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## **News release**

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### **EU's OTC derivative rules spread outside Europe**

From 2014 derivative end users outside Europe may be captured by Europe's new over-the-counter (OTC) derivative trading rules, known as the European Market and Infrastructure Regulation (EMIR).

EU rule makers are seeking to extend EMIR rules outside the EU to mitigate against trading activities outside the EU that could threaten financial stability in the EU and to make sure that market participants do not evade EMIR rules.

Crispian Lord, regulation partner at PwC, said:

“Many derivative traders outside the EEA are unaware that EMIR will apply to some or all of their trading from as early as next year. The biggest issue for them will be meeting the EMIR clearing obligation if the rule apply to trading taking place outside Europe.

“Non-financials outside Europe have been the winners as ESMA continues to narrow the scope of its extra-territorial proposals. However, for all counterparties outside the EU the application of more conditions and rules does make the rules more difficult for market users to understand and apply to their operational processes.

“Extra-territoriality of OTC derivative regimes is the topic du jour, but unfortunately for derivative users there appears to be little consistency among jurisdictions in how they extend their rules and recognise other similar regimes. This leaves derivative users subject to conflicting, duplicative and often inconsistent rules for the same transactions. The EMIR equivalence determinations are at this time of little relief for many derivative users trying to manage Dodd-Frank and EMIR rules.”

EMIR, which came into force in 2012, applies currently only to legal entities established in the European Economic Area (EEA). But on 15 November 2013, The European Securities and Markets Authority (ESMA) delivered draft proposals to entities located outside the EEA (third country entities, or TCEs) into EMIR scope under defined scenarios.

#### **Key points of proposed rules**

The EMIR third country rule proposals will extend EMIR OTC derivative clearing and non-centrally cleared margin, among other obligations, to:

1. within the EEA: all trading conducted between branch offices of two TCEs that would be classified under EMIR as Financial Counterparties





2. outside the EEU: OTC derivative trading conducted between two TCEs where one counterparty's trading is guaranteed by an EU Financial Counterparty, when the guarantee is over certain thresholds.

The proposals also specify scenarios likely to be deemed EMIR avoidance, which would also allow EU regulators to extend EMIR rules to TCE trading.

### **Evolution of the proposals**

ESMA consulted on most of its third country rule proposals in March 2012 and most recently in July 2013. The final rules published today do not substantially amend ESMA's established third country proposals, but provide more help for derivative users outside Europe:

- trading between EU branch offices of third country entities has been narrowed to include only trading between TCEs that would be classified under EMIR as Financial Counterparties
- a six month implementation period has been proposed, to allow third country entities to implement EMIR clearing and non-centrally cleared risk management processes

ESMA has also provided clarification on a number of interpretation issues raised by respondents to earlier consultations.

### **Equivalence relief: more kill than cure?**

A TCE caught by these proposals can opt to apply its home country rules instead of EMIR if it is established where the EU has determined the OTC derivative rules to be equivalent to EMIR. However, the first EMIR equivalence assessments, provided by ESMA to EU rule makers in September and October, were either heavily conditioned or incomplete. Equivalence will be of limited relief until jurisdictions outside the EEA complete their derivative reforms and rule makers come closer to harmonised rules.

The proposals are expected to be passed into law next year and will come into effect six months after completed, which is expected towards the end of 2014.

**END**

### **Notes to Editors**

- ESMA's announcement can be found [here](#).
- EMIR fulfils several of the Over the Counter (OTC) derivative market reforms agreed by G20 countries to reduce systemic risk and bring more transparency to both OTC and listed derivatives markets.
- The EMIR third country rules are designed to apply EMIR clearing and non-centrally cleared trade risk management obligations to all transactions which have a "direct, substantial and foreseeable effect in the European Union" or are deemed to be avoiding EMIR obligations.
- EMIR introduces three obligations for derivative counterparties: to clear all derivative contracts subject to mandatory central clearing, to apply non-centrally cleared risk management obligations to all contracts which are not centrally cleared and to report derivative transactions to regulators. All obligations except EMIR reporting will apply to entities outside the EEA that are captured under the final rules.



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