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REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL

on the International Treatment of Central Banks and Public Entities Managing Public Debt with regard to OTC Derivatives Transactions

1. INTRODUCTION

The Regulation on OTC derivatives, central counterparties and trade repositories (EMIR) of 4 July 2012 requires, *inter alia*, the central clearing of all standardised OTC derivatives contracts, the reporting of all derivatives contracts to trade repositories and the implementation of risk-mitigation techniques for those trades which are not centrally cleared.

According to Article 1(4) of EMIR, the Union's central banks and Union public bodies charged with or intervening in the management of public debt are exempted from EMIR and are therefore not subject to these obligations.

Under Article 1(6) of EMIR, the European Commission is empowered to amend the list of exempted entities by way of a Delegated Act if it concludes, after analysing the international treatment of central banks and of public bodies managing public debt in other jurisdictions' legal frameworks and informing the European Parliament and the Council of the results, that the exemption of the monetary responsibilities of those third-country central banks from the clearing and reporting obligation is necessary.

2. THE COMMISSION'S FIRST ASSESSMENT

The Commission carried out its first review of the OTC derivatives legal frameworks in Japan, Switzerland, the United States, Australia, Canada, and Hong Kong in 2013. On 22 March 2013, the Commission adopted a report[1] concluding that the legislative frameworks of Japan and the United States fulfilled the conditions for the central banks and public bodies responsible for the management of the public debt in these two jurisdictions to be exempted from certain EMIR requirements. They were subsequently added to the list of exempted entities in Article 1(4) of EMIR by way of Commission Delegated Regulation (EU) No 1002/2013[2].

The legislative frameworks in the four remaining jurisdictions were deemed to have been insufficiently advanced for their central banks and public debt management bodies to be included in the list of exempted entities. However, the report concluded that the Commission would "*monitor and report on the latest developments*" once their rules were finalised.

3. THE CURRENT ASSESSMENT

The current assessment includes the four jurisdictions included in the first assessment but not recommended for an exemption at that time as well as two other jurisdictions (Mexico and Singapore) which requested an assessment.

The assessment is based on information gathered directly from the jurisdictions under assessment, and looks at two specific aspects of these frameworks:

i) progress in the implementation of OTC derivative market reforms as agreed at the 2009 G20 summit in Pittsburgh;

ii) the treatment of central banks and public bodies charged with or intervening in the

[1] COM(2013) 158 of 22.3.2013

[2] COMMISSION DELEGATED REGULATION (EU) No 1002/2013 of 12 July 2013 amending Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories with regard to the list of exempted entities (OJ L 279, 19.10.2013, p. 2)

management of the public debt within the relevant legal frameworks in these jurisdictions as well as the risk-management standards applicable to the derivative transactions entered into by these entities.

The analysis shows that significant progress has been made in all jurisdictions under assessment with regard to the adoption and implementation of OTC derivatives reforms. Moreover, all six have addressed the issue of the applicability of the various requirements to central banks and public bodies charged with or intervening in the management of public debt.

4. PROGRESS IN OF OTC DERIVATIVES MARKETS REFORMS

4.1. Australia

The implementation of mandatory clearing, reporting or organised platform trading in Australia is a two stage process with, first, a decision by the relevant Minister on whether these requirements should apply to certain classes of OTC derivatives, and second, implementing regulations and rules issued by the Australian Securities and Investments Commission (ASIC). Risk mitigation techniques for non-centrally cleared OTC derivatives are being implemented by the Australian Prudential Regulation Authority (APRA).

Clearing obligation

Australian regulations implementing mandatory central clearing are set out in the *Corporations Amendment (Central Clearing and Single-Sided Reporting) Regulation 2015.* The regulation implements central clearing of prescribed classes of OTC interest rate derivatives for a small number of major domestic and foreign banks that act as dealers in the Australian OTC derivatives market. In December 2015, the ASIC Derivative Transaction Rules (Clearing) 2015 introduced mandatory central clearing of OTC interest rate derivatives denominated in several leading currencies. The clearing obligations started in April 2016.

Reporting obligation

The ASIC Derivative Transaction Rules (Reporting) 2013, amended in February 2015, introduce the obligation to report OTC derivative transactions. The reporting obligation currently covers all derivative asset classes and is in place since December 2015.

Risk-mitigation techniques

The prudential standard requiring the use of risk-mitigation techniques for non-centrally cleared OTC derivatives was released by APRA in October 2016. The rule mandates the application of several risk-mitigation techniques: rapid confirmation of transactions, portfolio reconciliation, portfolio compression, dispute resolutions procedures, and the existence of processes for determining valuations. A start date has not yet been set.

