International Developments
January 25, 2019
11:30 a.m. – 12:45 p.m.

Chair:
Nathaniel Lalone (Katten)

Panel:
Chris Bates (Clifford Chance)
Jacqueline Mesa (FIA)
Kazunari Mochizuki (JSFA)
Eric Pan (CFTC)
Patrick Pearson (European Commission)
Hard Brexit:
Three Major Challenges

ABA Business Law Section:
Derivatives & Futures Law Committee Winter Meeting
Naples, Florida / 25 January 2019

Nathaniel W. Lalone
Partner
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Overview

• Brexit:
  • What is it?
  • What is “Hard Brexit”?
• Three Major Challenges*
  • Loss of passporting
  • Access to market infrastructures
  • Continuity of contracts
• “No-Deal” Preparations
• Third Country Views – CFTC

* This is by no means an exhaustive list!
On 23 June 2016, the UK public voted 52%-48% to leave the European Union (EU).

Article 50 of the Treaty on European Union provides for:

- an EU Member State to notify the European Council of its intention to withdraw from the EU; and
- a two-year period during which the terms of the departing state’s withdrawal and a framework for a future relationship is agreed.

The UK submitted its “Article 50 Notice” to European Council President Donald Tusk on 29 March 2017.
“Hard Brexit”

• “Hard Brexit” refers to the expiry of the two-year window without an agreement between the UK and the EU.
  • Sometimes referred to as “No-Deal”, “Blind”, or “Kamikaze” Brexit.
• Only limited legislation would be in place:
  • European Communities Act 1972 repealed by European Union (Withdrawal) Act 2018.
  • No guarantee of any bilateral measures in place between the UK and individual EU Member States (e.g., France re the Channel Tunnel).
  • Heightened potential of unilateral protective measures by the UK as well as the EU (collectively) and the remaining 27 EU Member States (individually).
“Hard Brexit”

• What has been agreed? As of writing:
  • The UK Government and the EU27 have agreed a “backward-looking” Withdrawal Agreement that addresses:
    • Settlement of liabilities accrued by the UK during its EU membership;
    • Treatment of UK and EU27 citizens in the respective jurisdictions after Brexit; and
    • Arrangements to prevent a hard border between Northern Ireland (which is part of the UK) and the Republic of Ireland.
  • There is also a “forward-looking”, non-binding Political Declaration setting out the ambitions of the UK and the EU27 for the future economic relationship following Brexit.
“Hard Brexit”

• What is the approval process?
  • The UK Cabinet provided its initial political agreement to the deal.
  • The EU27 then provided its political agreement to the deal.
  • The deal has foundered in the UK House of Commons:
    • UK Prime Minister Theresa May scheduled, and then cancelled, a vote on the deal as criticism mounted.
    • Mrs May’s own party triggered a vote of confidence in her leadership of the Conservative Party – and by extension, her position as prime minister – which she won by a vote of 200-117.
    • In the absence of a vote on the plan, Members of Parliament have begun to argue for alternative solutions, such as renegotiation, a general election or a second referendum.
  • The European Court of Justice ruled that an EU Member State that submitted a valid Article 50 notice has the power to revoke that notice unilaterally in accordance with its constitutional principles.
Challenge #1: No More Passports

What is a Passport?

• EU financial services legislation is generally – but not entirely – characterised by the use of “passports” which permit a firm that is authorised or licensed in a given EU Member State to perform the services or activities for which it is licensed across the EU.

• *Example:* Investment services and activities are governed by the revised Markets in Financial Instruments Directive (“MiFID II”) which, like its predecessor MiFID, permits an authorised investment firm to provide investment services and perform investment activities anywhere in the EU.

• With London at the centre of the EU’s financial system, UK-based firms have benefited from the ability to passport their services and activities to clients and counterparties across the EU.
Challenge #1: No More Passports

What happens in a Hard Brexit?

• UK would become a “third country” under MiFID II.
  • Third-country firms must generally look to the domestic implementation of MiFID II licensing obligations in each EU Member State in which it intends to conduct investment business.
  • Many EU Member States have relatively undeveloped third-country licensing frameworks or exemptions for third-country firms active in the wholesale markets.
  • In effect, in a Hard Brexit, UK firms will be in the same position as any other third-country firm (e.g., US firms, Japanese firms, Australian firms, etc.).
• In addition, “inbound” passporting from the EU27 would no longer be permitted, and EU27 investment firms would need to determine a legal basis on which to continue to provide investment services or perform investment activities in the UK.
Challenge #1: No More Passports

Potential Solutions:

- **Article 46 of MiFIR**
  - This provision enables a “third-country passport” for firms in jurisdictions that benefit from a determination by the European Commission that their local statutory and regulatory regime applicable to investment services is equivalent to that established by MiFID II and MiFIR.
  - Equivalence decisions cannot be formally requested and are solely within the purview of the European Commission to grant.
  - No equivalence decisions under the Article 46 regime have yet been issued.

- **Business Restructuring**
  - Firms may find it necessary to establish a presence in an EU27 Member State that can be authorised under MiFID II.
  - Many international firms, as well as UK firms, have been working diligently on establishing EU27 presences and obtaining relevant licenses from the local regulator.
  - These work streams have, in many cases, anticipated some form of transition period that would no longer be available in the event of a “Hard Brexit”.
Challenge #2: Access to Infrastructure

- The UK serves as the home to much of the key market infrastructure relied on by EU27 firms, including:
  - central counterparties (“CCPs”)
    - ICE Clear Europe
    - LCH Limited
    - LME Clear Limited
  - trading venues
    - ICE Futures Europe
    - London Stock Exchange
    - Cboe Global Markets
    - many of the major inter-dealer brokers / MTFs / OTFs
  - repositories
    - UnaVista Limited
    - ICE Trade Vault Europe Limited
    - DTCC Derivatives Repository plc
    - Bloomberg Trade Repository Limited
Challenge #2: Access to Infrastructure

CCPs

- Key questions to determine service continuity:
  - Does UK law permit a UK CCP to offer clearing services to EU27 clearing members?
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  - Does EU law permit an EU27 CCP to offer clearing services to UK clearing members?
  - Can UK clearing members of EU CCPs offer clearing services to EU27 clients?
  - UK subsidiaries of EU27 banking groups will also face adverse capital consequences if UK CCPs are not “recognised” CCPs under EMIR.
Challenge #2: Access to Infrastructure

Potential Solutions

• Equivalence/Recognition under EMIR
  • EMIR permits third-country CCPs to offer clearing services to EU clearing members and EU trading venues where the relevant local jurisdiction benefits from an equivalence determination by the European Commission.
  • A third-country CCP can then apply for recognition pursuant to the equivalence determination.
  • Recognition also ensures that the third-country CCP is a “qualifying CCP” for purposes of the EU’s capital regime.

• Restructuring
  • UK and EU27 clearing members may be required to restructure their existing clearing arrangements if equivalence/recognition is unavailable.
Challenge #2: Access to Infrastructure

Trading Venues

- Key challenges:
  - MiFID II requires that providers of DEA to EU trading venues must be authorised investment firms, effectively restricting this to EU27 firms.
  - MiFID II also requires that own-account dealing firms that have DEA to EU trading venues must be authorised investment firms, effectively restricting this to EU27 firms.
  - MiFIR requires that OTC derivatives that are subject to mandatory trading obligations may only be executed on EU trading venues or equivalent third-country venues.
  - EMIR treats exchange-traded derivatives on non-recognised third-country venues as OTC, triggering specific compliance obligations that are not suitable for exchange-traded products.
  - In addition, the national regulatory regimes of each EU27 Member State govern the extent to which a UK trading venue can continue to provide trading connectivity to firms in a given EU Member State.
Challenge #2: Access to Infrastructure

Potential Solutions

• Equivalence
  • MiFIR contains a bespoke equivalence regime to permit EU27 firms to comply with a mandatory trading obligation on third-country venues that are considered equivalent for that purpose.
    • Example: CFTC-European Commission Agreement
    • However, this equivalence determination would not displace any national licensing requirements for a UK trading venue in an EU Member State where a trading participant may be located.

• Exemptive Relief
  • National regulatory regimes could be amended to provide licensing exemptions to UK firms that are DEA providers or DEA clients.
    • The same approach could be taken to facilitate continuity in access to UK trading venues.

• Restructuring
  • EU27 participants on UK trading venues, and UK participants on EU27 trading venues, may be required to restructure their existing trading access arrangements if equivalence or exemptive relief is unavailable.
Challenge #2: Access to Infrastructure

Repositories

- Key challenges:
  - EU firms cannot satisfy their reporting obligations by submitting reports to UK repositories.
  - Also potential risks for contract continuity.

Solutions

- Equivalence/Recognition
  - EMIR and SFTR provides for an equivalence/recognition regime for third-country repositories.
  - No such recognition has yet been made under either legislation.

- Restructuring
  - UK repositories may be required to establish EU27 presences, and vice versa.
Challenge #3: Continuity of Contracts

- Linked to Challenges #1 and #2, the majority of contracts for financial products and services will have a number of elements comprising different regulated activities embedded in them.

- To date, UK firms in the wholesale market have been able to transact in most complex derivatives products largely without restriction.
  - e.g., longer-dated OTC derivative contracts entered before Brexit, with the benefit of a passport.

