

# Clearing OTC derivatives: the Dodd-Frank Act and the new EU Regulation

---

25 - Jun - 2014

**Article for PLC Cross-border Capital Markets Handbook 2011 - ANTONY BRYCESON**

The European Commission's proposal for a new EU regulation (titled the European Market Infrastructure Regulation) on OTC derivatives, central counterparties and trade repositories (EU Regulation) was published on 15 September 2010, precisely two years after the commencement of the Lehman Brothers bankruptcy.

The EU Regulation is designed to meet the commitment by the G20 leaders in September 2009 that all standardised OTC derivatives contracts should be cleared through Central Counterparty Clearinghouses (CCPs), by the end of 2012 at the latest. It also provides for reporting of OTC derivatives contracts to trade repositories, and creates a framework for the regulation of CCPs and trade repositories in the EU. The anniversary of the commencement of the Lehman Brothers bankruptcy is particularly relevant, since the EU Regulation seeks to reduce systemic risk in derivatives markets.

This proposal follows equivalent proposals in the US under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). The Dodd-Frank Act, when fully effective, will make sweeping changes to the regulation and structure of the US derivatives markets and to participants in them.

The primary aim of these proposals is to increase transparency and liquidity in the markets for certain OTC transactions and to reduce counterparty risk (and therefore systemic risk), by requiring that robust CCPs stand "in the middle" of transactions.

Against this background, this article examines:

- ,,, Current OTC derivatives clearing.
- ,,, Documentation for CCP clearing models.
- ,,, Key legal and operational issues with moving OTC trades to a central clearing platform.
- ,,, The European Commission's proposals for OTC derivatives clearing and the equivalent proposals in the Dodd-Frank Act.

## **CLEARING OF OTC DERIVATIVES**

### Introduction to clearing

The term clearing, in relation to OTC derivatives, has sometimes been loosely used to refer to post-trade processing such as warehousing (whereby information about derivatives contracts is held centrally and certain processes such as payment instructions are automated). The term clearing in this article refers to a process where the original counterparty to a trade is substituted for a CCP.

To take a simple example of how this operates in practice:

- ,,, An original buyer and original seller execute a contract. They agree that the contract will clear through a certain clearing system.
- ,,, When the contract is accepted for clearing by the clearing system, they are no longer counterparties to each other. Instead, the CCP becomes the buyer to the seller and the seller to the buyer.

### Advantages of clearing

The principal benefits of clearing should be in the following areas:

„„ Better counterparty risk, since the clearinghouse is well regulated and well-capitalised, and holds enough collateral to “guarantee” performance of transactions.

„„ A more secure and certain environment for post-trade processes, due to the rules and processes operated by the CCP.

„„ Increased transparency, through reporting of prices, quantities and other transaction details, leading to enhanced liquidity.

„„ Netting of transactions at the end of each day, leading to possible reductions in capital or margin needed to support trading activity.

In this context, netting involves offsetting gains and losses on transactions, and offsetting payments to be made between the parties, to produce an overall net profit or loss, or net payments due or receivable between the parties.

However, in terms of netting, any capital or margin reduction benefit must be weighed against increased concentration risk, where an end-user’s transactions are concentrated in one clearinghouse or a small number of clearinghouses. These issues have existing parallels where an end-user has a concentration of OTC and/or foreign exchange (FX) positions with one dealer under an International Swaps and Derivatives Association (ISDA) Master Agreement. There may be netting benefits (and resulting lower collateral requirements) but concentration risk is also increased.

In practice, because the CCP is a strong counterparty and the likelihood of failure (that is, default due to solvency problems) is extremely remote, end-users will probably want to minimise the number of clearing systems they use, for netting benefits and to simplify operational management of exposures and collateral.

#### Existing clearing systems

OTC clearing is very topical due to impending regulation and the expected tide of standardised products moving to clearing systems.

