

WRMA 2009

European Meeting

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C L I F F O R D
C H A N C E

Regulatory Update

Overview

- Global initiatives
 - G20
 - Supranational Bodies
- EU initiatives
 - Derivatives
 - Data
- US initiatives
 - Derivatives
 - Insurance

Global Initiatives

- G20
 - Summits – London, Washington, Pittsburgh
 - Finance Ministers & CBGs – St Andrews
- Framework for Strong, Sustainable & Balanced Growth
 - Assisted by IMF & World Bank
 - Also FSB, OECD, MDBs, WTO, ILO etc.
 - Establish a mutual assessment process

Timeline

- January 2010
 - National & regional policy frameworks and programmes
- April 2010
 - Initial phase of cooperative mutual assessment process in conjunction with WB and IMF
- June 2010
 - Deliver a basket of policy options to the Leaders Summit
- November 2010
 - Refine mutual assessment process and specific policy recommendations to the Leaders Summit

EU –the history of the ECs responses

- October 2008
 - Industry consultation on CDS
- February 2009
 - De Larosiere Report – 31 recommendations
- March 2009
 - Communication - “Driving European Recovery”
- July 2009
 - Communication - “Ensuring Safe & Sound Derivatives Markets
- October 2009
 - Communication – “Future Policy Actions”

EC Communication – Future Policy Actions

- Seeks to address four main issues
 - Reduce counterparty credit risk
 - Reduce operational risk
 - Increase transparency
 - Enhance market integrity and oversight

Policy proposals – executive summary

- Mandatory use of CCPs for standardised
- Enhanced capital/collateral requirements for bilaterally-concluded trades
- Mandatory use of trade repositories
- *The policy proposals mark a “paradigm shift” away from the traditional view that derivatives require “only light-handed regulation”* Commissioner McCreevey

Clearing

- Central Counterparty Clearing (CCP)
 - Cover MiFID Instruments
 - EU legislation to govern operation of CCPs
 - Mandatory to clear standardised derivatives through CCPs
 - Trading to occur on “organised trading venues”
 - Recognition of third country CCPs

Bilateral derivatives transactions

- “Encourage” the move to CCPs
- Increased regulatory scrutiny of contracts
- Collateralisation of bilateral transactions
 - Initial margin
 - Variation margin
- Increased capital charges for non-CCP contracts
 - Netting
 - Collateralisation
 - Capital charges on residual exposure

Other matters

- Trade repositories
 - Mandatory use of trade repositories
 - Regulation of trade repositories
- Industry involvement in operational risk management
- Amending the CRD
- Stronger financial supervision
 - ESRC and ESFS
- AIFMD

EU Timeline

- Mid 2010
 - Regulations for CCPs
- End 2010
 - Higher capital requirements
 - Mandatory use of trade repositories
 - Review of MAD and MiFID
- Mid 2011
 - Pre and post trade transparency obligations.

Non-Financial Institutions

- EC recognises vital role of hedging normal business risks
- In principle most hedging should be achievable through standardised derivatives
- Derivatives must be priced appropriately to in relation to the systemic risk they entail
- Risks & costs must not be passed on to taxpayer

Implications for end users

- Cost of strengthening market infrastructure to be carried by economic beneficiaries
- Some costs will fall on non-financial entities
- Costs should over time
- Corporates will benefit from transparency proposals
- Non-financial institutions are not of systemic importance
- EC will carry out impact assessments

Environmental Information in the EU

- Environmental Information Directive
- Guidance on review due by 14 Feb 2004
- Published on 19 June 2007
- MS required to report on experience gained from application of Directive by 14 Feb 2009
- EC review of reports to follow

Reuse of Public Sector Information

- PSI Directive due for review by 1 July 2008
- Review published 7 May 2009 Focus on met data
 - Directive has helped reuse
 - More needs to be done
 - Extension to excluded sectors
 - Exclusivity carve out hindered review
- Will monitor for now
- Second review in 2012
 - Amendments to impact and scope

US - Overview

- Interaction with G20 actions
- Three bills under consideration
- Weather derivatives would constitute "swaps" under the Bills, rather than "security-based swaps"
- Therefore weather derivatives would fall under CFTC supervision, rather than SEC.
- All of the drafts generally require swap transactions to be centrally cleared, but get there in different ways and have (slightly) different exceptions.
- Pre and post trade reporting and collateral and capital requirements for bilateral transactions

Over-the-Counter Derivatives Markets Act of 2009

- House Financial Services Committee draft, sponsored by Rep. Barney Frank
- House Agriculture Committee draft, sponsored by Rep. Collin Peterson (proposed as an amendment by way of substitution of the Financial Services Committee draft)
- Senate Banking Committee draft, sponsored by Sen. Christopher Dodd

House Financial Services Committee

- **Requirement:**
- CFTC is required to monitor the market and designate certain swap contracts for central clearing, on the basis of criteria including –
 - Outstanding notional, liquidity, availability of pricing data
 - An adequately qualified clearinghouse being prepared to clear the contract
 - Mitigation of systemic risk
 - Impact on competition
 - “Reasonable legal certainty” about what would happen if the clearinghouse or its members go bankrupt
- **Exception:**
 - (a) No clearinghouse will accept the swap
 - OR
 - (b) One party to the swap is not a dealer or major swap participant
- **Major Swap Participant definition:**
 - A non-dealer who maintains a "substantial net position" in swaps (other than for hedging or risk management).
 - "Substantial net position" to be defined by CFTC and SEC by joint rulemaking (Treasury to break any deadlock)

House Agriculture Committee

- **Requirement:**

- Any swap must be submitted for clearing if a clearinghouse will accept it.
- Clearinghouses submit to CFTC swaps they propose to clear, CFTC has 90 days to respond (including 30-day public comment period).
- CFTC assessment criteria similar to Financial Services Committee version.

- **Exception:**

- One party to the swap is not a dealer or major swap participant

AND

- It has satisfied the CFTC how it meets its financial obligations relating to non-cleared swaps.

- **Major Swap Participant definition:**

- A non-dealer who maintains a "substantial net position" in swaps (no exception for hedging or risk management).
- "Substantial net position" to be defined by CFTC (alone).

Senate Banking Committee

- **Requirement:**
 - Any swap must be submitted for clearing if a clearinghouse will accept it.
 - Clearinghouses submit to CFTC swaps they propose to clear, CFTC has 90 days to respond (no public comment period).
 - Further, SEC and CFTC have 180 days from enactment of the Bill to come up with a list of swaps for which clearing is mandatory, regardless whether they have been submitted or not.
- **Exception:**
 - (a) No clearinghouse will accept the swapOR
 - (b) One party to the swap is not a dealer or major swap participant AND it does not meet the eligibility requirements of the relevant clearinghouse.
- **Major Swap Participant definition:**
 - A non-dealer whose net exposures to other market participants expose those market participants to significant credit losses if the MSP defaults.
 - Further definition to be adopted by CFTC and SEC jointly within 180 days of enactment of the Bill.

Insurance

- State based initiatives in relation to CDS
- Interaction with federal financial market legislation?

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