- Each affected element of a contract between a UK firm and an EU27 firm will need to be analysed to assess whether it remains permissible or whether it is now restricted or prohibited.
  - e.g., is it still permissible for a UK firm to exercise rights or perform obligations under the contract without being licensed in the EU?
  - Such assessments will need to be made at EU level (e.g., MiFID II) and relevant national levels (e.g., national licensing regimes).
  - As ever, it is possible that the outcome of the assessment may differ from EU27 Member State to EU27 Member State and counterparty to counterparty.

- Uncertainty as to whether elements of a continued activity or any changes to contracts are a regulated activity in the respective EU jurisdictions may have a material impact on the commercial outcomes that the contracts are meant to support, and could therefore lead to a wider renegotiation of the economic terms between the counterparties.
Challenge #3: Continuity of Contracts

- Affected contracts may need to be transferred, restructured or potentially terminated.
- Co-operation with counterparties could be difficult to secure.
- The implications of such actions could include:
  - significant demands upon management time and resource;
  - one-off reorganisation costs including impacting capital requirements for new entities;
  - crystallisation of tax liabilities;
  - the need to understand and evaluate commercial changes such as the credit risk of a new counterparty and any impact on netting positions; and
  - ongoing expense where it is not possible to restructure the affected contract on a like-for-like basis.
Challenge #3: Continuity of Contracts

Potential Solutions

• Legislation
  • Common EU legislative provisions could provide for continuity.
    • Not without precedent – see for instance the introduction of the Euro and EMIR.
  • Member States and the UK could each legislate to ensure contractual certainty for a specified number of years where appropriate or required.
    • Could allow time for business to “roll-off” of old entity and onto a new entity.
    • Depending on the timeframe provided, could also just delay the “cliff-edge”.
    • e.g., German proposal to amend Banking Act to empower BaFin to permit the continued performance of pre-Brexit financial transactions by UK firms with German counterparties until 2020.

• Repapering
  • As mentioned, there are significant drawbacks to repapering on a contract by contract basis.
Potential Mitigation: UK

• Retained EU Law
  • The UK proposes to transpose so-called “retained” EU law in its entirety into UK law on 29 March 2019 (“Exit Day”), with minor amendments to cure defects, e.g., replacing references to EU authorities with the relevant UK replacement.
  • Retained law includes primary legislation as well as secondary implementing measures.
  • Note that EU Directives have already been implemented under UK law.
  • There are special arrangements in place for so-called “in-flight” EU law, i.e. EU legislation that is in the process of finalisation but which will not be effective on Exit Day.
  • H.M. Treasury is in the process of preparing ~70 Statutory Instruments to facilitate the transposition of retained EU law into UK law.
Potential Mitigation: UK

- **Temporary Permissions/Recognition Regimes**
  - UK authorities have announced a “temporary permissions regime” and an accompanying “temporary recognition regime”.
  - The TPR will enable EU firms currently using a passport to operate in the UK to continue to do so following Exit Day.
  - The TRR will provide similar relief to non-UK CCPs that are currently permitted to offer clearing services in the UK.

- **UK National Regulatory Framework**
  - Overseas Persons Regime
  - Recognised Overseas Investment Exchange
  - Recognised Overseas Clearing House
Potential Mitigation: EU / Member States

- European Commission
  - Communication on Brexit Contingency Planning
  - Time-limited recognition of UK CCPs under EMIR
- European Supervisory Authorities
  - Draft RTS for OTC Derivative novation
  - ESMA Statement on Central Clearing
  - Requests for timely authorisation submissions
- Germany
  - Draft legislative amendments to facilitate contract continuity.
- France
  - Enabling framework to empower French authorities to limit financial and economic impact of a Hard Brexit.
Trans-Atlantic Impact: The CFTC

Existing EU-Specific Arrangements

• Some clarification/adjustment needed to account for the UK’s departure from the EU.

• EU-Specific Comparability Determinations
  • UK specific equivalents may be needed
  • e.g., Dually-Registered DCOs and CCPs, Transaction/Entity Level Requirements

• No-Action Letters

• Part 30.10 Orders

Impact of Post-Brexit EU Legislative Reforms

• The so-called “EMIR 2.2” will impose new supervisory and ongoing compliance requirements on third-country CCPs.

• The CFTC has expressed concerns about the potential invasive nature of these requirements as applied to US CCPs (e.g., CME).
# ABA – Hard Brexit: Three Major Challenges

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Memorandum

17 December 2018

AMERICAN BAR ASSOCIATION BUSINESS AND LAW SECTION

Derivatives & Futures Law Committee Winter Meeting

Florida, January 2019

PANEL ON INTERNATIONAL DEVELOPMENTS

Chris Bates, Partner, Clifford Chance LLP

1. Introduction

1.1 This paper aims to provide participants with an update on recent international developments relevant to the regulation of derivatives and futures markets and transactions, focusing on selected developments in the EU and the UK.

1.2 This paper is intended to be a summary of the matters discussed. It is not intended to be comprehensive or to provide legal advice to any person.

2. EU legislative initiatives

2.1 The EU institutions are seeking to reach agreement on several legislative initiatives before the end of the current terms of the European Parliament and the European Commission. Work in the current term of the Parliament comes to an end on 18 April 2019 before the Parliament elections at the end of May 2019. The term of the current Commission ends on 31 October 2019 and the process for appointment of the new Commission will begin well before then.

2.2 Legislative initiatives not finalised by the end of the Parliament's current term do not automatically lapse. However, if a legislative initiative is not agreed by the Parliament and the Council of the EU before the end of the Parliament's current term, there is likely to be at least a significant delay before the measure can be finalised and adopted.

2.3 In addition, a new Commission may decide to withdraw existing legislative proposals, applying the principle of 'legislative discontinuity', which applies at the start of the mandate of a new Commission. The incoming Commission may review the proposals which have been put to the legislators by its predecessor but not yet adopted. It then
decides whether to pursue work in these areas, taking into account the views expressed by Parliament.

EMIR REFIT

2.4 The European Market Infrastructure Regulation (EMIR) was adopted in 2012 and set the rules for the clearing, reporting and margining of OTC derivatives. EMIR also provides for the national authorisation of EU central counterparties (CCPs) and the recognition by the European Securities and Markets Authority (ESMA) of non-EU ('third-country') CCPs.

2.5 Between 2015 and 2016, the Commission undertook a review of the implementation of EMIR in the context of its regulatory fitness and performance programme (REFIT) which led to the adoption of a legislative proposal for a first set of amendments in May 2017. The Parliament and the Council of the EU have both proposed amendments to this proposal and are now seeking to reconcile those amendments and to finalise the text through the inter-institutional process known as the 'trilogue'.

2.6 The legislation that will emerge from trilogue is likely to include the following:

(a) An extension of the definition of 'financial counterparty' to cover a wider group of alternative investment funds. However, the Parliament and the Council texts did not adopt the Commission's proposal to extend the definition to cover securitisation special purpose entities.

(b) The introduction of a regime exempting small financial counterparties from the clearing obligation (but with no corresponding exemption from the margin rules) and changes to the regime for non-financial counterparties so that they would only become subject to the clearing obligation for the individual asset classes in which they exceed the clearing threshold.

(c) New powers for the Commission to suspend the clearing obligation in exceptional circumstances, while removing the 'front-loading' requirements.

(d) Requirements for clearing members (and clients of clearing members offering indirect clearing services) to provide their services on fair, reasonable, non-discriminatory and transparent commercial terms (FRANDT).

(e) Requirements for financial counterparties to assume responsibility for the reporting of trades with non-financial counterparties under the clearing threshold (while maintaining the principle of two-sided reporting), exemptions for non-financial counterparties from reporting intra-group transactions and
removal of the requirement to back-load reports of transactions that expired before the reporting obligation took effect.

(f) An extension of the exemption for pension schemes from the clearing obligation for another three years (the existing exemption has already expired).

2.7 Other areas that are under discussion include the extension of the exemption for central banks to cover all non-EU central banks, the treatment of physically-settled FX swaps and equity derivatives for margin purposes and new requirements for follow-up reports on possible exemptions from the clearing obligation for post-trade risk reduction services such as portfolio compression, the structure of the reporting obligation and the extension of CCP eligible collateral to include money market funds.

2.8 There are also discussions as to when the requirements should begin to apply, so as to give firms more time to implement the new rules. The Commission had proposed that some changes would take effect immediately after publication of the new law, although others would only apply after six or 18 months. In addition, the delays in adopting the legislation could mean that the new exemption from clearing for small financial counterparties may only come into effect after the start date of the clearing obligation for 'category 3' counterparties and that the relief from back-loading of expired transactions may come into force after the deadline for reporting those trades.

EMIR 2.2

2.9 The other output of the EMIR review was a second legislative proposal in June 2017 (amended in September 2017) amending EMIR to establish a new approach to the supervision of EU CCPs and for the recognition of non-EU CCPs by ESMA. This was accompanied by a proposal to amend the Statute of the European System of Central Banks to give the European Central Bank (ECB) powers with respect to the supervision of clearing systems. The Parliament has adopted its report on these proposals, but the Council has yet to finalise its general approach and so trilogue discussions will not get under way before 2019.

