

COMMISSION IMPLEMENTING DECISION (EU) 2016/377**of 15 March 2016****on the equivalence of the regulatory framework of the United States of America for central counterparties that are authorised and supervised by the Commodity Futures Trading Commission to the requirements of Regulation (EU) No 648/2012 of the European Parliament and of the Council**

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories ⁽¹⁾, and in particular Article 25(6) thereof,

Whereas:

- (1) The procedure for recognition of central counterparties ('CCPs') established in third countries set out in Article 25 of Regulation (EU) No 648/2012 aims to allow CCPs established and authorised in third countries whose regulatory standards are equivalent to those laid down in that Regulation to provide clearing services to clearing members or trading venues established in the Union. That recognition procedure and the equivalence decision provided for therein thus contribute to the achievement of the overarching aim of Regulation (EU) No 648/2012 to reduce systemic risk by extending the use of safe and sound CCPs to clear over-the-counter ('OTC') derivative contracts, including where those CCPs are established and authorised in a third country.
- (2) In order for a third country legal regime to be considered equivalent to the legal regime of the Union in respect of CCPs, the substantive outcome of the applicable legal and supervisory arrangements should be equivalent to Union requirements in respect of the regulatory objectives they achieve. The purpose of this equivalence assessment is therefore to verify that the legal and supervisory arrangements of the United States of America (USA) ensure that CCPs established and authorised therein do not expose clearing members and trading venues established in the Union to a higher level of risk than the latter could be exposed to by CCPs authorised in the Union and, consequently, do not pose unacceptable levels of systemic risk in the Union.
- (3) On 1 September 2013, the Commission received the technical advice of the European Securities and Markets Authority (ESMA) on the legal and supervisory arrangements applicable to CCPs established in the USA. That technical advice identified a number of differences between the legally binding requirements applicable, at jurisdictional level, to CCPs in the USA and the legally binding requirements applicable to CCPs under Regulation (EU) No 648/2012. This Decision is not only based, however, on a comparative analysis of the legally binding requirements applicable to CCPs in the USA, but also on an assessment of the outcome of those requirements, and their adequacy to mitigate the risks that clearing members and trading venues established in the Union may be exposed to in a manner considered equivalent to the outcome of the requirements laid down in Regulation (EU) No 648/2012).
- (4) In accordance with Article 25(6) of Regulation (EU) No 648/2012, three conditions need to be fulfilled in order to determine that the legal and supervisory arrangements of a third country regarding CCPs authorised therein are equivalent to those laid down in that Regulation.
- (5) According to the first condition, CCPs authorised in a third country must comply with legally binding requirements which are equivalent to the requirements laid down in Title IV of Regulation (EU) No 648/2012.
- (6) The legally binding requirements of the USA for CCPs authorised (the term used in the CFTC framework is 'registration') and supervised by the Commodity Futures Trading Commission (CFTC) are contained in the

⁽¹⁾ OJ L 201, 27.7.2012, p. 1.

Commodity Exchange Act ('the CEA'), as amended by Titles VII and VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ('the Dodd-Frank Act'), and the CFTC's regulations promulgated thereunder. The CFTC is the competent authority for the supervision of all derivative contracts that are not based on a single security (a bond or share), loan or a narrow based group or index of securities, and is responsible for authorising and regulating CCPs which provide clearing services for those derivative contracts ('derivative clearing organizations' or 'DCOs'). The derivative contracts falling under the competence of the CFTC therefore correspond to a subset of the derivative contracts covered by the provisions on CCPs set out in Regulation (EU) No 648/2012. This Decision relates solely to the equivalence of the legal and supervisory arrangements for DCOs and not to the legal and supervisory arrangements for CCPs which provide clearing services for derivative contracts falling under the competence of the Securities and Exchange Commission ('SEC'). Where a CCP is authorised as both a clearing agency under the jurisdiction of the SEC and a DCO, this Decision relates to those CCPs only in so far as they provide clearing services for derivative contracts falling under the CFTC's jurisdiction.

