more specifically Title VII, which addresses regulation of OTC derivatives. Key issues during the hearings included end-user swap transaction exemptions, regulatory harmonization, utilizing swap data repositories, the implementation timeline, and certain swap execution facility provisions.
- Many in Congress fear the short timeframe for writing the proposed rules may create unintended, negative consequences. These concerns have led to numerous calls for legislation to extend the deadline for finalization of Dodd-Frank related rules, particularly Title VII.
- **Budgetary Needs of Regulatory Agencies** – In recent testimony before Congressional Committees, SEC Chairwoman Mary Schapiro and CFTC Chairman Gary Gensler stressed the importance of receiving their full budgetary funding in order to effectively carry out their mandates under Dodd-Frank. In light of the on-going debate regarding the federal budget, it appears unlikely these funding needs will be met.



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