

# A Practical Guide to Navigating Derivatives Trading on US/EU Recognized Trading Venues

The announcement in October 2017 that the European Commission (EC) and US Commodity Futures Trading Commission (CFTC) had reached agreement on the mutual recognition of derivatives trading venues marked a big step forward in achieving cross-border harmonization between the European Union (EU) and US.

However, the agreement has spawned a number of important questions about the practical implications of how cross-border trading will work. This guide attempts to answer those questions. In particular, it analyzes the effect of mutual recognition on the order flow of trades executed on these venues, highlighting benefits and pointing to areas where further alignment would be welcome. The guide is also intended to help market participants navigate the numerous regulatory requirements related to trading on recognized venues by providing answers to commonly asked questions.

## OVERVIEW OF THE US-EU MARKETS FOR DERIVATIVES TRADED ON A VENUE<sup>1</sup>

Following the agreement on trading venue recognition, derivatives subject to a US or EU trading obligation may be traded on both US and EU recognized venues. As a result, the decision on where to trade should now be dictated by market liquidity and the choice of trading rules.

Although trading venue equivalency marks significant progress towards cross-border recognition of derivatives rules, the lack of global harmonization still poses compliance challenges, incurs operational costs, and frustrates the overall policy objective of improving and facilitating global derivatives trading. As highlighted in this guide, the absence of equivalency for clearing, reporting and registration-related requirements creates operational complexities, competitive disadvantages and regulatory burdens without commensurate risk-reducing benefits.

Accordingly, ISDA continues to encourage regulators to issue wholesale comparability determinations, using a risk-centered, outcomes-based approach, as proposed in the ISDA cross-border harmonization whitepaper<sup>2</sup>. Rule-by-rule analyses or granting equivalence for certain rule sets but not others continues to place market participants in a position of running duplicative, and sometimes conflicting, compliance programs in order to meet various US and EU requirements.

The sections below describe the mechanics of trade execution on the recognized venues, and provide examples of the regulatory complexities and compliance challenges that remain due to the absence of wholesale equivalency between US and EU derivatives regulatory regimes.

### Clearing

- Due to a lack of recognition of foreign clearing rules<sup>3</sup>, US and EU persons must still comply with their home-country clearing rules when executing trades on EU multilateral trading facilities (MTFs) or organized trading facilities (OTFs) and US swap execution facilities (SEFs). Furthermore, absent recognition, global firms operating in both the US and EU must have systems in place that facilitate clearing through both the US agency and EU principal-to-principal clearing models. They must also accommodate myriad reporting regimes (as described below), the application of which may be a function of which venue is chosen, which seems arbitrary.
- As noted in the 2017 ISDA cross-border harmonization paper<sup>4</sup>, clearing rules should be reviewed for comparability using an outcomes-based methodology. A benefit of this approach is that it compares rule sets on a holistic basis. Once a comparability determination is issued, it does not require compliance with specific rules of a foreign jurisdiction's clearing regime.

<sup>1</sup> This guide, including the diagrams, is intended to provide a general overview of transaction flows on CFTC/EU recognized venues. It should not be considered as legal advice or analysis. Market participants should obtain their own legal advice before taking any action based upon on this guide. In particular, this guide does not address the full detail of the cross-border application of trading, clearing or reporting rules and its implications. As such, it is assumed that no party is guaranteed by an entity in another jurisdiction and that no party is an affiliate conduit. Where an entity is identified as an EU person or counterparty, it is assumed they are not a US person, and vice versa

<sup>2</sup> Last year, ISDA published a general framework for issuing comparability determinations that employs a risk-centered, outcomes-based approach. For more details on ISDA's approach, please see *Cross-Border Harmonization of Derivatives Regulatory Regimes: A risk-based framework for substituted compliance via cross-border principles* (September 17, 2017), available at <https://www.isda.org/a/DGiDE/isda-cross-border-harmonization-final2.pdf>

<sup>3</sup> There is some equivalence in CCP recognition, but there is still an overall lack of equivalency between EU and US clearing rules

