OTC DERIVATIVES REGU
REGULATION MOVES CL

CEOs and finance directors that use derivatives to hedge risks in their businesses got a clearer picture of what new derivatives regulation may look like this month - and it may not be all bad news

By Chris Arnold, Partner in the Derivatives and Structured Products group at Mayer Brown

Lawmakers on both sides of the Atlantic have taken further steps towards the introduction of tough new regulation of the over-the-counter (OTC) derivatives market. However, companies using OTC derivatives to hedge against movements in interest rates, foreign exchange, commodity prices or other risks associated with their businesses may escape some of the most burdensome rules.

On 2 June, the European Parliament's Economic and Monetary Affairs Committee (ECON) adopted a resolution setting out its recommendations for a new EU-wide regime.

Although this resolution has no legal effect, the committee's recommendations are likely to influence the European Commission, which is due to publish its own proposals later this year. The Commission will ultimately need the support of the European Parliament if its proposals are to be enacted and the ECON resolution, if ratified by a plenary session of MEPs later this month, will send a strong message of what they are expecting to see.

The key pillars of the committee's proposals include (i) compulsory clearing of most OTC derivatives through regulated central clearinghouses, (ii) extensive global reporting standards and (iii) increased capital requirements for financial institutions where trades are not centrally cleared. In addition, the committee wants to see a ban on the use of OTC derivatives for purely speculative trading on certain asset classes, including commodities and agricultural products.

Speculative use of credit default swaps, which have come under intense focus in light of the Eurozone's sovereign debt problems, would also be prohibited under the recommendations and all such transactions would be required to be centrally cleared. In other areas, the committee wants to give powers to the newly formed European Securities and Markets Authority (ESMA) to set position limits to reduce systemic risk and to take action to tackle dysfunctions in the market as they arise.

Overall the measures are intended to reduce the volume of transactions by standardising OTC derivatives and to promote transparency in

ULATION: LOSER

Chris Arnold, Partner in the Derivatives and Structured Products group at Mayer Brown

what has traditionally been a private market.

However, the committee recognised that bespoke, individually negotiated OTC derivatives are still necessary to hedge certain risks and should not be subject to standardisation. In order to ensure that the proposed regulation would not disproportionately impact corporate end-users, the committee also proposed that small and medium sized enterprises using derivatives that are proportionate and appropriate to hedge risks in their principal business should be exempt from certain clearing and capital requirements, subject to maximum thresholds set by ESMA.

The committee acknowledged that close cooperation with the US authorities, as well as the rest of the G20, was vital to avoid regulatory arbitrage and to ensure that information is exchanged effectively, including with central clearinghouses located outside the EU. Notably in this regard, Hong Kong and Singapore are yet to announce any firm proposals for reform.

In the US, both the Senate and the House of Representatives have recently approved separate versions of a financial reform bill which focus on the same key themes of central clearing, extensive reporting, capital/collateral requirements and position limits. As with the ECON proposals, both versions of the bill contain exemptions from the clearing requirements for end-users using OTC derivatives for hedging purposes. The financial reform bill has now moved to a conference committee which is expected to reconcile and combine the two versions, including addressing controversial proposals in the Senate version requiring FDIC-insured banks to spin off their derivatives operations into new separately capitalised corporate entities.

A final version is expected by the end of June and will be passed back to both houses for approval before being signed into law by President Obama before the Independence Day holiday. ■

"AG Kokott rejected arguments raised that LPP should extend to lawyers qualified in jurisdictions outside the EU"

BUSINESSREVIEWEUROPE.EU

For past columns and online-only content, blogging and much more...
[Click here]