- (7) The legally binding requirements applicable to CCPs authorised by the CFTC include high-level standards that are set out by the core principles for DCOs contained in section 5b(c)(2) of the CEA and Subparts A and B of Part 39 of the CFTC Regulations. To be authorised by the CFTC, all CCPs must comply with those core principles. The core principles are complemented by specific enhanced risk management standards applicable to DCOs which have been designated by the Financial Stability Oversight Council of the USA as systemically important and for which the CFTC has been designated as the supervisory agency ('SIDCOs'). The enhanced risk management standards are set out in Subpart C of Part 39 of CFTC regulations (Regulations 39.30 to 39.42). The high-level standards and the specific enhanced risk management standards for SIDCOs (together, the 'primary rules') are applicable to SIDCOs and to DCOs which have not been designated as SIDCOs but have voluntarily opted to be legally bound by those specific risk management standards ('opt-in DCOs'). Those primary rules comprise the first tier of the legally binding requirements applicable to DCOs.
- (8) Pursuant to the primary rules, DCOs must adopt internal rules and procedures which must be approved by the CFTC. In respect of certain standards set out under the primary rules, the DCO's internal rules and procedures must provide prescriptive detail on the way in which the DCO will meet those standards. Moreover, those internal rules and procedures contain requirements which complement the ones prescribed by the primary rules. Once approved by the CFTC, the internal rules and procedures become legally binding on the DCO and form an integral part of the legal and supervisory arrangements with which those DCOs must comply. In the case of non-compliance with the primary rules or the DCO's internal rules and procedures, the CFTC has the power to sanction those DCOs, including by imposing penalties and suspension or revocation of the authorisation.
- (9) The legally binding requirements in the USA with respect to derivative contracts cleared by DCOs therefore comprise a two-tiered structure. The primary rules for SIDCOs and opt-in DCOs comprise the first tier of the legally binding requirements. The internal rules and procedures of the SIDCOs and opt-in DCOs comprise the second tier of the legally binding requirements. When determining equivalence in accordance with Article 25(6) of Regulation (EU) No 648/2012, the nature and detail of the legal requirements contained within the internal rules and procedures of SIDCOs and opt-in DCOs must, therefore, be considered alongside the primary rules in order to ensure that the legally binding requirements effected through those combined components of the legal and supervisory arrangements can be considered equivalent to the requirements laid down in Title IV of Regulation (EU) No 648/2012.
- (10) The primary rules applicable to SIDCOs and opt-in DCOs complemented by their internal rules and procedures deliver substantive outcomes equivalent to the effects of the rules contained in Title IV of Regulation (EU) No 648/2012. The primary rules include requirements on governance (including organisational requirements, requirements relating to senior management, risk committees, record keeping, qualifying holdings, information transmitted to the competent authority), conflicts of interest, outsourcing, conduct of business, business continuity and segregation, as well as liquidity risk, collateral requirements, investment policy, and settlement risk.
- (11) Although the primary rules with respect to liquidity risks do not require SIDCOs and opt-in DCOs to maintain eligible liquidity resources to meet the 'cover 2 principle', that is, liquid resources to cover the default of at least the two clearing members to which it has the largest exposures, those DCOs are nevertheless required to set-up procedures to cover any uncovered liquidity shortfall, ensuring that committed resources are available where losses exceed the default of the clearing member to which it has the largest exposure. Although this is a different

approach than the 'cover 2 principle' contained in Title IV of Regulation (EU) No 648/2012, it delivers substantive outcomes equivalent to the effects of the rules contained in Title IV of Regulation (EU) No 648/2012.