2.10 The proposals aimed to give ESMA and EU central banks a much stronger role in the supervision of EU CCPs, including requirements for national competent authorities to obtain the consent of ESMA or the central bank of issue of the relevant currency for certain supervisory decisions. These proposals seem likely to undergo significant change as a result of the views expressed by the Parliament and the Council during the legislative process.

2.11 The proposals also aimed to change the system of recognition for non-EU CCPs as follows:
(a) ESMA would continue to recognise non-EU CCPs that are not regarded as being systemically important in the EU (a 'Tier 1' CCP) in much the same way as under the current system, i.e., on the basis of deference to the CCP's (equivalent) home state regulation.

(b) If ESMA determines that a non-EU CCP is systemically important in the EU (a 'Tier 2' CCP), the CCP would only be recognised if the CCP also complies with the EU rules for CCPs (subject to the possibility of substituted compliance with home state regulations where there are comparable requirements in the CCP's home state) and with requirements imposed by EU central banks (where the CCP clears instruments in their currency). In addition, ESMA would have additional powers to conduct on-site examinations and require information from Tier 2 CCPs.

(c) If ESMA determines that a non-EU CCP is of such systemic importance that the risks to the EU cannot be adequately mitigated by the measures for Tier 2 CCPs (a 'Tier 3' CCP), ESMA would be able to refuse recognition. In that event, the CCP would have to establish a CCP within the EU if it wishes to provide clearing services to EU clearing members or trading venues.

2.12 The proposals for non-EU CCPs were largely motivated by concerns about the implications for the EU of the role of UK CCPs in relation to EU financial markets following Brexit. However, the proposals have also provoked a strong reaction from US Commodities and Futures Trading Commission (CFTC) as they are regarded as undermining the arrangements agreed in 2016 between the CFTC and the European Commission in relation to the cross-border activities of EU and US CCPs.

Investment firm review

2.13 In January 2018, the Commission submitted legislative proposals for a new regulation and directive on the prudential supervision of investment firms (the IFR and IFD).

2.14 These proposals aim to transfer the prudential supervision for large, systemically important non-deposit-taking investment firms to bank supervisors by designating those firms as 'credit institutions'. This would also mean that the ECB would directly supervise those firms where they are established in one of the Member States participating in the single supervisory mechanism. This is partly in response to Brexit as the ECB had expressed concern about its lack of oversight of large investment firms, with significant securities and derivatives trading activities, being established in the eurozone as part of international banks' Brexit relocation plans. National supervisors would continue to supervise other, non-systemically important investment firms but subject to a new regime for determining the capital requirements for those firms.
2.15 The IFR also included another proposal that is linked to the Commission's concerns about the important role that UK firms might continue to play in EU financial markets after Brexit. The Markets in Financial Instruments Regulation (MiFIR) includes a regime under which investment firms from non-EU states determined to have regulatory regimes equivalent to that in the EU are able to provide cross-border services to professional clients and eligible counterparties in the EU, subject to registration by ESMA (but without the need for individual authorisation in the Member States). The Commission proposal included changes to this regime that would require the Commission to carry out a 'detailed and granular' assessment of the non-EU state's regulatory regime where the services of firms from that state would be likely to be of systemic importance for the EU.

2.16 Amendments proposed by the Parliament would further limit this regime by restricting its scope so that it does not cover services that involve 'dealing on own account' or underwriting. If adopted, these changes would mean that non-EU firms (including UK firms after Brexit) could not rely on the regime for large parts of their securities and derivatives trading business with EU clients and counterparties even if there is an equivalence decision in respect of the relevant non-EU state. The Council has yet to finalise its position on this proposal. Some proposals in the Council would prevent firms using the regime for cross-border business altogether (by requiring any activities to be conducted through a branch). Other proposals would give the Commission power to require firms relying on the regime to comply with additional requirements specified by it where it considers appropriate.

**Benchmarks Regulation**

2.17 The EU Benchmarks Regulation (BMR) was adopted in 2016 and applied from 1 January 2018. It requires EU administrators of financial 'benchmarks' to be authorised or registered in the EU and to comply with regulatory requirements based on the IOSCO Principles for Financial Benchmarks and Principles for Oil Price Reporting Agencies. Contributors to EU benchmarks are also subject to specific requirements. EU supervised entities that use benchmarks in the EU are required to ensure that the benchmarks they use are provided by an EU administrator that is authorised or registered in the EU or, where they are provided by a non-EU administrator, that the benchmarks are qualified for use in the EU under one of the third-country regimes in the BMR. EU supervised entities that use benchmarks are also required to have robust written plans addressing the discontinuance of or material changes to the benchmarks and to reflect those plans in their contracts with clients.

2.18 The BMR includes transitional provisions that allows EU administrators of existing benchmarks until the end 2019 before they must apply for authorisation or registration...
and allows supervised entities to continue to use their benchmarks pending the outcome of the application. EU supervised entities are also able to use benchmarks provided by non-EU administrators up to the end of 2019 but after that will only be able to use those benchmarks in new instruments if the benchmarks have been qualified for use in the EU under one of the BMR's third-country regimes.

2.19 These provisions have given rise to a number of issues.

(a) Euribor and Eonia have been designated as 'critical benchmarks' under the BMR but their administrators may not be able to obtain authorisation or registration under the BMR before the expiry of the transitional period. Proposed amendments to a current legislative proposal on low carbon benchmarks would extend the transitional period under the BMR for these critical benchmarks by two years.

(b) The BMR specifies three regimes under which non-EU administrators may qualify their benchmarks for use in the EU: the equivalence, recognition and endorsement regimes. However, there are significant obstacles to non-EU administrators making use of these regimes. Few non-EU states have equivalent regimes for the authorisation of administrators of benchmarks (and where these exist they may be limited to local critical benchmarks). Non-EU administrators may also be unwilling or unable to seek recognition or endorsement for their benchmarks in the EU, e.g., because of the need to maintain an EU legal representative or have an EU supervised entity endorse their benchmarks, especially as the legal representative or supervised entity will have significant responsibilities in relation to the oversight of the benchmarks. As a result, there is a risk that, from the end of 2019, EU supervised entities might be prevented from using non-EU benchmarks in a wide range of derivative and other financial instruments. There are no current proposals to amend the BMR to extend the transitional period for these benchmarks.

(c) The requirement for firms to reflect their 'robust written plans' relating to discontinuance and changes to benchmarks in their contractual documents with clients has led to work by firms to amend documentation to provide for adequate fall-backs where a benchmark is discontinued. The ISDA 2018 Benchmarks Supplement Protocol represents one of the responses to this requirement.

Other changes

2.20 Other changes under consideration that are relevant to derivatives include the following:
(a) In November 2018, the Commission proposed a directive on the recovery and resolution of CCPs.

(b) The Commission proposals for reforms to the functioning of the European Supervisory Authorities (ESAs) have sparked debate about whether the ESAs (or the Commission) could be given formal powers that would correspond to the powers of US regulators to issue 'no action letters'.

(c) The Commission has launched a wide-ranging review of supervisory reporting, including reporting under EMIR and MiFIR, to determine the extent to which it is 'fit for purpose'.

(d) The so-called 'risk reduction package' of legislative proposals amending the EU capital requirements legislation (CRR and CRD4) and the EU Bank Recovery and Resolution Directive (BRRD) and the related EU regulation on the Single Resolution Mechanism (SRM) include proposals to introduce a new moratorium on termination of contracts in advance of resolution proceedings in addition to the existing post-resolution moratorium on termination. However, it seems likely that the eventual legislation will include a mechanism to prevent the moratorium lasting for an over-extended period that might adversely affect derivatives business. The eventual legislation is also likely to include new requirements for derivatives documentation to include provisions recognising the powers of the EU resolution authorities to stay termination of contracts where the contracts are entered into by EU institutions subject to BRRD or their subsidiaries and the contracts are governed by the law of a non-EU state.

(e) The current proposal for a new EU directive on preventive restructuring frameworks for insolvent businesses also includes provisions that would impose a moratorium on the termination of contracts and enforcement of collateral that might affect derivative contracts with non-financial corporates. However, it seems likely that there will be amendments that will allow Member States to exclude derivatives from these requirements.

(f) The Commission has again extended (to June 2019) the transitional provisions under CRR that allow EU institutions subject to CRR to treat non-EU CCPs as QCCPs for their regulatory capital purposes.

(g) Industry advocacy efforts are underway to encourage the ESAs to propose an extension to the transitional derogations from the clearing and margin requirements for certain intragroup transactions between EU and non-EU affiliates. Some of these expire soon (as early as 21 December 2018 in relation to the clearing obligation for G4 rates).
3. Brexit

3.1 The UK is to leave the EU at 11pm (UK time) on 29 March 2019.

3.2 This will have a major impact on firms using the UK for their derivatives business with clients and counterparties in the other 27 EU Member States (EU27), as well as those EU27 firms conducting derivatives business in the UK. Firms will lose their 'passport' rights under EU legislation to conduct cross-border business between the UK and the EU without local authorisation, as well as other privileges that apply to firms incorporated and operating within the EU single market. UK-based firms have been responding to the challenges by putting in place plans to relocate activities from the UK into the EU27, principally by creating new EU27 subsidiaries to conduct this business or by scaling up the activities of existing authorised entities in the EU27. In many cases, these plans are at an advanced stage but there are still challenges in fully completing the transfer of activities by the end of March.