4.2. Canada

The implementation of OTC derivatives markets reforms has two parallel strands. The Office of the Superintendent of Financial Institutions (OSFI), Canada's prudential regulator, sets broad requirements for federally regulated financial institutions (FRFIs) by means of guidelines. The provinces and territories are then responsible for market regulation in their specific jurisdictions. The Canadian Securities Administrators (CSA), an umbrella

organisation of Canada's provincial and territorial securities regulators, is responsible for the coordination and harmonisation of Canadian capital markets regulation. It develops regulations which are then promulgated and implemented by the provinces.

Clearing obligation

The clearing obligation is being implemented by all provincial securities regulators through a Proposed National Instrument 94-101 *Mandatory Central Counterparty Clearing of Derivatives* (Proposed NI 94-101) being developed by the CSA and, at the federal level, by OSFI through its Guideline B-7: *Derivatives Sound Practices*, which came into effect in December 2014. According to Guideline B-7, FRFIs are expected to centrally clear standardised derivatives where practical. Proposed NI 94-101 provides for the mandatory central clearing of certain OTC derivatives and lists the counterparties to which the clearing obligation will apply. The final rule should be adopted in early 2017.

Reporting obligation

The reporting obligation is being implemented at the provincial level through regulations enacted by each provincial securities regulator. There are specific regulations in Ontario, Quebec and Manitoba; in all other provinces (MI Jurisdictions), the reporting obligation has been implemented through Multilateral Instrument 96-101 *Trade Repositories and Derivatives Data Reporting* (MI 96-101). Trade reporting rules are fully in effect for all provinces since November 2016. The provincial and multilateral instruments are substantially harmonised with respect to the reporting obligation, and require the reporting of transactions which involve at least one local counterparty. At the federal level, Guideline B-7 requires FRFIs to report transactions pursuant to the reporting rules in effect in the province in which their head office or principal place of business is located.

Risk mitigation techniques

At the federal level, OSFI Guideline B-7 outlines the risk mitigation techniques for non-centrally cleared derivatives as they apply to FRFIs. In addition, OSFI Guideline E-22 *Margin Requirements for Non-Centrally Cleared Derivatives*, which came into effect in September 2016, addresses issues such as dispute resolution and valuation methodologies with respect to margin requirements for non-centrally cleared derivatives. At the provincial level, the CSA is currently developing a rule on dealer registration, which would impose risk mitigation techniques on derivatives market participants. The rule is expected to be published for comment in 2017 and enter into force in the first half of 2018.

4.3. Hong Kong

Hong Kong has a two-stage process for the implementation of OTC derivative market reforms. A regulatory framework is put in place by way of primary legislation, specifically the Securities and Futures (Amendment) Ordinance 2014, which amends the original Securities and Futures Ordinance (SFO) of 2002. This is followed by subsidiary legislation (i.e. rules) setting out detailed requirements for the reporting, clearing, and trading obligations, made by the Securities and Futures Commission (SFC) with the Hong Kong Monetary Authority's (HKMA) consent, and after consultation with the Financial Secretary.

Clearing obligation

The Amendment Ordinance introduces a mandatory obligation for the clearing of OTC

derivatives transactions. The empowering provisions require prescribed persons' to clear certain OTC derivative transactions through a designated central counterparty in accordance with the clearing rules. The implementation of this obligation will take place in phases. The rules for the first phase came into force in September 2016.

Reporting obligation

The Amendment Ordinance also establishes the reporting obligation. A prescribed person must report relevant OTC derivative transactions to the HKMA in accordance with requirements set out in the reporting rules. Phase 1 of reporting applies to a limited number of derivative types and to a slightly wider scope of persons than under the clearing obligation[3]. The rules for Phase 2 expand the product scope to cover all five asset classes and the range of information to be reported for each transaction. The scope of prescribed persons remains unchanged. Phase 2 reporting will start in July 2017.

Risk mitigation techniques

Two sets of risk-mitigation standards are foreseen in Hong Kong. The first, to be developed by the SFC, will apply only to corporations licensed by the SFC under the SFO (LCs). A consultation on the draft standards will be held in 2017. The second was developed by the HKMA and applies to institutions authorised by the HKMA (AIs) under the Banking Ordinance (BO). Implementation of these standards was originally targeted to start in September 2016. However, in August 2016, the HKMA deferred the start of implementation given similar delays announced by other major jurisdictions.