- (12) The primary rules with respect to participation, exposure management, margin requirements, default funds, other financial resources, default waterfall and default procedures, follow a similar approach to the rules contained in Title IV of Regulation (EU) No 648/2012 but differ in some aspects. With respect to the initial margin applied to clearing member's proprietary positions the primary rules provide for a minimum liquidation period of one day for non-OTC derivative contracts including futures, options, swaps on agricultural energy commodities and metals and five days for all other derivatives, with margin collected on a net basis. Union rules, however, set out minimum liquidation periods of two days for non-OTC derivative contracts and five days for OTC derivative contracts, typically with margin collected on a net basis. With respect to clearing members' proprietary positions therefore, the higher liquidation period of two days for non-OTC derivative contracts in the Union results in CCPs authorised in the Union collecting more margin in respect of those positions. Conversely, in the case of initial margins collected with respect to the positions of clients of clearing members, the primary rules require margin to be collected on a gross basis for all classes of derivative contracts, whereas Union law has no such requirement. This difference between net and gross margin collection results in equivalent outcomes with respect to the amount of margin that DCOs hold with respect to the positions of clients, which compensates for the difference in the liquidation period. Therefore the primary rules on margin requirements can be considered equivalent to Union law in so far as they relate to the positions of clients of clearing members. Further, Union law requires the application of one of three anti-procyclicality measures to ensure that initial margins do not fall too low in stable economic times and do not increase precipitously in times of stress, whereas the primary rules contain no such specific requirement. In doing so, such measures deliver stable and conservative margins. Additionally, the primary rules require SIDCOs and opt-in DCOs to apply the 'cover 2 principle' where those DCOs have been designated as being systemically important in multiple jurisdictions or where they are involved in activities with a more complex risk profile. Union rules, in contrast, require the 'cover 2 principle' for all CCPs.
- (13) The legal and supervisory arrangements of the USA applicable to DCOs should therefore be deemed equivalent provided that, according to the internal rules and procedures of DCOs that are authorised as SIDCOs and opt-in DCOs, they ensure that DCOs comply with the following requirements. Those requirements are: (1) for non-OTC derivative contracts executed on regulated markets, a liquidation period of two days with respect to the initial margin applied to clearing members' proprietary positions; (2) for all derivative contracts, measures to limit procyclicality which deliver stable and conservative margins, and are equivalent to at least one of the options as laid down in Title IV of Regulation (EU) No 648/2012; and (3) a sufficient pre-funded available financial resources enabling the DCO to withstand the default of at least the two clearing members to which it has the largest exposures under extreme but plausible market conditions taking account of additional risks to which those DCOs are exposed arising from the simultaneous failure of entities in the group of defaulting clearing members.
- (14) The Commission notes that specific features concerning certain listed agricultural derivative contracts executed on regulated markets in the USA and cleared by DCOs relate to markets that largely serve domestic non-financial counterparties in the USA who manage their commercial risks through those contracts and who have a low degree of systemic interconnectedness with the rest of the financial system. The risk arising from clearing those contracts is negligible with respect to clearing members and trading venues established in the Union. As a result, the assessment of equivalence is not substantially affected by the regulatory features applicable to those agricultural derivative contracts.
- (15) It should therefore be concluded that the legal and supervisory arrangements of the CFTC comprising the primary rules and the internal rules and procedures of SIDCOs and the opt-in DCOs which meet the standards set out in this Decision with respect to risk management should be considered legally binding requirements which are equivalent to the requirements laid down in Title IV of Regulation (EU) No 648/2012. Only SIDCOs and opt-in DCOs complying with those legally binding requirements (i.e. the primary rules as complemented by the internal rules and procedures approved by the CFTC and meeting the standards set out in this act) may be eligible for recognition by ESMA, which should verify, in accordance with Article 25(2)(b) of Regulation (EU) No 648/2012, that those standards are part of the internal rules and procedures of any CCP subject to that regime and applying for recognition in the Union. Likewise ESMA monitors in accordance with Article 25(5) of Regulation (EU) No 648/2012 that the equivalent regime as defined in this Decision, including the conditions contained herein, continues to be met and may withdraw the recognition where this is not the case. In particular, ESMA will check that the CCP applies a two-day liquidation period with respect to clearing members' proprietary positions in non-OTC derivative contracts and that the CCP applies measures designed to limit procyclicality that are equivalent in delivering stable and conservative margins to any of the three measures set out under

Regulation (EU) No 648/2012, and that the CCP maintains sufficient pre-funded available financial resources enabling it to withstand the default of at least the two clearing members to which it has the largest exposures under extreme but plausible market conditions taking account of additional risks to which those CCPs are exposed arising from the simultaneous failure of entities in the group of the defaulting clearing members.