Proposed withdrawal agreement

3.3 The UK government and the EU negotiators have negotiated an agreement setting out the terms on which the UK will withdraw from the EU. This agreement is subject to ratification by both parties. On the EU side, ratification requires the consent of the European Parliament and the final endorsement of the Council of the EU. On the UK side, ratification requires a vote in the UK Parliament and the enactment of legislation to give effect to the agreement in UK domestic law. At present, it appears that the UK government is unable to secure the necessary majorities in the UK Parliament and so it is possible that the withdrawal agreement may never be concluded.

3.4 However, if the agreement were concluded in its agreed form, it would establish a transition (or implementation) period lasting from the date of the UK's withdrawal until the end of 2020 and capable of being extended by one or two more years by agreement of the parties. During the transition period, the withdrawal agreement would largely preserve the status quo for business (although the UK will lose its voice in the institutional structure of the EU, including the right to vote on new laws). In particular, the UK would continue to apply EU law, including new EU laws that apply during that period, and the UK would be treated as if it were a Member State for the purposes of EU law, both as it applies in the UK and as it is applied in the EU27. Therefore, firms would have more time to complete their relocation plans.

3.5 The proposed withdrawal agreement also envisages that during the transition period, the UK and the EU would negotiate and conclude a new agreement or set of agreements governing the long-term relationship between the parties. A draft political declaration agreed alongside the draft withdrawal agreement sets out the parameters for this
negotiation. With respect to financial services, the declaration envisages that EU will treat the UK in much the same way as other 'third countries' as both parties would retain regulatory and decision-making autonomy, including the ability to take equivalence decisions in their own interests. However, the declaration also envisages that the EU and the UK would seek to conclude equivalence assessments of each other's regulatory regimes by 1 July 2020, that the UK and the EU should maintain close and structured cooperation on regulatory and supervisory matters and that there should be "transparency and appropriate consultation" in the process of adoption, suspension and withdrawal of equivalence decisions.

3.6 The agreement envisages a 'backstop' arrangement between the UK and the EU to avoid a 'hard' land border between the Republic of Ireland and Northern Ireland requiring customs and other procedures for goods crossing that border. This would come into effect at the end of the transition period unless superseded by a long-term agreement between the parties that addresses these issues. The backstop arrangement does not include provisions that would address the continued provision of cross-border services between the UK and the EU.

'No deal scenario'

3.7 Firms preparing for Brexit have been encouraged to 'hope for the best but prepare for the worst'. Financial services firms have therefore been preparing for Brexit on the assumption that the UK leaves the EU at the end of March 2019 without the UK concluding a withdrawal agreement with the EU and therefore without any transitional arrangements agreed between the UK and the EU. The importance of these preparations has been reinforced by the recent political deadlock in the UK over the approval of the withdrawal agreement.

3.8 The authorities have emphasised that firms have the primary responsibility for these preparations. However, the EU and the UK have each indicated that they will take some unilateral actions to mitigate the impact of this 'no deal scenario' on the financial sector.

3.9 The EU actions are relatively limited.

(a) The European Commission has now accepted that there would be risks to financial stability if EU firms were prohibited from using UK CCPs to clear their derivative and other transactions after the UK's withdrawal from the EU in a no deal scenario. Therefore, it is proposing to adopt, in the next few days after writing, a decision recognising the equivalence of the planned UK post-Brexit regime regulating UK CCPs, with a view to ESMA granting recognition to existing UK CCPs under EMIR with effect from the UK's withdrawal from the EU. However, this decision would expire 12 months after Brexit and its
extension would depend on the UK and the EU reaching a wider long-term arrangement on UK access to the single market. The Commission also reserves the right to review (and withdraw) the decision for other reasons, including if there are changes in the UK regime or if the UK authorities fail to implement the detailed requirements proposed by the Commission for ESMA’s access to supervisory information on UK CCPs. The Commission is also proposing to adopt a similar equivalence decision in respect of UK central securities depositories (limited to a 24-month period after Brexit).

(b) There are a number of obstacles to be overcome when UK firms are transferring business with EU clients or counterparties to their affiliates in the EU. One of these is the possibility that the novation of existing derivatives transactions to the EU affiliate may result in the transaction losing the benefit of exemptions from clearing or margining requirements under EMIR that apply to certain legacy transactions. To address this, the ESAs have proposed amendments to the existing technical standards that would create a 12-month window after a 'no deal' Brexit within which these novations could take place without triggering those requirements. These changes are subject to endorsement by the Commission and no objection from the Parliament and the Council.

(c) The Commission has indicated that it is up to Member States to take other legislative actions that may be necessary to mitigate the impacts of Brexit on cross-border business arising in a no-deal scenario. As a result, there have been legislative initiatives in several Member States, including Finland, France, Germany, the Netherlands and Sweden. It is expected that other Member States will publish initiatives shortly. In most cases, the legislation aims to give regulators powers to allow UK firms to continue to conduct some types of cross-border activity without full local authorisation for a period after Brexit, with a view to allowing UK firms to continue to service existing cross-border derivatives and other transactions that have not yet been transferred to EU affiliates (including by conducting so-called 'life-cycle events', such as portfolio compression). However, in most cases, the scope of permitted cross-border activity will depend on the use the regulators make of the powers conferred on them. In addition, in some cases, the legislation also aims to preserve the protection currently available to UK clearing or settlement systems (while the UK is a Member State) against the insolvency of a local participant, in order to facilitate continued membership of UK systems by local firms.

(d) The Commission has also encouraged the ESAs to conclude supervisory cooperation agreements with the UK authorities (an agreement between the ESMA and the UK authorities is a pre-condition to ESMA recognition of UK
CCPs and central securities depositories). In addition, Member State competent authorities are expected to seek to agree supervisory cooperation agreements with the UK authorities to facilitate continued cooperation in the supervision of other entities (e.g., to allow investment management firms to delegate investment management activities to UK affiliates).

3.10 The UK proposes to take a much wider range of actions to mitigate the impact of a no-deal scenario on the financial sector.

(a) In June 2018, the UK enacted the European Union (Withdrawal) Act 2018 (EUWA). The EUWA repeals the UK legislation underpinning the UK's membership of the EU with effect from the day the UK leaves the EU ('exit day'). It also converts existing EU law into UK domestic law as from exit day while giving the UK government extensive powers to adopt regulations modifying UK domestic law and the 'onshored' elements of EU law to ensure that it works effectively when the UK is no longer an EU Member State. The UK government has also adopted regulations delegating powers under the EUWA to the UK regulators to adapt their existing rulebooks and existing EU technical standards to reflect the UK's exit from the EU.

(b) The UK government is expected to adopt approximately 80 statutory instruments setting out regulations adapting EU-derived financial services legislation (of which approximately 30 have now been published). These instruments are subject to Parliamentary scrutiny and in some cases will require approval by resolutions in Parliament. The UK regulators have now published consultation documents proposing extensive changes to their rulebooks and existing technical standards.

(c) In addition, the UK government has proposed additional legislation to enable it to adapt UK law in the two years following Brexit to maintain alignment with expected post-Brexit changes to EU law. The government also proposes to grant the UK regulators additional powers to make transitional arrangements to mitigate the impact on firms of the change in the regulatory regime on exit day resulting from the UK exit from the EU.

(d) The approach of the UK government and regulators to onshoring EU law under the EUWA is, with limited exceptions, to treat EU firms and EU-related situations after Brexit in the same way as the EU law currently treats non-EU firms and situations. However, the Government is implementing a number of transitional regimes to mitigate the immediate impact of Brexit on firms and their clients. For example, the Government is establishing a temporary permissions regime under which EU firms passporting into the UK at exit day
can receive temporary permission to operate in the UK for up to three years while they apply for full authorisation (HM Treasury will have powers to extend this period). It is expected that the Government will propose additional regulations to allow EU firms to perform regulated activities connected to the performance of existing contracts after the expiry of these permissions.

(c) In some cases, these measures may have impacts on non-EU firms. For example, the regulations onshoring EMIR will transfer to the Bank of England the task of recognising third-country CCPs in the UK. This will mean that CCPs currently authorised in other Member States will need to seek recognition in the UK by the Bank of England. In addition, non-EU CCPs currently recognised or seeking recognition by ESMA will need to seek recognition by the Bank of England as well. In both cases, this will require HM Treasury to adopt new equivalence determinations with respect to their home state regimes and for the CCPs’ home state authorities to enter into new supervisory cooperation agreements with the Bank of England. However, to mitigate the impact of this new regime on both EU and non-EU CCPs, the onshoring regulations put in place a regime under which non-UK CCPs that are currently authorised or recognised in the EU (or benefiting from transitional arrangements) can elect for temporary recognition in the UK for up to three years pending grant of full recognition (again, HM Treasury will have powers to extend this period).