4.4. Mexico

The general rules on OTC derivative transactions are set out in the 'Rules to carry out derivative transactions' (Circular 4/2012) issued by the Mexican central bank (Banco de México, BdM) in March 2012, with subsequent amendments. Some specific rules (e.g. incorporation of CCPs) were issued jointly by the BdM, the Ministry of Finance (SHCP) and the National Banking and Securities Commission (CNBV).

Clearing obligation

Circular 4/2012 establishes that standardised derivative transactions between local banks or brokerage firms and certain other entities (local and foreign) must be settled through clearing houses incorporated in accordance with rules issued jointly by the BdM, the SHCP, and the CNBV or through foreign institutions acting as CCPs and recognised by the BdM. The clearing obligation is in force since April 2016 for transactions between local counterparties and since November 2016 for transactions executed between a local and a foreign counterparty. Recent amendments to Circular 4/2012 establish criteria to determine OTC products as standardised and therefore subject to central clearing requirements

Reporting obligation

Circular 4/2012 requires local banks, brokerage firms, investment funds, and *sofomes* (multiple-purpose financial institutions) to report their derivatives transactions to the BdM. Rules issued jointly by the BdM, SHCP and CNBV also require local CCPs to report to them

[3] The reporting obligation is extended to CCPs.

all contracts that they receive for clearing or any other transactions reported on a voluntary basis. The reporting obligation to the BdM covers all asset classes and both OTC and exchange-traded derivatives. However, only counterparties established in Mexico are legally obliged to ensure that the transaction is reported.

Risk-mitigation techniques

Since April 2016, local banks, brokerage firms, investment funds, general deposit warehouses, and *sofomes* are required to put in place at least the following risk mitigation techniques with respect to non-centrally cleared OTC derivative transactions: confirmation, daily valuation, reconciliation, mechanisms for dispute resolutions, and periodic assessments of whether to engage in portfolio compression. Further regulatory requirements for local banks and brokerage firms regarding risk mitigation of their transactions are set out in the 'Rules for Banks' and 'Rules for Brokerage Firms' issued by the CNBV.

4.5. Singapore

The legislative framework for OTC derivatives has two levels of legislation: general framework legislation adopted by Parliament and specific rules adopted by the Monetary Authority of Singapore (MAS).

Clearing obligation

Part VIB (Clearing and Derivatives Contracts) of the Securities and Futures Act (SFA), in place since November 2012, establishes the necessary legislative framework for mandating the clearing of derivatives. The MAS is currently in the process of finalising regulations for mandatory clearing. Adoption is planned for the first half of 2017. The new rules would require the clearing of interest rate swaps denominated in Singapore and US dollars.

Reporting obligation

The legislative framework for the reporting obligation was put in place by Part VIA (Reporting of Derivatives Contracts) of the SFA. The specific rules for reporting were subsequently set out in the Securities and Futures (Reporting of Derivatives Contracts) Regulations 2013 (SF(RDC)R), which entered into force in October 2013. The rules require certain ‘specified persons’ to report interest rate, credit, and foreign exchange derivative transactions. The reporting requirement is fully in force since November 2015.

Risk-mitigation techniques

Rules on risk mitigation techniques are currently being finalised. The proposed rules require MAS-licensed entities dealing in OTC derivative contracts to apply the following risk mitigation techniques in respect of their non-cleared OTC derivative transactions: confirmation, a dispute resolution process, daily valuation, portfolio reconciliation and portfolio compression. The MAS expects the risk mitigation requirements to become effective in 2017.

4.6. Switzerland

The regulatory framework for OTC derivative transactions has a basic legislative act, the Swiss Financial Market Infrastructure Act (FMIA), which sets out market conduct rules on derivatives trading, and subsequent implementing ordinances, specifically the Swiss

Financial Market Infrastructure Ordinance (FMIO), which sets out the specific rules and requirements in detail. Both the FMIA and FMIO entered into effect in January 2016.

Clearing obligation

The FMIA and the FMIO provide for the clearing of OTC derivatives transactions and set specific rules related to this obligation. The clearing obligation in principle covers all OTC derivative transactions, with certain exemptions for some (mostly smaller) counterparties. The obligation is being phased in depending on the types of contracts and counterparties.

Reporting obligation

The FMIA and the FMIO provide for an obligation to report all OTC derivative transactions and specify the relevant rules, including those describing which of the counterparties has the responsibility to report the transaction and what information is to be reported.

