European Securities and Markets Authority

The Chair

Date: 13 December 2012
ESMA/2012/824

Written statement from the Chair of the European Securities and Markets Authority (ESMA) to the Agriculture Committee of the U.S. House of Representatives on the Dodd-Frank derivatives reform and the challenges facing U.S. and international markets

Dear Chairman Conaway, Ranking Member Boswell, and Members of the Committee,

I would like to thank you on behalf of ESMA for your invitation to testify before this Committee on the important topic of derivatives reform. Unfortunately, due to other urgent obligations I am unable to be physically present at today's hearing. ESMA is submitting this statement to highlight, in particular, some issues in relation to the application of the Dodd-Frank Act to non-US persons. I know that the European Commission, with which we have worked very closely in this process, is attending the hearing and will be able to expand on some of these points.

I will now briefly introduce ESMA to you. As an independent agency of the European Union (EU) our mission is to enhance the protection of investors and reinforce stable and well-functioning financial markets in the EU. ESMA achieves this mission by building the single rule book for EU financial markets and ensuring its consistent application and supervision across the EU. ESMA also contributes to the supervision of financial services firms with a pan-European reach, either through direct supervision or through the active co-ordination of national supervisory activity.

ESMA is deeply committed to finding convergent regulatory solutions to ensure there is an internationally coordinated application of the G20 commitments. The Dodd-Frank Act in the United States and the EMIR Regulation in the EU have many similarities, and both regimes are broadly aligned on many substantial points. However, there are some differences that require joint action and mutual understanding by regulators, like the CFTC and ESMA, which are tasked with drafting the secondary regulation that will allow the implementation of the respective Act and Regulation.

One of the differences between our respective regulatory frameworks relates to the registration of foreign entities, such as swap dealers (when they fall above the relevant threshold), which is required under US rules but not under EU rules. This registration requirement will apply to entities that are already authorised as dealers (investment firms or banks) under EU rules, and the US regime will therefore apply to entities and transactions that are also subject to EU rules. As the two sets of rules are similar in substance, there is a clear case for avoiding the situation where a particular entity or transaction is

simultaneously subject to two sets of rules. The application of two sets of rules to a single entity or transaction will lead to legal uncertainty and will be unnecessarily burdensome for firms.

The main relevant international regulators have been working together to seek ways to achieve convergence on the application of the rules that legislators in our respective jurisdictions enacted to reform OTC derivatives markets. ESMA has cooperated with its peers in other jurisdictions and found many points in common, including with the CFTC. As highlighted in the statement issued by the OTC Derivatives Market Regulators following their meeting on 28 November, a number of conflicting, duplicative and inconsistent requirements have been identified when analysing the simultaneous application of different national regulations. These requirements, if applied on a cross-border basis to the same entities and transactions, would, in certain cases, impede a transaction from taking place or might impede an entity from operating with US counterparties. This would have serious consequences for global market liquidity and might even have financial stability consequences.

These conflicting and duplicative requirements are, amongst others:

1) different applications of the clearing obligation;
2) different bilateral margin requirements;
3) privacy and data protection constraints;
4) different scope and exemptions (non-financial counterparties, inter-affiliates, pension funds, small banks, etc.);
5) different requirements for CCPs and trade repositories; and
6) indemnification requirements in the US.

The group of international OTC Derivatives Market Regulators reached some common understanding of the problems that these conflicting and duplicative requirements may give rise to. They have also agreed to carry out further work to identify mutually acceptable solutions to address these problems, but more work is needed.

ESMA considers that it is of fundamental importance to avoid the application of two or more sets of rules to the same entities or transactions, if those entities and transactions are subject to appropriate requirements in their home jurisdiction. Therefore, we would urge US regulators to rely to the maximum extent on equivalent requirements enshrined in EU law, instead of imposing US requirements when those non-US entities are dealing with US persons. When a duplicative application of rules cannot be avoided, we believe it is essential to identify and mitigate any possible conflict that might arise from that situation.

ESMA has welcomed as a workable solution, the use of mechanisms like "substituted compliance", which would allow US-registered foreign swap dealers to apply their home jurisdiction rules, to the extent that they are producing the same result as the corresponding US rules. However, while this is moving in the right direction, we remain concerned about the fact that in its current version it would not be applicable to

transactions in which one of the counterparties is a person established or domiciled in the US. We remain confident that, through common work, we will reach an agreement to allow the maximum possible use of mutual recognition and substituted compliance as ways to minimise conflicts and overlaps between different sets of laws.

Pending any such agreement, and until a framework for dealing with the above issues is finalised, we are of the view that registration and other requirements should be suspended for foreign entities. In this vein, ESMA would like to express its strong concerns about maintaining the deadline for the registration of foreign swap dealers by the end of 2012, despite a possible temporary waiver from some related obligations. This is due to the three reasons outlined below.

Firstly, the registration requirement that EU swap dealers face is required at a stage when several associated rules that they will have to comply with in the future are not yet final. In addition, international coordination efforts are still under development and subject to the dialogue between international OTC Derivatives Market regulators. Therefore, foreign swap dealers would be required to register without knowing with sufficient certainty the complete set of rules that will bind them as a consequence of their registration, and how those rules will be applied in an international context - including how substituted compliance will work.

Secondly, ESMA remains concerned about the fact that the registration application grants access to the US supervisors and the US Department of Justice to the books and records of registered swap dealers. It is important to reconcile this with the privacy or blocking laws that in many jurisdictions restrict the type of data that banks and investment firms can share with anyone except their national supervisors with a statutory power to require those data.

Thirdly, while we have achieved some progress on reaching an agreed approach to resolving cross-border issues, our international dialogue has not yet been exhausted and, therefore, fixing the registration requirement ahead of the conclusion of that dialogue could undermine the above-mentioned cooperation process.

I would like to thank you again for the opportunity to submit ESMA's views on this important matter to your Committee.

Yours sincerely,

Steven Maijoor
Chair
European Securities and Markets Authority