<sup>4</sup> See ISDA cross-border whitepaper, supra note 2

## Real-time Reporting

- While the EU has permitted EU persons to comply with US real-time reporting rules in lieu of EU post-trade transparency obligations in certain circumstances (based on an equivalence assessment)<sup>5</sup>, the CFTC has not yet reached an equivalent determination. As a result, trades executed on MTFs/OTFs between US and EU counterparties may be disseminated to the public twice and at different times.
- Aside from the unnecessary burdens imposed by duplicative reporting regimes, subjecting the same trade to both US real-time reporting rules and EU post-trade transparency obligations creates competitive disadvantages. For example, EU persons may be unwilling to trade with US persons on MTFs or OTFs, as their trades may be disclosed prior to their publication in the EU. Further, having the same trade made public in both the EU and US makes it ultimately more difficult for firms to create a true picture of market liquidity from the resultant data sets.
- As noted in the ISDA cross-border harmonization paper<sup>6</sup>, unlike regulatory reporting, real-time public reporting is intended to provide post-trade price transparency. It is not intended to address or mitigate risk associated with trading derivatives. It should therefore be left within the remit of regulators in the jurisdiction where that activity is taking place.
- ISDA is encouraged that EU regulators have recognized this distinction. The CFTC may follow suit. Following the publication of the order of exemption, the CFTC has stated<sup>7</sup> that it will review whether any staff action is necessary with respect to the real-time public reporting requirements under the CFTC's regulations, for certain publicly reportable swap transactions executed on an exempted MTF or OTF. That's in order to account for the post-trade transparency requirements to which these transactions will also be subject in the EU under the Markets in Financial Instruments Regulation (MIFIR).

## Regulatory Reporting

- Compliance with regulatory reporting remains challenging. Due to a lack of comparability in reporting regimes, entities subject to both regimes must report certain details of their trades executed on MTFs/OTFs to multiple entities within various time frames, including:
  - US regulatory reporting of the alpha swap to a swap data repository (SDR) as soon as technologically practicable (ASTP), or T+1 for swaps between two buy-side counterparties<sup>8</sup>;
  - Regulatory reporting to EU registered or recognized trade repositories in T+1 under the European Market Infrastructure Regulation (EMIR);
  - MIFIR transaction reporting to national competent authorities (NCAs) in T+1; and
  - US real-time reporting to an SDR ASTP.

<sup>5</sup> ESMA is still in the process of completing its assessment

<sup>6</sup> See ISDA cross-border whitepaper, supra note 2

<sup>7</sup> See CFTC Press Release, CFTC Approves Exemption from SEF Registration Requirement for Multilateral Trading Facilities and Organised Trading Facilities Authorized Within the EU (Dec. 8, 2018), available at <http://www.cftc.gov/PressRoom/PressReleases/pr7656-17>

<sup>8</sup> CFTC Part 45.3(d)

- As a result of the lack of reporting equivalency, US counterparties and non-US swap dealers (SDs) executing on MTFs/OTFs are now expected to have reporting systems in place to send their alpha swaps to SDRs. Additionally, US buy-side firms may be required to send data to SDRs when executing trades on MTFs/OTFs (where they are not absolved of responsibility by the reporting hierarchy set out in the CFTC rules).

Similarly, EU investment firms are now expected to have systems in place to report certain of their SEF trades to the relevant NCA, and EU counterparties executing trades on a SEF may be expected to report their trades to a registered or recognized trade repository.

- It is encouraging that both the CFTC and the EC have proposed steps to make it easier for foreign regulators to access their respective trade repositories<sup>9</sup>. As further outlined in the ISDA cross-border harmonization paper<sup>10</sup>, ISDA believes the US and EU regulatory reporting regimes should be deemed equivalent, as both rule sets provide regulators with sufficient information on the nature and magnitude of derivatives exposures and sufficient information on individual transactions.

## Business Conduct Obligations

- Since the US and EU have not taken a holistic approach to recognition of each other's rule sets, EU persons may still be subject to EU-based best execution rules and business conduct requirements when executing their trades on a SEF. In line with the position in the ISDA cross-border harmonization paper<sup>11</sup>, ISDA questions the necessity of the cross-border application of these rules, as they are not intended to mitigate systemic risk.
- ISDA welcomes the CFTC's expected decision not to impose certain US external business conduct rules requirements on US persons executing trades on MTFs/OTFs. EU regulators should take a similar approach and allow its investment firms to not comply with EU best execution reporting requirements and disclosure obligations when trading on a SEF.

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<sup>9</sup> See Article 76a of the proposed amendment to EMIR under EMIR 2.1; see also Section 86001 of the Fixing America's Surface Transportation (FAST) Act (eliminating the indemnification requirement that non-US regulators must indemnify US SDRs and the CFTC before being granted access to data); CFTC Proposed Amendments To Swap Data Access Provisions and Certain Other Matters, 82 Fed. Reg. 8369 (Jan. 25, 2017), available at <https://www.cftc.gov/sites/default/files/idc/groups/public/@lrfederalregister/documents/file/2017-01287a.pdf>

<sup>10</sup> See ISDA cross-border whitepaper, *supra* note 2

<sup>11</sup> See ISDA cross-border whitepaper, *supra* note 2

## US PERSON TRADING ON AN MTF/OTF

### General Registration Obligations

#### 1.1: In order to trade on an MTF or OTF, am I required to be authorized by (or registered with) EU regulators?

No. You will not have to register with EU regulators simply by virtue of trading on an MTF or OTF.