However, clearing of OTC derivatives is not a new idea. The impending regulation will accelerate a process which has already begun.

Clearing systems in different forms have been operating successfully for many years, primarily for interest rate swaps and, more recently, credit default swaps and energy derivatives. A credit default swap is a contract between a buyer and a seller which relates to a reference entity such as a government or a company, whereby the buyer makes payments to the seller, and in return, if the reference entity defaults, the seller makes certain specified payments to the buyer.

A significant proportion of the worldwide interest rate swap market is already cleared through CCPs. Although credit default swaps and interest rate swaps may be very different, they share fundamental features common to all OTC products:

„„ They are privately negotiated synthetic transactions, the economic terms of which are agreed between two parties at the time of execution. A synthetic transaction is one which relates to the value of certain specified assets, but does not itself involve any ownership interest (for example a purchase or sale) in those assets.

„„ The transaction is then confirmed either manually or by an automated process, and is governed by an ISDA Master Agreement.

Subject to liquidity and operational issues, if one product type can be cleared, it should be theoretically possible to clear any OTC product.

Although FX forwards and currency options are not always categorised as derivatives, they also have features in common with OTC derivatives, and are now generally subject to ISDA Master Agreements. In practice, the less standardised an instrument is, the more difficult it is to clear it.

The use of clearing systems for OTC products to date has been driven by commercial reasons rather than mandatory requirements of law and regulation. Clearing systems are already changing their processes and documentation to adapt to the new environment, in anticipation of a very substantial increase in clearing volumes.

#### Evolution of OTC clearing

The concepts involved in clearing OTC products are not new. Clearing of OTC derivatives through a CCP already takes place.

For example, the SwapClear system of LCH.Clearnet Ltd works so that:

„„ Two counterparties execute a swap in the normal way, subject to an ISDA Master Agreement.

,,, The swap is then matched and submitted for clearing.

,,, Once accepted for clearing, the swap becomes subject to the LCH.Clearnet rules.

,,, The original swap between the parties is replaced by two swaps on the same economic terms as the original swap, and standard clearinghouse terms then apply to the swap.

,,, Once the original swap is accepted by the clearinghouse, each original participant ceases to have exposure to its original counterparty with whom it executed the swap, because the counterparty becomes the CCP.

,,, The LCH.Clearnet rules govern the swap and netting of payments applies.

,,, Both initial margin and variation margin must be posted by clearing members, in the normal course of events, to protect the clearinghouse.

Clearing models for OTC derivatives generally derive from:

,,, Traditional futures clearing (for exchange-traded derivatives).

,,, The principles involved in OTC derivatives intermediation.

**Futures clearing.** Traditional futures clearing is a tried and tested model where, broadly:

,,, Futures contracts are novated to a CCP, and the rules of the clearinghouse govern the contracts.

,,, An end-user must use the services of a clearing member (typically a derivatives dealer) to settle a futures trade.

,,, These services are governed by a futures clearing agreement, whereby a mirror or “back-to back” trade, on identical economic terms to the cleared trade, takes effect between the end-user and the clearing member. An enduser which has a back-to back trade with a clearing member will be in the same position as against the clearing member as the clearing member will be as against the CCP.

**OTC derivatives intermediation.** OTC derivatives intermediation can broadly be described as the extension of prime brokerage or give-up arrangements to OTC derivatives. Broadly speaking, prime brokerage in this context refers to services provided by a prime broker for settlement of transactions, and give-up refers to the process whereby a transaction is directed for settlement following execution. In a wider sense, the term prime brokerage is used to refer to a suite of services (the core ones typically being settlement of securities trades and securities financing) provided to end-users such as hedge funds.

Although now diminished due to the financial crisis and a consequent focus on risk aversion, a market for intermediating FX transactions, credit default swaps and interest rate swaps developed in the years up to the financial crisis. This involved:

,,, The “prime broker” providing end-users with the facility to execute specified categories of eligible transactions with designated executing dealers.