Risk-mitigation techniques

The rules concerning the use of risk mitigation techniques required for non-centrally cleared OTC derivative transactions are once again set out in the FMIA and the FMIO. The Swiss regulatory framework includes requirements for the timely confirmation of trades, portfolio reconciliation, portfolio compression, and procedures for dispute resolution.

5. INTERNATIONAL TREATMENT OF CENTRAL BANKS AND PUBLIC DEBT MANAGEMENT BODIES

5.1. Australia

Clearing obligation

The 2015 Regulation states that clearing requirements in relation to a derivative transaction cannot be imposed on a person who is not an Australian or a foreign clearing entity in relation to the transaction. Furthermore, the regulation prevents the derivative transaction rules from imposing clearing requirements on a range of foreign public entities including, among others, central banks and government debt offices.

Reporting obligation

The *Corporations Amendment (Derivatives Transactions) Regulation 2013* clarifies that the trade reporting obligation cannot be imposed on so-called ‘end users’. This essentially limits the application of the reporting obligation to Australian deposit-taking institutions, licensed clearing and settlement facilities, financial service licensees, and persons providing financial services relating to derivatives to wholesale clients in Australia under a specific licensing exemption granted by the Australian authorities. As such, central banks and public debt management bodies are not subject to the requirement.

Risk-mitigation techniques

Under the recently adopted requirements, risk mitigation techniques apply to APRA-regulated institutions in their transactions with covered counterparties. The definition of these institutions does not include any central banks or public bodies charged with or intervening in debt management. The definition of a 'covered counterparty' in turn excludes sovereigns,

central banks, multilateral development banks, public sector entities, and the Bank for International Settlements. Therefore, risk mitigation requirements do not apply to any central banks or public debt management bodies.

5.2. Canada

Clearing obligation

Guideline B-7 applies only to FRFIs. Since central banks and public debt management bodies do not fall within this definition, they are out of the scope of the OFSI rules on clearing. At provincial level, proposed NI 94-101 explicitly exempts transactions with certain Canadian institutions as well as foreign central banks and public bodies owned in whole or in part by a foreign government from the clearing obligation. It is expected that the above exemptions will remain in the final rule.

Reporting obligation

While there is no specific exemption foreseen for foreign central banks or public debt management bodies from the trade reporting rules, these in effect require that trades between a Canadian counterparty and any foreign public bodies need to be reported only by the Canadian counterparty. Foreign central banks and all public bodies are therefore not subject to the reporting obligation.

Risk mitigation techniques

As with the clearing obligation, the OSFI guidelines apply to FRFIs only. As such, central banks and all public bodies are out of scope of the OSFI rules on risk mitigation techniques. At the provincial level, the registration rule is intended to apply only to derivatives dealers. As such, central banks and public debt management bodies are currently not within scope of this rule. While the registration rule is still being finalised, it is not expected that its scope of application will change.

5.3. Hong Kong

Clearing obligation

The clearing obligation applies to interest rate swap (IRS) transactions among major dealers. These include, inside Hong Kong, AIs, money brokers approved by the HKMA under the BO (AMBs), or LCs which have reached a minimum clearing threshold. Major dealers outside Hong Kong are pre-identified in a list published by the SFC. The list includes entities such as clearing members of the largest IRS CCPs in a number of markets or global systemically important banks published by the Financial Stability Board. Since foreign central banks and public debt management bodies do not fall into any of these categories, they are outside the scope of the clearing obligation in Hong Kong.

Reporting obligation

Since Phase 1 of the reporting obligation applies to nearly the same scope of entities as the clearing obligation, foreign central banks and public debt management bodies are not subject to the reporting obligation. While Phase 2 extends the application of the reporting requirement to all five asset classes and increases the amount of information to be reported, it does not modify the scope of entities covered by the obligation. As such, foreign central

banks and public debt management bodies will remain exempt from the reporting obligation.

Risk-mitigation techniques

The risk mitigation standards to be defined by the SFC will, in general, apply only as long as OTC derivatives transactions are booked in SFC-licensed firms. Since, at present this is not the case, these standards will not be applicable for OTC derivative transactions. On the other hand, the framework developed by the HKMA applies to both domestic and foreign AIs with respect to non-centrally cleared derivatives transactions entered into with a 'covered entity'. The definition of covered entities explicitly excludes central banks and eligible public sector entities (PSEs). As such, central banks will not be subject to the proposed framework as long as they have the status of a central bank in their respective jurisdiction. For PSEs, as long as an entity qualifies as a PSE for capital adequacy purposes in its jurisdiction (irrespective of whether or not it is charged with intervening in public debt management), it will be exempt from the risk mitigation requirements.