(f) The UK authorities are also liaising with regulators in non-EU jurisdictions to seek actions to mitigate the impact on firms of the UK’s exit from the EU. For example, the CFTC has granted a number of reliefs from its derivatives rules that apply where firms are subject to comparable requirements under EU law. The UK authorities are working with the CFTC with a view to the CFTC taking action to make similar reliefs available where firms are subject to the corresponding requirements under the UK law applicable after Brexit. The UK authorities are working with authorities in some other jurisdictions where similar issues may arise.

(g) These mitigating actions will reduce but not eliminate the need for firms and other parties to take action in a no-deal scenario. They may need to take steps to opt into temporary permission or recognition regimes and to take steps to comply with new requirements. These may involve notices to clients or counterparties, changes to documentation or new internal compliance arrangements.
Other outcomes

3.11 The current political stalemate in the UK may lead to a request to extend the two-year period for negotiating the withdrawal agreement with the EU that expires on 29 March 2019. The European Council acting unanimously, in agreement with the UK, has the power to extend this period and thus to defer the UK's exit from the EU.

3.12 In addition, the Court of Justice of the EU has recently issued a judgment deciding that the UK has the unilateral right, based on a decision taken in accordance with its constitutional requirements, to revoke its notice terminating the UK's membership of the EU. To do so, the UK would need to give an irrevocable and unconditional notice to the European Council to that effect at any time before the UK's withdrawal becomes effective. In that event, the UK would continue to be a Member State on the same terms as today.

3.13 However, at the time of writing, there is no clear future path for Brexit. There are calls within the UK from different political actors for a pause to the withdrawal process to allow a second referendum on the UK's membership of the EU, for a general election to replace the current government and for renegotiation of the withdrawal agreement to remove or amend the Irish 'backstop' or to replace the existing ambitions for a long-term relationship with either a closer or a more distant relationship with the EU. On the EU side, EU leaders have indicated that they are unwilling to renegotiate the withdrawal agreement. Furthermore, most, if not all, political actors in the EU and the UK consider that a 'no-deal scenario' is extremely undesirable and should be avoided. However, the default position remains that, if no action is taken, the UK will leave the EU at the end of March 2019 without a withdrawal agreement or any agreed transition arrangements.
CFTC Chairman Authors White Paper on Cross Border Swaps Regulation Version 2.0

By: Ian Cuillerier, Edward So and Rhys Bortignon

Prepared for the ABA Business Law Section: Derivatives & Futures Law Committee Meeting

January 24-26, 2019, Naples, FL

1. Introduction

On October 1, 2018, Chairman J. Christopher Giancarlo of the Commodity Futures Trading Commission ("CFTC") published a white paper entitled “Cross-Border Swaps Regulation Version 2.0: A Risk-Based Approach with Deference to Comparable Non-US Regulation” (the “White Paper”). The White Paper is intended to contribute to the process of cross-border swaps reform to produce a regulatory framework consistent with congressional intent, while balancing the need to both (i) mitigate systemic risk and support swap market activity to promote economic growth and (ii) show deference to non-US regulation when it achieves comparable outcomes to CFTC regulation.

The White Paper offers high-level principles and recommendations for reform. It does not propose detailed modifications to specific CFTC regulations, and refrains from setting any timetables for implementation. Chairman Giancarlo considered the CFTC’s experience over the last few years in regulating the US derivatives market, the need for comity with non-US regulators and the implementation of swaps reforms in non-US jurisdictions to determine where the original regulatory efforts would benefit from reconsideration. From this, Chairman Giancarlo developed the principles and recommendations set out in the White Paper.

The White Paper complements the white paper previously published by CFTC Chairman J. Christopher Giancarlo and CFTC Chief Economist Bruce Tuckman on April 26, 2018. For further information on that white paper, please refer to our client alert available at the link here.

This client alert will discuss the CFTC’s existing rules and guidance as well as the White Paper’s proposals for further reform of the CFTC’s cross-border framework.

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1 Ian Cuillerier and Edward So are partners and Rhys Bortignon is an associate in the New York office of White & Case LLP. This article is current as of December 18, 2018.


3 This White Paper assessed the successes and deficiencies of the CFTC’s implementation of the Dodd-Frank Act in five areas: central counterparty clearing, trade reporting, trade execution, swap dealer capital and the end-user exception.
2. **Background**

2.1 **CFTC’s Jurisdiction**

Section 2(i) of the US Commodity Exchange Act provides in pertinent part that the CFTC’s jurisdiction over swaps shall not apply to activities outside the US unless they have a “direct and significant connection with activities in, or effect on, commerce in the United States...”. The scope of the CFTC’s extraterritorial jurisdiction has been the subject of several CFTC rules, rule proposals, guidance, staff advisories and no-action relief. In the White Paper, Chairman Giancarlo argues that the CFTC’s existing cross-border framework, in certain respects, extends the CFTC’s jurisdiction beyond what Congress intended when it passed the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”).

2.2 **CFTC Cross-Border Guidance**

On July 26, 2013, the CFTC issued interpretive guidance (the “CFTC Cross-Border Guidance”) setting forth its views on the cross-border application of certain provisions of the Dodd-Frank Act. The CFTC Cross-Border Guidance addressed several important topics:

- the final definition of the term “US person,” including the treatment of foreign branches of US swap dealers and major swap participants, guaranteed affiliates, and conduit affiliates;

- the determinations of whether a non-US person is engaged in more than a de minimis level of swap dealing or holds swap positions above any of the major swap participant thresholds; and

- compliance obligations, including substituted compliance by non-US persons, foreign branches of US swap dealers and major swap participants with entity-level requirements and transaction-level requirements.

The CFTC noted in the CFTC Cross-Border Guidance that it has a strong supervisory interest in swap dealing activities that occur within the US, regardless of the status of the counterparties.

For further information on the CFTC Cross-Border Guidance, please refer to our client alert available here.

2.3 **CFTC Staff Advisory 13-69**

In response to requests from market participants for clarification regarding the applicability of US transaction-level requirements for swaps between a non-US swap dealer and a non-US counterparty,

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4 Section 2(i), Commodity Exchange Act (7 USC § 2(i)).
5 Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations, 78 FR 45291 (July 26, 2013), available here.
the CFTC issued Staff Advisory 13-69 (the “Staff Advisory”) on November 14, 2013. In the Staff Advisory, the CFTC concluded that personnel or agents of a non-US swap dealer, regardless of whether the non-US swap dealer is an affiliate of a US person, are generally required to comply with transaction-level requirements if such personnel or agents (i) are located in the US and (ii) regularly arrange, negotiate or execute swaps with a non-US person. In reaching this conclusion, the CFTC reasoned that agents of a non-US swap dealer that regularly arrange, negotiate or execute swaps are performing core, front-office activities, and to the extent these activities are conducted in the US, they would be within the scope of regulation by the Dodd-Frank Act.

Following the release of the Staff Advisory, the CFTC received multiple requests from non-US swap dealers for no-action relief to extend the timeline for compliance with such transaction-level requirements in order to allow regulated entities to make the necessary internal policy adjustments to comply with the requirements. In response, on November 26, 2013, the CFTC granted time-limited relief, which was subsequently extended by a series of no-action letters, the most recent of which extended the deadline to the effective date of any corresponding CFTC action specifically addressing whether a particular transaction-level requirement is applicable to such situation.

2.4 Cross-Border Application of the CFTC’s Initial and Variation Margin Rules

On May 24, 2016, the CFTC issued final rules and accompanying interpretative guidance setting forth the application of the CFTC’s initial and variation margin rules to cross-border swap transactions (the “CFTC Cross-Border Margin Rules”). The application of the CFTC’s final initial and variation margin rules to cross-border swap transactions was not set out in the CFTC Cross-Border Guidance, but was rather explicitly addressed in this separate rulemaking.

Among the various concepts used in the CFTC Cross-Border Margin Rules, the CFTC introduced a new entity classification of “foreign consolidated subsidiary” (“Foreign Consolidated Subsidiary”). This was defined to capture any swap dealer or major swap participant subject to the CFTC’s jurisdiction that is not a US person in which an ultimate parent entity that is a US person has a controlling interest, in accordance with US GAAP, such that the ultimate parent entity includes the non-US swap dealer or major swap

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6 CFTC Staff Advisory No. 13-69 (November 14, 2013), available here.
participant’s operating results, financial position and statement of cash flows in its consolidated financial statement, in accordance with US GAAP.

Notwithstanding that the Foreign Consolidated Subsidiary entity classification was also included in the 2016 Proposed Cross-Border Rule (as defined and discussed below), Chairman Giancarlo stated in the White Paper that he did not consider this entity classification, on its own, to be an appropriate method of determining the cross-border applicability of Dodd-Frank Act requirements. We note that the White Paper did not discuss the CFTC Cross-Border Margin Rules.

For further information on the CFTC Cross-Border Margin Rules, please refer to our client alert, available here.

2.5 2016 CFTC Cross-Border Proposed Rules
On October 11, 2016, the CFTC released proposed rules and accompanying interpretative guidance (the “2016 CFTC Cross-Border Proposed Rules”) which set forth the application of certain requirements under the Dodd-Frank Act to cross-border swap transactions. The purpose of the 2016 CFTC Cross-Border Proposed Rules was to codify a definitional foundation for the CFTC’s cross-border framework and the rules regarding the cross-border application of both swap dealer and major swap participant de minimis threshold calculations and certain of the CFTC’s external business conduct standards applicable to swap dealers and major swap participants.