,,, Following execution, the executing dealer and the end-user would each feed trade details to the prime broker.

,,, If the prime broker accepted the trade (a well-drafted give-up agreement should be as clear as possible about the conditions for acceptance), it would become a counterparty, in the middle of two back-to-back trades:

,,, one with the end-user (governed by its ISDA Master Agreement with the end-user);

,,, the other with the executing dealer (governed by its ISDA Master Agreement with the executing dealer).

The most notable feature is the use of back-to-back trades with an intermediating party. Much like CCP clearing, this tends to concentrate responsibilities for risk management on the prime broker.

Risk management is crucial, particularly the ability of the prime broker to monitor and control the flow of new transactions. Prime brokers would typically establish limits per product type and per day, on the amount a single client can trade with a particular executing dealer, and aggregate limits. Large demands are placed on back office systems and the clarity of the underlying documentation is critical.

#### Documentation for CCP clearing models

Documentation for CCP clearing models is typically complicated and never perfect. There will always be compromise and areas (for

example, conditions of acceptance for clearing) which prove to be an inexact science. A non-cleared bilateral trade documented under an ISDA Master Agreement (with no unusual terms) arguably provides greater contractual certainty. Other than the ISDA Master Agreement and supplemental documentation such as confirmations, there are no other “elements”. However, the robust overall framework that clearinghouse rules provide, and the increased commoditisation of the underlying transactions, should outweigh these issues.

#### Existing clearing structures

Generally, in OTC clearing transaction and documentation systems, there are two levels of transaction and of documentation for each trade initiated by an end-user. End-users are not generally clearing members of a clearing system. They therefore cannot contract directly with the CCP, so must feed their transactions through a clearing member, with the clearing member acting as intermediary.

Existing clearing systems for OTC derivatives work on either a principal-to-principal basis or an agency basis. In an agency clearing system, the clearing member acts as intermediary (in the capacity as agent) and the principals are the end-user and the CCP. UK-based clearinghouses generally apply principal-to-principal clearing, and this article focuses on this form of clearing.

In a futures trade, the customer side trade is a principal-to-principal transaction governed by a futures customer agreement. This is typically a form of master agreement with close-out netting provisions. Close-out netting is a process whereby, following a party's default, all obligations between the parties are offset against each other to produce one single payment owing between the parties. Futures customer agreements are generally drafted in a more dealer-friendly way than, for example, ISDA Master Agreements. In addition, these agreements typically incorporate the clearinghouse rules, so that any action taken by the clearinghouse by operation of clearinghouse rules, which affects the clearinghouse transaction, are also applied to the customer side transaction.

Clearinghouse rules usually contain wide powers in an emergency or other undesirable situation, or clearing member default, to allow the CCP to close out transactions, exercise rights of set-off and so on.

Clearing systems also operate differently in how they characterise transactions through the clearing process:

„„ Some clearinghouses may convert OTC trades into futures contracts through the clearing process, upon which the resulting futures contract is novated to the CCP.

„„ In other systems, OTC trades remain characterised as such after clearing.

As part of their review of their customer documentation and the clearinghouse rules, end-users will wish to consider the characterisation of their cleared trades.

#### Existing clearing documentation

Existing OTC clearing documentation structures between the clearing member and the end-user originate from either futures customer documentation or ISDA Master Agreements, or a combination of both.

The end-user and the clearing member may use an annex to the ISDA Master Agreement to apply to cleared transactions. The annex overrides the terms of the original ISDA Master Agreement for cleared transactions, in particular in relation to provision of margin and consequences of default.

Alternatively, the parties may use a futures customer agreement as the primary agreement, but with an annex to deal specifically with OTC trades to be cleared. Futures agreements in the UK market have certain master agreement characteristics similar to those in the ISDA Master Agreement including, crucially, default and close-out netting provisions. However, subject to negotiation, they generally provide for wide discretions in favour of the dealer (for example in margining terms and imposition of position limits). End-users may therefore find themselves having futures clearing agreement provisions, which are generally more onerous (particularly in their default provisions), applying to OTC trades.