However, US persons have to identify whether they will need to be authorized by regulators in any EU member state based on their activities carried out in that EU member state – for example, as an investment firm under the revised Markets in Financial Instruments Directive (MIFID II). In practice, SDs that are trading through an EU establishment (eg, a branch) may require authorization as an investment firm to carry out investment services and activities within the EU.

However, US entities trading on an MTF or OTF on a cross-border basis without an EU establishment (eg, a branch) are less likely to require authorization<sup>12</sup>.

#### 1.2: What EU entity level requirements will apply to a US SD or US money manager that is also authorized in the EU when trading on an MTF/OTF?

A US SD or US money manager that is authorized in the EU (for example, as a MIFID II investment firm) may be subject to a range of EU regulations as a result of its authorization. When trading on an MTF or OTF, these obligations may include (among others) rules on:

- *Best execution:* With respect to client trades, these rules may impose an obligation to take all sufficient steps to obtain, when executing orders, the best possible result for their clients. Firms may also be required to report

the top five execution venues (in terms of trading volumes) where they execute client orders, and information on the quality of execution obtained. The report must be made public annually.

- *Client disclosures:* Firms are required to provide disclosure on an ongoing basis to their clients, including disclosures on execution, reports on services provided, and information on costs and charges, both in advance of and after the services are provided.
- *Inducements and conflicts of interest:* Firms are required to take all appropriate steps to identify and prevent or manage conflicts of interest, and must make certain disclosures to their customers on this issue. In particular, there are significant restrictions on managers receiving research from their executing brokers.

#### 1.3: I am an SD. Do I need to comply with US external business conduct (EBC) requirements when I execute my trade on an MTF or OTF?

Yes, but not all. The CFTC is expected to issue relief from certain EBC requirements for trades executed on an MTF/OTF. The forthcoming relief is expected to parallel existing relief for trades executed on SEFs. Once the relief is issued, you will therefore only have to comply with the following EBC requirements:

- Establishing policies and procedures to ensure compliance and prevent evasion;
- Record retention;
- Prohibition on fraud, manipulation, abusive practices;
- Requirements to communicate with your counterparty in a fair and balanced manner<sup>13</sup>.

<sup>12</sup> In each case, firms should obtain legal advice in each EU member state in which they trade

<sup>13</sup> Note: The CFTC is expected to issue such relief in the coming weeks

#### **1.4: When executing a trade on an MTF or OTF, does my counterparty have to count its trades toward the CFTC swap dealer de minimis threshold?**

Yes, non-US persons engaging in dealer activities must count all swaps entered into with US persons (except with foreign branches of US SDs) towards their swap dealer de minimis threshold calculations, as per the CFTC cross-border guidance<sup>14</sup>.

It is expected that the CFTC will issue relief for non-US persons from compliance with the obligation in the guidance to count swaps executed anonymously on MTFs and OTFs towards their de minimis threshold.

### **Pre-execution Considerations**

#### **1.5: Do EU pre-trade transparency requirements apply to my trade?**

Yes, unless a waiver has been issued by the relevant EU NCA. The MIFID II pre-trade transparency requirements apply in principle to all derivatives that fall within the list of MIFID financial instruments and are traded on an MTF or OTF, including those subject to the MIFID II trading obligation and those traded on a trading venue voluntarily.

The MIFID II pre-trade transparency obligation

will apply to MTFs and OTFs, which are required to make public current bid and offer prices and the depth of trading interest (including actionable indications of interest) at those prices that are advertised through their systems. Your orders and actionable indications of interest will therefore form part of that publication.

#### **1.6: How do I know if my trade has a waiver and is therefore exempted from the EU pre-trade transparency requirements?**

NCAs are able to waive pre-trade transparency obligations under certain circumstances. Examples of these circumstances include:

- Orders that are large in scale<sup>15</sup> (LIS) compared with normal market size (ie, block trades)<sup>16</sup>;
- Actionable indications of interest in request-for-quote and voice trading systems that are above the size specific to the financial instrument (SSTI) in question<sup>17</sup>;
- Certain package transactions – for example, packages where one component is LIS (as long as the package is not considered liquid as a whole)<sup>18</sup>.

The waivers are only issued at the NCA's discretion and are subject to review by the European Securities and Markets Authority (ESMA).