5.4. Mexico

Clearing obligation

According to Circular 4/2012, only local banks and brokerage firms are required to clear their OTC derivative transactions through central counterparties when trading with other local banks or brokerage firms, local or foreign institutional investors, or foreign banks or brokerage firms. Central banks and public debt management bodies are therefore exempt from the clearing obligation.

Reporting obligation

Circular 4/2012 states that where a derivative transaction is entered into between a local counterparty subject to the reporting requirement and an entity established in a foreign jurisdiction, only the Mexican financial entity is legally obliged to report a derivative transaction to the BdM. Central banks and public debt management bodies are therefore exempted.

Risk-mitigation techniques

Given that the risk mitigation techniques defined in Circular 4/2012 apply to local banks, brokerage firms, investment funds, general deposit warehouses, and *sofomes*, foreign central banks and public debt management bodies are exempt from the obligation to apply these risk mitigation techniques.

5.5. Singapore

Clearing obligation

Under the draft regulations on mandatory clearing issued for consultation in 2015, the MAS has proposed that a range of international institutions, including foreign central banks and all public bodies be exempted from the clearing obligations. The MAS intends to maintain the proposed exemption in the final rules.

Reporting obligation

Part II of the Securities and Futures Act together with the fourth Schedule of the SF(RDC)R explicitly exempt from the reporting obligation foreign central banks and all public bodies, among a range of other international institutions.

Risk-mitigation techniques

The requirements on risk-mitigation techniques being developed by the MAS will only apply to holders of a CMS license and banks licensed in Singapore that deal in OTC derivatives. Given that foreign central banks and public debt management bodies will not normally be required to hold a CMS license, they will not be subject to the obligation.

5.6. Switzerland

Clearing obligation

As counterparties, foreign central banks and foreign public debt management bodies are outside the scope of the derivatives market conduct rules (and thereby the clearing obligation) as these bodies do not generally have a registered office in Switzerland. Moreover, derivative transactions with a range of foreign institutions, including central banks and public debt management bodies are not subject to the FMIA market conduct rules for derivatives (and thus to the clearing obligation).

Reporting obligation

The situation for the reporting obligation is analogous to that for the clearing obligation – foreign central banks and public debt management bodies are outside of the scope of the derivatives market conduct rules as they do not generally have a registered office in Switzerland. While derivative transactions between a Swiss counterparty within the scope of the FMIA rules and a foreign central bank or foreign public debt management body are subject to the FMIA reporting obligations, the obligation to report the transaction falls to the relevant Swiss counterparty only. In addition, the Swiss regulatory framework permits exempting derivative transactions with such entities from the reporting obligation entirely, subject to reciprocity.

Risk-mitigation techniques

With regard to the obligation to apply risk mitigation techniques to non-centrally cleared OTC derivative transactions, the situation is identical to that for the clearing obligation. As counterparties, foreign central banks and public debt management bodies are not subject to the derivative market conduct rules. As regards derivative transactions with these entities, the FMIO provides for a specific exemption.

6. CONCLUSION

The legislative frameworks implementing the OTC derivative reforms agreed in Pittsburgh in 2009 are now full in place in Australia, Hong Kong, Mexico, and Switzerland, and will be so shortly in Canada and Singapore. Furthermore, in all of these jurisdictions, the legislative frameworks either do or will not apply to central banks and public debt management bodies.

The Commission therefore concludes that Article 1(4) of EMIR should be amended to

exempt from certain EMIR requirements the central banks and public bodies charged with or intervening in the management of public debt from Australia, Canada, Hong Kong, Mexico, Singapore and Switzerland.

Exempting these entities will prevent EMIR requirements from interfering with the conduct of their monetary responsibilities and other tasks of common interest, and will promote a level playing field in the application of OTC derivatives reforms with regard to transactions with such entities in these jurisdictions. It will also contribute to greater international coherence and consistency in OTC derivatives reform implementation.

The comparative analysis presented in this report is not the last of its kind. The Commission will monitor developments in these and other G20 jurisdictions with respect to the implementation of rules on OTC derivative transactions and will update the report as the reform process in these jurisdictions advances, including by removing certain third countries from the list of exempted entities should the regulatory arrangements in those third countries no longer meet the conditions for an exemption. Further amendments of Article 1(4) of EMIR can therefore be expected.