#### Impact of clearinghouse rules

Incorporating clearinghouse rules into documentation between the end-user and the clearing member very significantly changes documentation for OTC trades. In theory at least, parties have a large amount of freedom to document OTC trades (albeit

generally using the ISDA architecture), including bespoke terms. The inclusion of clearinghouse rules introduces a certain rigidity.

While the clearinghouse rules generally provide significant discretions in favour of the clearinghouse and are generally non-negotiable, the terms between the end-user and the clearing member are likely to be negotiable in many areas, notwithstanding that the clearing member will generally seek wide discretions in its favour.

For example, while margin terms are dictated in part by the clearinghouse rules, a clearing member may seek a wide discretion to require additional margin from the end-user. This is generally the case under futures customer agreements (the rationale being that the clearing member takes greater risk on the end-user than it does on the CCP). It is also likely to apply to clearing arrangements which use the ISDA Master Agreement with a deemed (or mandatorily amended) Credit Support Annex (CSA). Collateral requirements under the deemed CSA generally provide for the clearinghouse minimum margin amount plus an additional buffer amount (typically characterised as Independent Amount).

CCPs can generally change their rules unilaterally (that is, without requiring consent). Therefore, to analyse the documentation fully, end-users must also review the relevant clearinghouse rules. These rules are likely to have a significant impact on the underlying documentation between the end-user and the clearing member.

#### Acceptance and rejection for clearing

Give-up procedures for OTC trades for clearing throw up similar problems to those arising in relation to OTC derivative prime brokerage or give-up arrangements. Two levels of acceptance are needed before a trade is accepted for clearing. The clearing member must accept or “affirm” the trade, and the clearinghouse must do the same.

In the event of rejection of a trade, a party may want to resubmit the trade for clearing through the same clearing member. If it has a pre-existing relationship with another clearing member, it may submit the trade for clearing through that other clearing member.

If a transaction is (ultimately) not accepted, the parties have a number of choices available to them:

,,, They may elect to terminate the transaction with a breakage or “compensation” amount payable between them, according to the value of the transaction at the time of termination.

,,, Where possible they may agree to cancel the transaction.

,,, They may wish to continue the transaction on a non-cleared bilateral basis.

Where termination is agreed, end-users should ensure that compensation payments are required to be made both ways, not just to the executing dealer. It is important to have appropriate contractual arrangements (in addition to the clearinghouse rules) in place for dealing with problem trades, to avoid disputes. These contractual arrangements should also address conditionality. In other words, whether acceptance for clearing is a condition of the contract, that is, whether a binding contract indeed exists between the parties if the trade is not accepted for clearing. Fundamental issues such as these, between end-user and executing dealer, may not be satisfactorily addressed by the clearing system rules.

If the original parties to the trade elect to continue that trade, they need to do so on the basis of an existing ISDA Master Agreement between them, or a long form confirmation which incorporates the key terms of the ISDA Master Agreement. In a transaction which falls within mandatory clearing requirements as set by the relevant regulations, parties must assess whether this will be feasible following release of the relevant technical standards under the regulations, or whether termination or cancellation will be necessary.

On an operational level, the affirmation (that is, initial acceptance) and matching process of trade details at both clearing member and CCP level is key to avoiding problem trades. In addition, a trade may be rejected for other reasons such as risk limits being exceeded. The advantages for an end-user in having relationships with multiple clearing members include the ability to resubmit a trade for clearing through another clearing member, and diversification of both credit and operational risk. Disadvantages may include increased costs and increased back office and operational demands on the end-user.