<sup>14</sup> 78 Fed. Reg. 45292 (July 26, 2013) (hereinafter, Cross-Border Guidance)

<sup>15</sup> The orders that are large in scale are set out in Annex III of Commission Delegated Regulation (EU) 2017/583, available at <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017R0583&from=EN>. If orders meet the definitions of large in scale in Annex III, pre-trade transparency may be waived. However, this waiver is at the discretion of NCAs and subject to review by ESMA. NCAs are not permitted to apply their own definitions of large in scale

<sup>16</sup> For example, for fixed-to-floating, single currency interest rate swaps where there is a liquid market, the LIS threshold floor is €5 million. For index credit default swaps where there is a liquid market, the floor is €5 million. See Annex III of Commission Delegated Regulation (EU) 2017/583, available at <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017R0583&from=EN>

<sup>17</sup> For instance, for fixed-to-floating single currency interest rate swaps where there is a liquid market, the SSTI threshold floor is €4 million. For index credit default swaps where there is a liquid market, the floor is €2.5 million. See Annex III of Commission Delegated Regulation (EU) 2017/583, available at <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017R0583&from=EN>

<sup>18</sup> See Article 9 of MIFIR for the complete list of potential waivers

## Execution Considerations

### 1.7: Do I have to follow MTF/OTF trading rules when I execute my trade on one of the recognized venues?

Yes. MTFs and OTFs each have their own rule books, which market participants are expected to sign up to in order to be on-boarded. MTFs and OTFs are required to establish transparent rules for fair and orderly trading, for setting out the criteria for determining the financial instruments that can be traded on them, for enabling non-discriminatory access by their participants, and for efficient settlement of transactions<sup>19</sup>.

Notably, where MTFs/OTFs are delegated the responsibility to report transactions to regulators by investment firms<sup>20</sup>, such reports will include trader identification. MTFs/OTFs may therefore require investment firms executing trades on their platforms that wish to delegate reporting of all such trades to the MTF/OTF to disclose trader identification as a part of the on-boarding process.

### 1.8: If my counterparty is also a US person, can I discharge my made-available-to-trade (MAT) obligations on equivalent MTFs/OTFs?

Yes. MTF/OTF rules will apply in addition to US applicable regulatory requirements such as reporting and clearing obligations.

### 1.9: Will EU straight-through-processing (STP) rules apply to my trade?

Yes.

- For electronic orders, the MTF/OTF is required to ensure that the order passes a pre-trade check against any limits set for the client by the clearing member within 60 seconds of receiving the order, and to send the transaction to the central counterparty

(CCP) within 10 seconds after execution. If the order fails the check, then the MTF/OTF must notify both the client and clearing member in real-time.

- For non-electronic orders, the MTF/OTF is required to ensure that the order passes a pre-trade check against any limits set for the client by the clearing member within 10 minutes from receiving the order, and to send the transaction to the CCP within 10 minutes after execution. If the order fails the check, then the MTF/OTF must notify both the client and clearing member within five minutes.
- In either case, the CCP must accept or reject each trade for clearing within 10 seconds of receiving the transaction. The CCP must inform the clearing member and MTF/OTF of any non-acceptance on a real-time basis.
- The clearing member and the MTF/OTF must inform the counterparty of non-acceptance as soon as the CCP informs them<sup>21</sup>.

### 1.10: What happens if I execute an erroneous trade on an MTF/OTF that is subsequently rejected from clearing?

If your trade was not accepted for clearing due to a technical or clerical error, the derivatives transaction can be re-submitted for clearing within one hour from the previous submission in the form of a new transaction, but with the same economic terms minus the error (ie, old terms, new trade). Both counterparties must agree to the re-submission and the re-submitted trade is not subject to any pre-trade transparency requirements.

If your trade was executed electronically and was rejected from clearing for any other reason, then the trading venue will void the transaction. If the trade was not executed electronically, then the treatment of the transaction is governed by the rules of the relevant MTF/OTF.

<sup>19</sup> Article 18 of MIFID II

<sup>20</sup> As permitted under Article 26(7) of MIFIR

<sup>21</sup> Note: STP rules only apply to the types of transactions being considered by this guide, which are derivatives transactions that are subject to an EMIR clearing mandate or intended to be cleared



### 1.11: How do I execute a block or package transaction on an MTF/OTF?

Blocks (in the following context, trades that are LIS):

Trades that are LIS are not exempted from the EU trading obligation and must therefore be traded on a venue<sup>22</sup>. However, transactions above the relevant pre-trade LIS threshold can be negotiated or pre-arranged off-venue<sup>23</sup>.

ESMA has also clarified that these transactions are subject to the pre-trade checks set out in the STP rules<sup>24</sup>.