It was intended that the 2016 CFTC Cross-Border Proposed Rules, along with other future rulemakings, would supersede the CFTC Cross-Border Guidance with respect to the matters covered by such rules. However, following the release of the White Paper, it would seem that these proposed rules are unlikely to be finalized in their proposed form and will instead be replaced with new proposals that are consistent with the concepts and principles outlined in the White Paper.

3. White Paper’s Proposed Cross-Border Approach of the CFTC
In the White Paper, Chairman Giancarlo first maintains that it is inappropriate for the CFTC to continue to rely on interpretative policy statements or guidance (such as the CFTC Cross-Border Guidance) in lieu of formal rules and advocates that it should instead adopt rules through a process that complies with notice-and-comment and cost-benefit consideration requirements.

The White Paper notes that the CFTC Chairman intends to direct CFTC staff to develop new rule proposals based on the principles set forth in the White Paper to address cross-border swaps transactions.

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9 Cross-Border Application of the Registration Thresholds and External Business Conduct Standards Applicable to Swap Dealers and Major Swap Participants, 81 FR 71946 (October 18, 2016), available here.
The resulting final rules would replace the existing mixture of CFTC rules and guidance as well as certain CFTC staff advisories and no-action letters.

The White Paper recommends that any such new rule proposals should be guided by the following six (6) principles:

<table>
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<tr>
<th>Principle 1</th>
<th>The CFTC should recognize the distinction between swaps reforms intended to mitigate systemic risk and reforms designed to address particular market and trading practices that may be adapted appropriately to local market conditions.</th>
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<td>Swaps reforms that are designed to mitigate systemic risk include swaps clearing, margin for uncleared swaps, dealer capital, and recordkeeping and regulatory reporting. These reforms seek to mitigate the type of risk that may have a “direct and significant” connection with the US.</td>
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<td>Swaps reforms that are designed to address market and trading practices include public trade reporting and price transparency, trading platform design, trade execution methodologies and mechanics, and personnel qualifications, examinations and regulatory oversight. These reforms generally have less of a “direct and significant” connection with the US and it may therefore be more appropriate for these rules to be adapted to suit individual local markets.</td>
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<th>Principle 2</th>
<th>The CFTC should pursue multilateralism, not unilateralism, for swaps reforms that are designed to mitigate systemic risk.</th>
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<td>The CFTC’s jurisdiction should continue to apply cross-border to US firms on an “entity” basis, with substituted compliance available for non-US jurisdictions that are “strictly comparable.”</td>
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<th>Principle 3</th>
<th>The current division of global swaps markets into separate US person and non-US person marketplaces should be ended. Markets in regulatory jurisdictions that have adopted the G20 swaps reforms should each function as a unified marketplace, under one set of comparable trading rules and under one competent regulator.</th>
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<td>The fragmentation of global swaps markets into distinct trading and liquidity pools containing US market participants in one pool and non-US market participants in others is incompatible with, and detrimental to, global swaps reform efforts.</td>
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<td>Principle</td>
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<td>4</td>
<td>The CFTC shall be a rule maker, not a rule taker, in overseeing US markets. Non-US regulators should defer to the CFTC with respect to oversight of US derivatives trading markets and, conversely, the CFTC should defer to non-US regulators for activities conducted primarily in their jurisdictions if their regulatory framework is comparable to the CFTC’s. The CFTC should seek to reconcile its rules with those adopted in non-US jurisdictions as appropriate.</td>
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<td>5</td>
<td>The CFTC should act with deference to non-US regulators in jurisdictions that have adopted comparable G20 swaps reforms, seeking stricter comparability for substituted compliance for requirements intended to address systemic risk and more flexible comparability for substituted compliance for requirements intended to address market and trading practices. The CFTC should act with deference to non-US regulators in jurisdictions that have adopted comparable G20 swaps reforms. However, the CFTC should undertake a tiered approach to substituted compliance by requiring stricter comparability for requirements intended to address systemic risk and allowing more flexible comparability for requirements intended to address market practices such as market access, price transparency, and professional conduct requirements which have less to do with systemic risk.</td>
</tr>
<tr>
<td>6</td>
<td>The CFTC should act to encourage adoption of comparable swaps reform regulation in non-US jurisdictions that have not adopted swaps reform for any significant swaps trading activity. The CFTC should generally defer to non-US jurisdictions that have adopted regulations comparable to the CFTC’s regime. For those non-US jurisdictions that have not adopted comparable reforms, US rules should apply to US-related entities, subject to materiality thresholds.</td>
</tr>
</tbody>
</table>

Below we address each of the areas of swaps reform considered in the White Paper: Registration of Non-US CCPs, Registration of Non-US Trading Venues, Registration of Non-US Swap Dealers, Clearing and Trade Execution Requirements, and ANE Transactions.
4. **White Paper’s Cross-Border Recommendations**

Consistent with the above principles, the White Paper recommends that the CFTC address cross-border regulation of swaps based on whether the applicable entity or activity is within (i) the US, (ii) a Comparable Jurisdiction or (iii) a Non-Comparable Jurisdiction.

<table>
<thead>
<tr>
<th><strong>Comparable Jurisdiction</strong></th>
<th>A foreign jurisdiction that has adopted the G20 reforms such that a CFTC comparability determination would conclude that the jurisdiction’s regime was comparable to the CFTC’s regime.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Non-Comparable Jurisdiction</strong></td>
<td>A jurisdiction that does not have a comparable regime to the CFTC’s regime.</td>
</tr>
</tbody>
</table>

4.1 **Registration of Non-US CCPs**

Given that many regulated central counterparties (“CCPs”) operate in non-US jurisdictions and under different regulatory regimes, Chairman Giancarlo argues in the White Paper that overlapping regulation and supervision should be avoided as this creates inefficiencies and increases the costs of US persons accessing non-US CCPs.

<table>
<thead>
<tr>
<th>United States</th>
<th>Comparable Jurisdictions</th>
<th>Non-Comparable Jurisdictions</th>
</tr>
</thead>
<tbody>
<tr>
<td>The CFTC should continue to require a CCP located in the US that seeks to clear swaps under the jurisdiction of the CFTC to register with the CFTC as a derivatives clearing organization (“DCO”) and be subject to the CFTC’s oversight and jurisdiction.</td>
<td>The CFTC should use its exemptive authority for non-US CCPs that do not pose substantial risk to the US financial system, thereby permitting non-US CCPs to provide clearing services to US customers indirectly through non-US clearing members that are not registered with the CFTC. However, non-US CCPs that clear swaps for US persons and</td>
<td>The starting point for CFTC staff consideration is that non-US CCPs that seek to clear for US persons would be required to register as a DCO. To provide more time for non-US jurisdictions to develop comparable standards, the CFTC should consider providing relief from DCO registration for non-US CCPs whose members are foreign branches of US banks that are registered as swap</td>
</tr>
</tbody>
</table>

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10 Section 725(h) of the Dodd-Frank Act permits the CFTC to exempt a non-US CCP from registration for the clearing of swaps if the CFTC determines that the CCP is subject to “comparable, comprehensive supervision and regulation” by appropriate government authorities in the CCP’s home country.
4.2 Registration of Non-US Trading Venues

The CFTC currently requires that a multilateral trading platform located outside the US that provides US persons located in the US, including personnel and agents of non-US persons located in the US, with the ability to trade or execute swaps on the platform to register with the CFTC as either a swap execution facility ("SEF") or derivatives contract market ("DCM").

The White Paper argues that this registration requirement has resulted in the bifurcation of the global swaps markets by forcing non-US trading venues to deny participation to persons located in the US.

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**Table: United States, Comparable Jurisdictions, Non-Comparable Jurisdictions**

<table>
<thead>
<tr>
<th>United States</th>
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<th>Non-Comparable Jurisdictions</th>
</tr>
</thead>
<tbody>
<tr>
<td>are deemed by the CFTC to pose substantial risk specific to the US financial system would continue to be required to register with, and be regulated by, the CFTC.</td>
<td>dealers (&quot;Foreign Branches&quot;), provided those Foreign Branches limit their clearing activities to proprietary and affiliate accounts or clearing customers that are non-US persons. Risks would be mitigated as the Foreign Branch must be a registered swap dealer, subject to US capital, margin and risk management requirements. Any such relief would be subject to reporting and information-sharing arrangements as well as the right of the CFTC to terminate the relief for cause.</td>
<td></td>
</tr>
</tbody>
</table>

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11 CFTC Division of Market Oversight, Division of Market Oversight Guidance on Application of Certain Commission Regulations to Swap Execution Facilities (November 15, 2013), available [here](#).
<table>
<thead>
<tr>
<th>United States</th>
<th>Comparable Jurisdictions</th>
<th>Non-Comparable Jurisdictions</th>
</tr>
</thead>
<tbody>
<tr>
<td>the CFTC as a SEF or DCM.</td>
<td>Jurisdictions with respect to all types of swaps. This would permit such venues to have US and non-US participants, with the intention of reducing or even eliminating the bifurcation of global swaps markets by permitting each Comparable Jurisdiction to function as a unified marketplace under that jurisdiction’s own rules.</td>
<td>persons access to the trading venue directly or indirectly through a non-US intermediary, subject to a materiality threshold to be set by the CFTC. The threshold should be based on a level of trading involving US persons that does not meet the “direct and significant” standard. By adopting a materiality threshold, the CFTC would permit non-US trading venues in Non-Comparable Jurisdictions to provide trading services to US persons on a limited basis without registration.</td>
</tr>
</tbody>
</table>

4.3 Registration of Non-US Swap Dealers

In the White Paper, Chairman Giancarlo argues that the CFTC’s approach to its swap dealer registration rules has resulted in an inappropriate extraterritorial application of those rules that does not appropriately consider whether the dealing activity truly poses a “direct and significant” risk to the US financial system.