When compared to the traditional environment for trading FX and OTC products on a bilateral basis under an ISDA Master Agreement (where contractual arrangements consist of the master agreement and trade confirmation only), clearing introduces further layers of complexity by way of multiple parties and different sets of documentation. Considering the operational challenges in clearing OTC trades, an end-user should review the relevant legal or contractual documentation with an eye on operational variables and uncertainties, to ensure documentation covers potential problems satisfactorily.

## **KEY ISSUES: MOVING OTC TRADES TO CENTRAL CLEARING**

### Concentration risk

A criticism of CCP clearing is concentration risk. In previous times, an end-user such as a successful fixed income hedge fund may have established numerous ISDA Master Agreements with numerous different counterparties. In a new environment where all its derivatives trading must be cleared, an end-user may use just one clearinghouse. Rather than taking on numerous different risk profiles represented by each ISDA Master Agreement counterparty, its risk is concentrated in one central counterparty.

The hedge fund may also have the facility to be collateralised under its Credit Support Annexes with each of the numerous counterparties. In contrast, it is unlikely to have an equivalent facility to be collateralised in a clearing model (although it is acknowledged that cash payments may be made in certain clearing systems instead of collateralisation). Therefore there may be significantly greater counterparty risk for the end-user in the CCP model, due to both concentration risk and lack of collateralisation.

For these reasons, the robustness of the CCP is critical.

However, concentration issues applying to CCP clearing of OTC products should be broadly the same as for CCP clearing of exchange-traded derivatives. CCPs for exchange-traded derivatives generally manage their risks quite effectively. A critical question for CCPs in OTC derivatives clearing is whether the risk controls employed by CCPs for exchange-traded derivatives will be equally effective when applied to OTC derivatives, which are generally less liquid and more difficult to value accurately. Presumably, the more liquid and commoditised the OTC product is, the less critical these issues should be, and vice versa.

### Segregation of margin or collateral

In the event of the default of a clearing member, the CCP generally looks to transfer open positions from the insolvent clearing member to a solvent clearing member. Segregation of a customer's collateral generally protects the collateral, that is, ringfences it from the insolvency of the clearing member. Since positions are margined or collateralised, both at CCP level and at clearing member level, the ability to transfer open positions to a new broker may depend on how, at CCP level, margin or collateral is held on behalf of each underlying customer:

,,, If all margin or collateral is held in a commingled omnibus account and is difficult to trace to individual customers, this is likely to hinder the process of transferring positions.

,,, In an ideal world (and despite operational challenges), collateral at CCP level should be held in individual segregated accounts relating to each underlying customer (or group of underlying customers under the management of a particular investment manager), rather than in an omnibus account relating to multiple customers of the clearing member.

However, there is nothing to stop a customer from posting further (or new) margin to the new clearing member to collateralise transferred positions. One further issue is whether margin is posted with a clearing member on a gross or net basis, and whether the clearing member is required to post margin to the CCP on a gross or net basis:

,,, A series of positions in a trading book are margined on a gross basis if each individual position is treated as if it were the sole position in the trading book.

,,, Positions in a trading book are margined on a net basis if the profit element on certain positions is offset against losses on other positions in the trading book, resulting in lower overall margining obligations.

Any such analysis is important to assess how transferable positions will be in the event of failure of the clearing member.

### Virtuous liquidity circle

As the new regulations intend, the level of standardisation and transparency offered by CCPs should facilitate greater liquidity and make it easier to price OTC contracts. Such markets should operate increasingly like futures markets, where plenty of transparency exists. CCP platforms are likely to provide more frequent mark-to-market valuations than for non-cleared OTC products.

### How will end-users know which CCP to use?

End-users will probably look to their prime brokers, and perhaps other substantial dealer relationships, for guidance on which CCP platform to use. Most or all major derivatives dealers will be clearing members of the relevant CCP systems. An end-user will need to trade through such dealers, unless the end-user is itself allowed to become a clearing member, and is willing to devote the necessary resources to membership.