Packages:

ESMA requires the trading-obligated component of the following packages to be traded on venue:

- All components are subject to the trading obligation.
- One or more component is subject to the trading obligation and all other components are subject to the clearing obligation.
- At least one component is an interest rate swap subject to the trading obligation and all other components are government bonds dominated in the same currency<sup>25</sup>.

### 1.12: Will the MTF/OTF or EU regulators monitor trading on an MTF or OTF?

Both. Although an entity does not become subject to enforcement by an EU regulator

simply by virtue of trading on an MTF or OTF, US persons may potentially be subject to the following oversight:

- MTF/OTF rules are typically contractual in nature and can be enforced according to their governing law. MTFs and OTFs are required to regularly monitor compliance with their rules by their members, participants or users<sup>26</sup>, and may suspend or remove a trader for non-compliance with the rules<sup>27</sup>.
- US entities may also be responsible for compliance with MIFID II (eg, business conduct requirements) if their activity falls within the territorial scope of MIFID II, as defined by the relevant NCA.
- MTFs and OTFs are required to inform their NCA of any significant infringement of their rules, disorderly trading conditions, or conduct that may indicate violations of the EU's Market Abuse Regulation, including insider dealing, unlawful disclosure of inside information and market manipulation.

## Clearing Considerations

### 1.13: Assuming my trade is subject to the US clearing mandate or is voluntarily cleared, under which clearing model (agency or principal) do I have to clear my trade?

The answer to this question depends on whether you are clearing on your own behalf (house trades) or through a clearing broker as a customer of the clearing broker (customer trades).

<sup>22</sup> See Final Report Draft RTS on the trading obligation for derivatives under MIFIR (September 28, 2017), available at [https://www.esma.europa.eu/sites/default/files/library/esma70-156-227\\_final\\_report\\_trading\\_obligation\\_derivatives.pdf](https://www.esma.europa.eu/sites/default/files/library/esma70-156-227_final_report_trading_obligation_derivatives.pdf). See also Commission Delegated Regulation (EU) 2017/2417 (Nov. 17, 2017), available at <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017R2417&from=EN>

<sup>23</sup> Subject to meeting the conditions of the relevant LIS waiver from the pre-trade transparency requirements. See ESMA, Questions and Answers on MIFID II and MIFIR Transparency Topics, Section 5, Question 11 (March 28, 2018), <https://www.esma.europa.eu/press-news/esma-news/esma-updates-its-mifid-ii-qas-market-structures-and-transparency-topics>

<sup>24</sup> Id

<sup>25</sup> See ESMA Opinion on the Treatment of Packages under the Trading Obligation for Derivatives (March 21, 2018), available at [https://www.esma.europa.eu/sites/default/files/library/esma70-156-322\\_opinion\\_packages\\_and\\_to.pdf](https://www.esma.europa.eu/sites/default/files/library/esma70-156-322_opinion_packages_and_to.pdf)

<sup>26</sup> Article 31 of MIFID II

<sup>27</sup> Article 32 of MIFID II



For house trades, you may clear directly as a clearing member (assuming you are a direct clearing member). For customer trades, however, you must clear your trade through the agency model (ie, US futures commission merchant (FCM) model)<sup>28</sup>.

Either way, your trade must be cleared through a clearing house that is a CFTC-registered derivatives clearing organization (DCO) or a DCO that is exempt from registration. The CCPs that are authorized by ESMA and registered as DCOs are: Eurex Clearing AG, LCH SA, LCH Ltd and ICE Clear Europe Limited (ICE Clear Europe).

As a practical matter, dually registered CCPs that offer both an FCM clearing model and a principal-to-principal model would facilitate one leg being cleared via the FCM model and the other leg being cleared via the principal model.

**1.14: Will my CCP follow the timing outlined in US rules or EU rules when accepting or rejecting a trade for clearing?**

The US and EU time frames are aligned<sup>29</sup>. Both the US DCOs and EU CCPs must accept or reject a trade within 10 seconds after receiving the relevant information from the trading platform.

## Reporting Considerations

**1.15: Do EU post-trade transparency obligations (real-time reporting) apply to my trade?**

Yes. The MIFID II post-trade transparency requirements (real-time reporting) apply in principle to all derivatives traded on an MTF or OTF that are MIFID II financial instruments. MTFs/OTFs have an obligation to send the price, size and time of each trade for public dissemination after execution as close to real-time as is technologically practicable<sup>30</sup>. However, NCAs may authorize deferred publication, as noted in Q&A 1.16.