The White Paper sets out the following with respect to the cross-border application of swap dealer registration and the counting of swaps notional amounts to the swap dealer *de minimis* registration threshold.

<table>
<thead>
<tr>
<th>United States</th>
<th>Comparable Jurisdictions</th>
<th>Non-Comparable Jurisdictions</th>
</tr>
</thead>
<tbody>
<tr>
<td>The CFTC should continue to require US persons to count all of their swap dealing</td>
<td>**Guaranteed Entities:**¹² The CFTC should require these entities to count all of their swap</td>
<td><strong>Guaranteed Entities:</strong> The CFTC should continue to require these entities to count all of their</td>
</tr>
</tbody>
</table>

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¹² The White Paper notes that the term “Guaranteed Entity” has the same definition as in the 2016 CFTC Proposed Cross-Border Rules (i.e., a non-US person whose swaps are guaranteed by a US person).
<table>
<thead>
<tr>
<th>United States</th>
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</tr>
</thead>
<tbody>
<tr>
<td>transactions toward the <em>de minimis</em> threshold, including transactions conducted through a Foreign Branch, whether with US or non-US persons.</td>
<td>dealing activity toward their <em>de minimis</em> threshold, regardless of the status of their counterparties. In deference to home country regulators, Guaranteed Entities would be permitted to rely on substituted compliance for applicable requirements.</td>
<td>swap dealing activity toward their <em>de minimis</em> threshold, regardless of the status of their counterparty. Substituted compliance would not be available.</td>
</tr>
</tbody>
</table>

**Other Non-US Persons (including Foreign Consolidated Subsidiaries):**

The CFTC should require these entities to count their swap dealing activity with US persons and Guaranteed Entities, except swaps with (1) Guaranteed Entities that are registered as swap dealers (or are affiliated with registered swap dealers), (2) Guaranteed Entities that are guaranteed by a non-financial guarantor or (3) Foreign Branches. Substituted compliance would not be available. As an alternative, the White Paper suggests that the CFTC consider not requiring Other Non-US Persons to count dealing swaps with Guaranteed Entities toward their *de minimis* threshold.

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13 In the 2016 CFTC Proposed Cross-Border Rules, these exemptions were removed. The White Paper, however, recommends that these exemptions be retained as the types of transactions captured by these exemptions do not have a direct and significant connection with the US financial system.

14 For Non-Comparable Jurisdictions, the White Paper notes that the issue of Foreign Consolidated Subsidiaries is more complex and that the CFTC should consider the issue in light of the requirements of the Dodd-Frank Act and the concepts and principles set out in the White Paper.
the White Paper suggests that the CFTC consider not requiring Other Non-US Persons to count dealing swaps with Guaranteed Entities toward their *de minimis* threshold.

In addition, all non-US swap dealers would not be required to count the following towards their *de minimis* threshold:

- swaps executed anonymously on a registered or exempt trading platform and that are cleared by a registered or exempt clearing organization; and
- ANE Transactions (see below).

### 4.4 Clearing and Trade Execution Requirements

Broadly, the Dodd-Frank Act requires that a swap be cleared if the CFTC has issued a clearing determination that the swap is required to be cleared, unless an exception or exemption applies.\(^{15}\) Additionally, if a swap is required to be cleared, the Dodd-Frank Act requires that the swap be executed on a DCM or SEF, unless no DCM or SEF makes the swap available to trade.\(^{16}\) The White Paper reasons that, while the clearing requirement addresses systemic risk to the US financial system, the accompanying trade execution requirement does not and instead furthers the goals of market efficiency and enhanced transparency. The White Paper recommends a cross-border approach that takes into account the differing purposes of these requirements.

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\(^{15}\) Section 2(h)(1), US Commodity Exchange Act (7 USC § 2(h)(1)).

\(^{16}\) Section 2(h)(8), US Commodity Exchange Act (7 USC § 2(h)(8)).
<table>
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<th>United States</th>
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</tr>
</thead>
<tbody>
<tr>
<td>US persons (including their Foreign Branches) should continue to be subject to the CFTC’s swaps clearing and trade execution requirements for all applicable swaps, unless an exception or exemption applies.</td>
<td>Non-US persons, including Guaranteed Entities and FCS, should be permitted to rely on substituted compliance with respect to the CFTC’s swap clearing and trade execution requirements.</td>
<td><strong>Foreign Branches:</strong> The CFTC’s swap clearing requirement should apply to all swaps of Foreign Branches that are subject to the clearing requirement, subject to a materiality threshold for swaps with Other Non-US Persons. <strong>Guaranteed Entities:</strong> The CFTC’s swap clearing requirement should apply to all swaps subject to the clearing requirement between Guaranteed Entities and (1) US persons, including Foreign Branches, (2) Guaranteed Entities and (3) subject to a materiality threshold, other Non-US Persons, unless the swaps are subject to initial margin or variation margin requirements consistent with established international standards. <strong>Other Non-US Persons:</strong> The CFTC’s swap clearing requirement should apply to all swaps subject to the clearing requirement with (1) US persons, including Foreign Branches and (2) Guaranteed Entities, unless the swaps are subject to initial margin or variation margin requirements consistent with established international standards.</td>
</tr>
</tbody>
</table>
4.5 ANE Transactions

2016 CFTC Cross-Border Proposed Rules

The 2016 CFTC Cross-Border Proposed Rules addressed the regulation of swap activity by non-US entities that would fall within the scope of transactions that are arranged, negotiated or executed using personnel located in the US (“ANE Transactions”). These terms do not include internal back-office activities such as clerical tasks that are performed by personnel who are not involved in the sale or trading of the swap.

White Paper

The recommendations of the White Paper in connection with the regulation of ANE Transactions are predicated on two preliminary points:

- If a swap is executed in the US (irrespective of whether or not it is also arranged or negotiated), then the counterparties should be required to follow US swap execution rules. That is, it would be subject to the CFTC’s clearing and trade execution requirements, which would require such swap to be traded on a SEF and centrally cleared, unless an exception or exemption applied.

- ANE Transactions are, by definition, between non-US persons and do not pose systemic risk to the US financial system merely by virtue of being arranged, negotiated or executed within the US and, for this reason, ANE Transactions should not count toward a potential non-US swap dealers’ de minimis threshold if the non-US dealer is in a Comparable Jurisdiction.

Taking into account the above preliminary points, the White Paper sets out two scenarios where swaps are arranged or negotiated in the US but executed in a Comparable Jurisdiction (i.e., the first preliminary point above does not apply as the swap is not executed in the US).
Intermediary Scenario

*Third-party US intermediary located in the US, such as an Introducing Broker, arranges or negotiates among multiple non-US participants.*

The White Paper notes that the intermediary should be a SEF, with the effect that the trade would be subject to the SEF rules.\(^{17}\) The White Paper argues that this is consistent with the territorial approach that transactions conducted in the US should be subject to US rules.

Agent/Employee Scenario

*US-based agent/employee of a non-US swap dealer located in the US arranges or negotiates a swap with a non-US person.*

The White Paper’s territorial approach would require that the activity of the US-based agent/employee be subject to US swaps trading rules. As mentioned above, this trade would not count toward a non-US swap dealers’ *de minimis* threshold if the non-US swap dealer is in a Comparable Jurisdiction.

The White Paper mentions that where the non-US swap dealer is subject to regulation in a Comparable Jurisdiction, there may be a basis for substituted compliance to be available.

5. **Analysis and Final Thoughts**

We highlight below some analysis and final thoughts on certain of the concepts and principles set forth in the White Paper.

5.1 **Foreign Consolidated Subsidiaries**

Unlike the 2016 CFTC Proposed Cross-Border Rules and the CFTC Cross-Border Margin Rules, Chairman Giancarlo did not include a separate “Foreign Consolidated Subsidiary” category in the White Paper. Chairman Giancarlo argues that it is overreach to require a Foreign Consolidated Subsidiary that engages in swap dealing activity wholly outside the United States to register with the CFTC, based solely on the theory that they pose a hypothetical risk to the US financial system due to an accounting connection. Instead, a better approach would be to not require a Foreign Consolidated Subsidiary to register as a swap dealer if their dealing activities occur wholly outside the US and are addressed, from a

\(^{17}\) For further information on the CFTC Chairman’s view of how the SEF rules should apply, as well as other swap regulations, please refer to our client alert available here.
risk perspective, by their home country regulator through comparable regulation. Accordingly, in Comparable Jurisdictions, the White Paper recommends that Foreign Consolidated Subsidiaries whose swap dealing activity occurs outside the United States and does not involve direct activity in the US with US persons not be required to register as a swap dealer if they are subject to comparable regulation by a non-US regulator, including being subject to capital and margin requirements for uncleared swaps. For Non-Comparable Jurisdictions, the White Paper notes that this is more complex and that the CFTC should consider the issue in light of the requirements of the Dodd-Frank Act and the concepts and principles set out in the White Paper.