- (16) According to the second condition under Article 25(6) of Regulation (EU) No 648/2012, the legal and supervisory arrangements in respect of CCPs established in the USA must further provide for effective supervision and enforcement of CCPs in that jurisdiction on an ongoing basis.
- (17) The CFTC conducts ongoing monitoring of DCOs' compliance with risk management requirements through surveillance and risk-based examination procedures including the testing of prudential requirements. The CFTC conducts examinations with examination teams. Upon completion of the examination, the CFTC drafts a report summarising the results of the examination, including any issues of concern. The report outlines any deficiencies perceived, and various measures are available to the CFTC to ensure that DCOs appropriately address any identified issues, including by imposing penalties and suspension or revocation of the authorisation where the deficiencies are not addressed. This report, or information contained in the report, as well as any measure adopted therefrom may be shared with third country regulators under cooperation arrangements.
- (18) It should therefore be concluded that the legal and supervisory arrangements in respect of DCOs provide for effective supervision and enforcement on an ongoing basis.
- (19) According to the third condition under Article 25(6) of Regulation (EU) No 648/2012, the legal and supervisory arrangements of the USA must include an effective equivalent system for the recognition of CCPs authorised under third country legal regimes ('third country CCPs').
- (20) Third country CCPs may apply to the CFTC for DCO authorisation. Pursuant to its statutory authority under 7 U.S.C. § 2(i), the CFTC may provide for substituted compliance in respect of third country CCPs to the extent that it has determined comparability between its requirements for DCOs and the requirements of the third country's regulatory regime. Where substituted compliance is provided, a third country CCP authorised as a DCO may meet the CFTC's requirements by complying with the comparable requirements in its own (third country) jurisdiction. The conclusion of a memorandum of understanding between the CFTC and the competent third-country supervisory authority of the applicant CCP is also required for recognition to be granted.
- (21) It should therefore be concluded that the legal and supervisory arrangements of the CFTC provide for an effective equivalent system for the recognition of third country CCPs.
- (22) This Decision is based on the legally binding requirements relating to SIDCOs and opt-in DCOs applicable in the USA at the time of the adoption of this Decision. The Commission, in cooperation with ESMA, should continue monitoring on a regular basis the evolution of the legal and supervisory arrangements for SIDCOs and opt-in DCOs and the fulfilment of the conditions on the basis of which this Decision has been taken.
- (23) The regular review of the legal and supervisory arrangements applicable to SIDCOs and opt-in DCOs in the USA is without prejudice to the possibility of the Commission to undertake a specific review at any time, where relevant developments and, in particular, the verifications undertaken by ESMA or the information available to it as a result of the supervisory cooperation with CFTC in accordance with the procedures and mechanisms referred to Article 25(7) of Regulation (EU) No 648/2012, make it necessary for the Commission to re-assess the equivalence granted by this Decision. Such re-assessment could lead to the repeal of this Decision.
- (24) The measures provided for in this Decision are in accordance with the opinion of the European Securities Committee,

HAS ADOPTED THIS DECISION:

Article 1

1. For the purposes of Article 25(6) of Regulation (EU) No 648/2012, the legal and supervisory arrangements of the United States of America (USA) for derivatives clearing organisations consisting of Section 5b of the Commodity Exchange Act and Subparts A, B and C of Part 39 of the CFTC Regulations, with the exception of Regulation 39.35 and 39.39, shall be considered equivalent to the requirements of Title IV of Regulation (EU) No 648/2012 where the internal rules and procedures of derivatives clearing organisations which have been designated, by the authorities of the USA, as systemically important ('systemically important derivatives clearing organisations'), and of derivatives clearing organisations which have opted to become subject to the rules contained in section Subpart C of Part 39 of the CFTC Regulations and are authorised and supervised by the CFTC ('opt-in derivatives clearing organisations'), contain the elements referred to in paragraph 2 and 3.