### When will end-users move to CCPs?

Broadly, trades subject to mandatory clearing (that is, considered standardised and eligible for clearing) are likely to be those liquid enough to be priced at least on a daily basis. Market participants therefore already have an expectation of the types of products likely to move to mandatory clearing. For example, index and single-name credit default swaps are more likely to be subject to mandatory clearing than a credit default swap on a synthetic collateralised debt obligation because the former are relatively liquid (that is, there is a ready market of buyers and sellers, as evidenced by bids and offers that change throughout a trading day).

However, without knowledge of the technical details relating to the regulations, end-users will be reluctant to jump on the clearing bandwagon. Once the relevant details are known, end-users will assess the need to establish new trading relationships with clearing members to cater for their anticipated trading requirements.

We can expect to see clearing members (and perhaps CCPs) undertaking road shows to end-users to attract business.

Established clearinghouses (and their overseas subsidiaries) such as Chicago Mercantile Exchange, InterContinental Exchange, International Derivatives Clearinghouse and LCH.Clearnet will adapt their existing clearing services in anticipation of higher volumes, and will begin new services. New entrants are expected to emerge in spite of the substantial start-up costs.

## **THE NEW EU REGULATION**

The EU Regulation will be directly applicable in all EU member states so that, in theory at least, there should not be any inconsistencies in implementation or differences of interpretation between member states.

The EU Regulation and the Dodd-Frank Act share many common features, since they both aim to implement the original commitment of the G20 leaders. Both will lead to fundamental changes in the regulation and operation of derivatives markets in the EU and the US, and will place significant requirements on participants in those markets, both dealers and end-users. However, both the EU Regulation and the Dodd-Frank Act are framework proposals. It will not be possible to assess the full effect of the proposals until the technical standards and implementing rules, which will have a significant effect on how the two regimes operate in practice, are published.

### Differences between the US and EU regulations

Despite a common approach taken to principles, there are likely to be significant differences in regulatory approach in the EU and the US. In both cases, regulatory authorities will have broad authority to interpret key provisions. A concern of many market participants is the possibility of complying with both sets of regulations.

Both will have extra-territorial consequences and are likely to be inconsistent in certain respects. It is possible that a certain amount of regulatory arbitrage may result. There will be a transitional period while market participants adjust to the new landscape and regulators clarify interpretations of key provisions.

The following section does not examine in depth the differences between the US and EU approaches. It looks at how some of the important common issues are addressed.

## Trading and transparency

One feature of the Dodd-Frank Act which is not covered by the EU Regulation concerns the trading and transparency of OTC derivatives transactions. The reason is that these issues are already being considered in the review of Directive 2004/39/EC on markets in financial instruments (MiFID), which is a separate process.

## Types of derivatives covered

Both the EU Regulation and the Dodd-Frank Act seek to impose clearing and reporting on a broadly defined class of OTC derivatives, and give regulators the ultimate decision on when the clearing obligation applies. They both include exemptions from clearing.

The EU Regulation applies to OTC derivatives regulated under the EU markets in MiFID, which includes swaps, options, futures, forwards and CFDs (contracts for differences). Spot FX contracts are excluded and it seems that FX forwards are also excluded.

Although spot FX contracts are arguably not derivatives (since the contract is executed there and then, there being no mark-to-market value), FX forwards are margined, derivative-like contracts. The "mark-to-market" value of a contract refers to its inherent value, at a given point in time.

The Dodd-Frank Act applies to a broad class of OTC derivatives including transactions which in the future become known as swaps. Spot FX and FX forwards may, at the option of the US Treasury Secretary, be excluded from clearing but not from the reporting obligation. It seems that the Dodd-Frank Act does not apply to certain types of physically settled commodity transactions and certain physically settled forward transactions in securities.

Options on securities and exchange-traded futures are not covered but are to continue to be subject to existing regulations.