**1.16: Can I defer the public dissemination of my trade to a later time?**

Yes, but only for certain trades. NCAs may be<sup>31</sup> able to provide for deferred publication for transactions that are:

- LIS<sup>32</sup>;
- Related to a derivative for which there is not a liquid market; and
- Trades that are above SSTI<sup>33</sup>.

Authorizations for deferred publication are only issued at the NCA's discretion and are subject to review by ESMA.

<sup>28</sup> The CFTC's December 2017 order of exemption for MTFs/OTFs made it clear that: (1) when a swap executed by a US person on an MTF or OTF is a customer position, the swap, if intended to be cleared, must be cleared through an FCM at a derivatives clearing organization (DCO); (2) when a swap executed by a US person on an MTF or OTF is a proprietary position, the swap, if intended to be cleared, must be cleared either through a DCO or a clearing organization that has been exempted from DCO registration; and (3) when a swap is subject to the clearing requirement, and is entered into by a person that is subject to such clearing requirement, the swap must be cleared either through a DCO or a clearing organization that has been exempted from DCO registration (although if the swap is a customer position, it must be cleared through an FCM at a DCO, and cannot be cleared through a clearing organization that has been exempted from DCO registration). See also CFTC Regulation 39.12(b)(6); CFTC Regulation 3.10(c)

<sup>29</sup> CFTC Staff Guidance on Swaps Straight-Through Processing (September 26, 2013)

<sup>30</sup> From January 3, 2018 until January 3, 2021, there is a firm deadline of 15 minutes after execution. After January 3, 2021, this will reduce to five minutes

<sup>31</sup> See Article 8 of Commission Delegated Regulation (EU) 2017/583 for the full list of potential waivers

<sup>32</sup> For example, for fixed-to-floating, single currency interest rate swaps where there is a liquid market, the LIS threshold floor is €10 million. For index credit default swaps where there is a liquid market, the floor is €10 million. See Annex III of Commission Delegated Regulation (EU) 2017/583, available at <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017R0583&from=EN>

<sup>33</sup> For instance, for fixed-to-floating single currency interest rate swaps where there is a liquid market, the SSTI threshold floor is €9 million. For index credit default swaps where there is a liquid market, the floor is €7.5 million. See Annex III of Commission Delegated Regulation (EU) 2017/583, available at <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017R0583&from=EN>

Deferred publication generally only applies until 7pm (in the local time of the firm) on the second working day after the date of the transaction. However, NCAs may additionally allow publication of the volume of an individual transaction or details of non-equity instruments to be deferred for four weeks. They may also allow, for an indefinite period of time, aggregated publication of transactions in respect of sovereign debt instruments.

**1.17: Do US post-trade transparency obligations (real-time reporting) apply to my trade?**

Yes. Since the reporting rules have not been determined equivalent, trades executed on an MTF/ OTF are viewed as off-facility transactions for US real-time reporting purposes and are subject to the reporting hierarchy provided in the CFTC rules<sup>34</sup>. For example:

- If only one counterparty is an SD, then that counterparty will be responsible for sending the trade to the SDR as soon as technologically practicable.
- If a trade is between a US hedge fund or pension fund and an investment firm (that is not a SD), then the counterparties will have to agree on which will be responsible for reporting. In practice, the US person is likely to report. This may be problematic for US buy-side participants that are not set up to send trades to an SDR.

**1.18: Is my trade subject to EU regulatory reporting?**

It depends. If you are a MIFID II firm (eg, a branch of US entity in the EU), then you will be subject to MIFIR transaction reporting obligations (reporting to the relevant NCA in T+1). As a practical matter, however, MTFs/

OTFs will send your trade to the relevant NCA. Importantly, this delegation of responsibility does not relieve you from the obligation to ensure that the trade is sent to the relevant NCA.

The EMIR reporting obligations will also apply to you if you are a MIFID II firm that is not a third-country branch<sup>35</sup>. Under these rules, you must report certain details of your trade to registered or recognized EU trade repositories on a T+1 basis.

**1.19: Is my trade subject to US regulatory reporting?**

Yes, since the reporting rules have not been determined equivalent, trades executed on MTFs/OTFs are treated as off-facility swap transactions for US regulatory reporting purposes and are subject to the reporting hierarchy provided in the CFTC's rules<sup>36</sup>. Therefore, you may be required to report your alpha swap to an SDR per the reporting hierarchy. For example, if you are an SD and your counterparty is not an SD, then you will have to send the relevant details of your alpha swap to an SDR<sup>37</sup>. In practice, this may impose new reporting obligations on counterparties as SEFs are required to send alpha swaps to SDRs on counterparties' behalf in the US.