2. The specific rules contained in the internal rules and procedures of systemically important derivatives clearing organisations and opt-in derivatives clearing organisations referred to in paragraph 1 shall, with respect to the principle set out in CFTC Regulation 39.13, include specific risk management measures ensuring that initial margins are calculated and collected on the basis of the following parameters:

- (a) in the case of clearing members' proprietary positions in derivative contracts executed on regulated markets or designated contract markets pursuant to Section 5 of the Commodity Exchange Act (CEA), 7 USC 7, a liquidation period of two days calculated on a net basis;
- (b) in the case of all derivative contracts, measures designed to limit procyclicality equivalent to at least one of the following:
 - (i) measures applying a margin buffer at least equal to 25 % of the calculated margins which the central counterparty allows to be temporarily exhausted in periods where calculated margin requirements are rising significantly;
 - (ii) measures assigning at least 25 % weight to stressed observations in the look-back period;
 - (iii) measures ensuring that margin requirements are not lower than those that would be calculated using volatility estimated over a 10 year historical look-back period.

3. The specific rules contained in the internal rules and procedures of systemically important derivatives clearing organisations and opt-in derivatives clearing organisations referred to in paragraph 1 shall, with respect to the principle set out in CFTC Regulations 39.11 and 39.33, include specific measures in respect of financial resources ensuring that the systemically important derivatives clearing organisation or the opt-in derivatives clearing organisation maintains sufficient pre-funded available financial resources enabling that derivatives clearing organisation to withstand the default of at least the two clearing members to which it has the largest exposures under extreme but plausible market conditions taking account of additional risks to that derivatives clearing organisation arising from the simultaneous failure of entities in the group of defaulting clearing members.

Article 2

1. Derivative contracts referred to in paragraph 2 of Article 1 shall not include agricultural commodity derivative contracts which fulfil all of the following conditions:

- (a) they are based on an underlying agricultural product referencing grades, prices, weights, measures or conversion factors for agricultural commodities and their products as published by the United States Department Of Agriculture and traded on a US-designated contract market pursuant to Section 5 of the Commodity Exchange Act (CEA), 7 USC 7, or are based on an underlying agricultural product of sugar, soybean oil, soybean meal, cocoa, coffee, or lumber and traded on a US-designated contract market pursuant to Section 5 of the Commodity Exchange Act (CEA), 7 USC 7;
- (b) they are based on an underlying agricultural product that forms the basis of an agricultural commodity derivative contract offered for clearing by a derivatives clearing organization established in the USA;

- (c) where they specify one or more places of production of the underlying agricultural product, none of those places of production is inside the Union;
- (d) they meet any of the following conditions:
 - (i) they are physically settled and, except where they are based on an underlying agricultural product of coffee, all the places of delivery are outside the Union;
 - (ii) they are cash settled and, except where they are based on an underlying agricultural product of coffee or sugar, the settlement amount is not based on prices for an underlying agricultural product for which at least one of the places of delivery is inside the Union.

The condition laid down in point (b) of the first subparagraph shall be deemed not to be fulfilled for a given agricultural commodity derivative contract where the majority of such contracts cleared by the derivatives clearing organization established in the USA are cleared for counterparties established in the Union and those contracts are also offered for clearing by a central counterparty authorised in the Union.

2. Article 1(3) shall not apply to systemically important derivatives clearing organisations or opt-in derivatives clearing organisations which only clear the derivative contracts referred to in paragraph 1 of this Article.

Article 3

This Decision shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

Done at Brussels, 15 March 2016.

For the Commission
The President
Jean-Claude JUNCKER