5.2 Non-US Banks and Brokers: Counting of Dealing Swaps

Non-US banks and brokers engaged in swap dealing activity in non-US markets regularly look to the deeper liquidity found in the New York and London markets to hedge their local client facing swaps. Assuming that the regularity and nature of their swaps business constitutes swap dealing activity, swaps entered into in order to hedge risk and exposure from this local market activity would also be included in the swap dealing activity of the non-US bank or broker. Both the original local market client-facing swap and the related hedging swap with a dealer in a larger market are likely within the scope of what the CFTC would consider to be “swap dealing activity”.

Under the CFTC Cross-Border Guidance, a non-US person (that is not a guaranteed affiliate or a conduit affiliate\textsuperscript{18}) is only required to count towards its swap dealer \textit{de minimis} threshold those dealing swaps that are entered into with US persons (other than foreign branches of a US swap dealer) and guaranteed affiliates (except where the guaranteed affiliate is a registered swap dealer, is engaged in a \textit{de minimis} level of swap dealing activity and is affiliated with a swap dealer, or is guaranteed by a non-financial entity).

The result was different, however, under the 2016 CFTC Proposed Cross-Border Rules, which would have required the non-US person to count each swap entered into with any US person, Guaranteed Entity or Foreign Consolidated Subsidiary toward its swap dealer \textit{de minimis} threshold. In addition, Foreign Consolidated Subsidiaries themselves were also required to count all their dealing swaps. By treating Foreign Consolidated Subsidiaries the same as Guaranteed Entities, the CFTC significantly expanded its jurisdiction over non-US banks and brokers that were not otherwise captured under the CFTC Cross-

\textsuperscript{18} Under the CFTC Cross-Border Guidance, “guaranteed affiliate” refers to a non-US person that is affiliated with and guaranteed by a US person and the concept of a “conduit affiliate” is used by the CFTC to capture vehicles or conduits that effect swap transactions with third parties on behalf of US persons, but generally do not include swap dealers or affiliates of swap dealers.
Border Rules by requiring them to count additional swaps, which had the practical effect of increasing the likelihood that they would exceed the *de minimis* threshold and be required to register as swap dealers.

Under the White Paper, the entity classifications found in the 2016 Proposed Cross-Border Rules were retained (e.g., no “affiliate conduit” classification) and the exemptions found in the CFTC Cross-Border Guidance were generally restored with respect to non-US banks and brokers in Comparable Jurisdictions and Non-Comparable Jurisdictions. However, for Foreign Consolidated Subsidiaries themselves, the position remains somewhat uncertain as the White Paper does not provide a firm recommendation on how they should be treated – while the White Paper presents some examples of situations where Foreign Consolidated Subsidiaries should be treated similarly to Other Non-US Persons, the White Paper concludes that further consideration was warranted by CFTC staff in order to determine how to properly treat Foreign Consolidated Subsidiaries.

### 5.3 Next Steps

The White Paper marks a continuation of Chairman Giancarlo’s focus on reassessing the efficacy of existing CFTC swap regulations. In particular, the White Paper indicates a strong preference to consolidate the current approach on cross-border application of CFTC swap regulations into a single set of coherent rules, which would replace the existing mixture of CFTC rules and guidance as well as certain CFTC staff advisories and no-action letters. While market participants may welcome many of the principals and recommendations set forth in the White Paper, it remains to be seen to what extent these will influence future CFTC rulemakings.
International Developments

Panellist Bios
Panellist Bios

Chris Bates – Clifford Chance

Chris Bates is a partner and head of Clifford Chance's financial regulation practice in London. He advises banks, securities firms and other financial institutions on issues associated with the UK exit from the EU, the regulatory response to the financial crisis, the impact of the EU single market program, financial services regulation and regulatory capital, as well as advising on securities and derivatives transactions and mergers and acquisitions in the financial sector. Mr. Bates is a member of the Council of the International Regulatory Strategy Group advising the City Corporation and TheCityUK. He is an active participant in other industry and official committees and working groups on regulatory issues, as well as advising a number of industry associations on regulatory matters.

Mr. Bates joined Clifford Chance in 1980 and from 1983 to 1988 was based in the firm's Hong Kong office. He is a Solicitor of the Supreme Court in England and holds degrees from Oxford University and Columbia Law School.

Nathaniel Lalone – Katten Muchin Rosenman

Nathaniel Lalone, a partner at Katten Muchin Rosenman UK LLP, has a broad range of experience in the regulation of financial products and financial markets, and frequently provides regulatory and compliance advice to trading venues, clearing houses and buy-side firms active in the over-the-counter (OTC) derivatives, futures and securities markets. He is actively involved in advising clients on the implementation of MiFID 2 and MiFIR in the European Union as well as the international reach of US financial services regulation. He also has significant experience with structuring and documentation relating to OTC derivatives and structured products.

Nate received his A.B. from Harvard College and his law degree from the Harvard Law School. He also holds advanced degrees from Cambridge, where he studied European Union politics with a focus on financial services. He also was a 2004 Fulbright Scholar to the European Union.

Jackie Mesa – FIA, Inc.

Jackie Mesa joined the FIA in June 2013 and is responsible for helping develop, implement and manage FIA’s global regulatory and policy agenda. Mesa works with the FIA policy teams in the U.S., Europe and Asia to implement consistent global policy positions for members worldwide and works with regulators and policy-makers on cross-border policies that impact members. Mesa also leads FIA’s work on the Basel III capital requirements for cleared derivatives and clearinghouse risk. Prior to joining FIA, Mesa served in various positions at the U.S. Commodity Futures Trading Commission, including as Director of International Affairs from 2006-2013. As director, she was the principal advisor to the Commission on international policy.

She also represented the CFTC in international groups, such as the International Organization of Securities Commissions (IOSCO) and in bilateral fora, such as the US-EU Financial Markets Regulatory Dialogue (FMRD) and the US-China Strategic Economic Dialogue. Mesa served as IOSCO’s Chairman for the Committee 7 on Commodity Derivatives Regulation and IOSCO’s Chairman for the Monitoring Group for the Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information.

Kazunari Mochizuki – Japan Financial Services Agency

Kazunari Mochizuki is the Director for International Financial Markets (Settlements) at the Financial Services Agency of Japan (JFSA). Mr. Mochizuki joined the JFSA in 2006. He started his career at the JFSA in the Office of International Affairs and, for the last several years, he has been involved in issues related to OTC derivatives reforms and to regulation/supervision of financial market
infrastructures. In this context, he has been actively involved in the work of the Financial Stability Board as well as CPMI-IOSCO.

Before joining the JFSA, he had worked for several investment banks in Tokyo. He holds a Masters of Economics from the Graduate School of Kobe University (1996).

**Eric Pan – U.S. Commodity Futures Trading Commission**

Eric J. Pan is the Director of the Office of International Affairs at the U.S. Commodity Futures Trading Commission (CFTC). Eric oversees all CFTC international initiatives, provides guidance regarding international issues raised in Commission matters, and represents the CFTC in international bodies, including the International Organization of Securities Commissions (IOSCO) and the Financial Stability Board (FSB). He is responsible for the CFTC’s engagement with non-US regulatory counterparts, including those in Europe, China, India and Japan, and manages the development and governance of international workstreams involving the CFTC. In international fora, Eric chairs the IOSCO Committee on Derivatives, the OTC Derivatives Regulators Group, and the FSB Working Group on UTI and UPI Governance and assists the CFTC Chairman in chairing the IOSCO Cyber Task Force and the IOSCO Task Force on Market Fragmentation. He also has represented the CFTC in the IOSCO Board and in international workstreams related to derivatives reform, central clearinghouse regulation and supervision, trade reporting, data harmonization, margin regulation, market conduct and corporate governance, cybersecurity, fintech and regtech, data protection, cross-border information sharing, benchmarks, and trading.

Before joining the CFTC, Eric was Associate Director for International Regulatory Policy at the U.S. Securities and Exchange Commission, recruited in 2011 from academia to assist in the implementation of the Dodd-Frank Act and the G-20 reforms. Before entering government service, he was a professor of law, director of a center on corporate governance, and lawyer in private practice. Eric received his A.B. in Economics from Harvard College, M.Sc. in European and International Politics from the University of Edinburgh, and J.D. from the Harvard Law School. He is a member of the American Law Institute.

**Patrick Pearson – European Commission**

Patrick Pearson is Head of Unit of Financial Markets Infrastructure in the European Commission’s Financial Stability, Financial Services and Capital Markets Union Directorate General. He previously headed the Resolution and Crisis management and the Banking Supervision teams and was responsible for the Financial Services Action Plan.

Before joining the European Commission in 1987, Patrick Pearson worked for the legal service and the foreign financial market affairs divisions in Dutch Finance Ministry in The Hague. He has a law degree from Leiden University in the Netherlands.