## Scope of clearing obligation

Broadly, the EU proposals apply to financial counterparties who trade with other financial counterparties, and to non financial counterparties whose trading exceeds a specified threshold. Under the US regulations the clearing obligation appears to be wider, since it applies to all those who enter into eligible contracts other than non-financial counterparties entering into certain types of hedging transactions.

Under the EU Regulation, the new European Securities and Markets Authority (ESMA) will decide which OTC derivatives are subject to a clearing obligation. ESMA will have broad powers, and can provide that certain types of contract must be cleared even where no clearer currently provides such a service. However, the EU Regulation does not specify any related powers, and such a scenario seems unlikely to arise in practice.

Similarly, under the Dodd-Frank Act, the relevant regulators must determine which OTC derivatives are subject to a clearing obligation, although the evaluation criteria are different (for example, the US regulators must take into account the effect on competition, including clearing costs) when compared to the EU Regulation. The US regulators can take action even if no CCP currently clears the contract (for example, to restrict trading in such contracts), and can also stay the application of the clearing obligation.

The Dodd-Frank Act requires the execution of OTC derivatives subject to the clearing obligation on a swap execution facility or designated contract market, real time post-trade transparency for cleared derivatives trades and position limits. In the EU, these issues are being addressed separately as part of the MiFID review, which is a separate process.

## Reporting obligations

The reporting obligations under the EU Regulation and the Dodd-Frank Act both follow the principle that:

,,, Cleared OTC transactions must be reported to a trade repository (or failing which, the regulator).

,,, Non-cleared OTC transactions are subject to a reporting requirement.

Under the EU Regulation, non-financial counterparties are required to report their OTC trades only where the positions exceed a threshold to be set by the regulator. The EU Regulation provides that reports must be made no later than the business day following the date of execution (or modification or termination) of the trade.

## Regulation of CCPs



Very broadly:

„ The EU Regulation contains requirements that substantially all risk exposure of a CCP is collateralised through payment or delivery of margin.

„ In contrast, the Dodd-Frank Act requires that regulators should develop appropriate standards for the organisation and operation of CCPs.

ESMA is given the power to recognise a CCP in a non-EU country if the Commission determines that the legal and supervisory framework in that country is equivalent to the requirements of the EU Regulation. The question of mutual recognition of third country CCPs remains to be resolved.

#### Ownership of CCPs

The Dodd-Frank Act requires US regulators to determine whether to limit ownership of CCPs by large banks and non-bank financial holding companies supervised by the Federal Reserve. Under the EU Regulation, holders of direct or indirect significant shareholdings in a CCP must notify their holdings to the regulator, and are subject to approval by the regulator.

Both the Dodd-Frank Act and the EU Regulation contain provisions for management of conflicts of interest by CCPs and others.

#### Requirements for segregation of collateral

The EU Regulation provides that each clearing member of a CCP must identify and segregate in its accounts with the CCP its own positions and those of its clients. Otherwise, details of segregation requirements, both at clearing member and CCP levels, remain to be seen.

#### Uncleared swaps

The EU Regulation provides that financial counterparties, and non-financial counterparties exceeding the applicable clearing threshold, which enter into uncleared trades, must have appropriate measures in place to monitor, minimise and mitigate credit risk and operational risk.

The Dodd-Frank Act imposes capital and margin requirements on swap dealers and major swap participants which enter into uncleared swaps, and provisions by which counterparties can require swap dealers or major swap participants to segregate initial margin on uncleared swaps.

Although much is yet to be revealed in the technical standards, the EU Regulation appears to be marginally less restrictive for end-users. Under the Dodd-Frank Act, the clearing obligation appears to have wider application.

Antony Bryceson. Qualified: England and Wales (solicitor), 1995; Hong Kong (solicitor), 1997

Areas of practice. Investment funds; advisers and derivatives.

Recent transactions

„ Advising buy side clients on all aspects of their custody, trading and financing arrangements, including prime brokerage, futures, securities lending, repo and OTC derivatives.

„ Collateral and derivatives clearing.