<sup>34</sup> CFTC Regulation 43.3(a)(3)

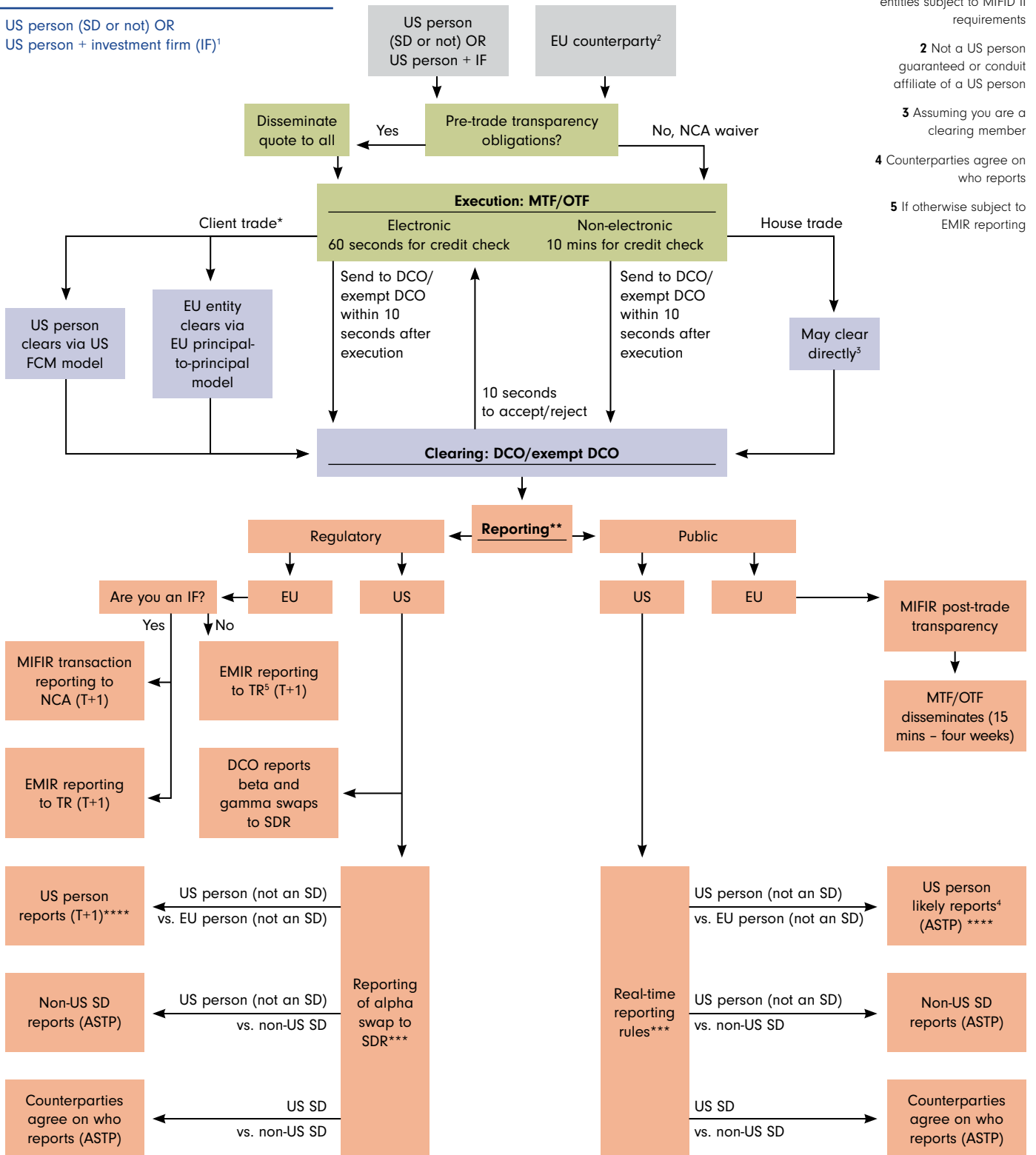
<sup>35</sup> EMIR reporting obligations apply to financial counterparties and non-financial counterparties (but not third-country equivalents thereof), while MIFIR reporting obligations apply only to entities subject to MIFID II. All entities subject to MIFID II, except third-country branches, will be financial counterparties and therefore subject to EMIR

<sup>36</sup> CFTC Regulation 45.8

<sup>37</sup> Note that beta and gamma swaps are reported to SDRs by the DCO

### MTF/OTF Execution Order Flow

US person (SD or not) OR  
US person + investment firm (IF)<sup>1</sup>



### Compliance Issues

\*No mutual recognition of US and EU clearing rules → two separate clearing models

\*\*No reporting recognition → need for additional compliance systems for US persons + IF, including:

- US regulatory reporting to SDR (ASTP or T+1)
- EMIR regulatory reporting to EU registered or recognized TRs (T+1)
- MIFIR transaction reporting to NCA (T+1)
- US real-time reporting to SDR (ASTP)

\*\*\*New obligations for US counterparties and non-US SDs to send their swaps executed on recognized MTFs/OTFs to SDRs for regulatory and real-time reporting

\*\*\*\*Reporting requirements potentially now fall on US buy side (when facing EU person)

## EU PERSON TRADING ON A SEF

### General Registration Obligations

#### 2.1: Do any EU regulations apply to my trade on a SEF?

Yes. When EU entities face US entities on a SEF, they generally remain subject to applicable regulations imposed on them in the EU<sup>38</sup>. For MIFID II investment firms, some examples may include:

- *Best execution:* Firms may be required to put in place an execution policy, agreed by their clients, and be able to demonstrate to their clients that they have executed client orders in accordance with that policy. Firms may also be required to report the top five execution venues (in terms of trading volumes) where they execute client orders, and information on the quality of execution obtained. The report must be made public annually. While SEFs may have data on their activities that can be used by investment firms to compile their annual top five execution venue reports, SEFs are not subject to best execution disclosures like MTFs and OTFs<sup>39</sup>. It may therefore be challenging for investment firms to obtain the required data from some SEFs.
- *Client disclosures:* Firms are required to provide disclosure on an ongoing basis to their clients, including disclosures on execution, reports on services provided and information on costs and charges, both in advance of and after the services are provided<sup>40</sup>.

- *Conflicts of interest:* Firms are required to take all appropriate steps to identify and prevent or manage conflicts of interest, and must make disclosures to their customers on their conflicts of interest policy and about situations where conflicts are not preventable<sup>41</sup>.

#### 2.2: When I execute my trade on a SEF, do I have to count my trades with US persons towards the CFTC swap dealer de minimis threshold?

Yes if engaging in dealer activities, unless the transaction is executed anonymously on a SEF<sup>42</sup>. Note, however, that non-US persons do not have to count their swaps with foreign branches of US SDs, even where such transaction is not executed anonymously<sup>43</sup>.

<sup>38</sup> Note: under the rules applicable in the EU entity's home member state, trading on a SEF may place that entity outside the territorial scope of certain elements of MIFID II. For example, certain regulations may not apply to EU entities where they trade on a SEF through a branch in the US

<sup>39</sup> Under Commission Delegated Regulation (EU) 2017/575, MTFs and OTFs are required to publish certain data on the transactions executed on them. These obligations do not apply to a SEF

<sup>40</sup> MIFID II does not limit the definition of client by reference to the jurisdiction of that client. See Article 4(1)(9) of MIFID II. Where an EU firm provides services to a US client, that firm may be required to comply with MIFID II rules on client disclosures. Therefore, US firms may need to be set up to receive disclosures from at least some EU firms

<sup>41</sup> Separately, note that since ESMA has not conclusively determined whether SEF trading is considered as 'OTC' for the purposes of determining whether a firm is a systematic internaliser (SI) under MIFID II. SEF trades may be included in that determination

<sup>42</sup> See Cross-Border Guidance, supra note 12, at 45325 (noting that non-US persons that are not guaranteed or conduit affiliates do not have to count swaps executed anonymously on a SEF toward their swap dealer de minimis threshold)

<sup>43</sup> Id. at 45315

## Pre-execution Considerations

### 2.3: Do EU style pre-trade transparency requirements apply under US regulations to my trade?

No, the US does not have pre-trade transparency requirements similar to those in the EU<sup>44</sup>. Current US rules achieve pre-trade transparency by requiring a request-for-quote (RFQ) to three, or order book trading protocols to be used for transactions required to be executed on SEFs<sup>45</sup>.

## Execution Considerations

### 2.4: Do I have to comply with the SEF rules when I execute my trade on a SEF?

Yes, you must comply with US trading rules and the rules of the relevant SEF on which you are executing your trade. Market participants should review the rule books of the SEFs on which they expect to execute their trades. Note, however, that the US trading rules are expected to change in the near future to permit any method of execution on a SEF.

### 2.5: Will US STP rules apply to my trade?

Yes.

- Trades executed on a SEF must be subject to a pre-trade credit check (timing is not specified, unlike under EU rules)<sup>46</sup>.
- Trades must be affirmed and routed to the relevant DCO (or exempt DCO) for clearing within 10 minutes after execution<sup>47</sup>.

- DCOs have 10 seconds to accept or reject the trade for clearing after receiving the relevant information<sup>48</sup>.

### 2.6: What happens if I execute an erroneous trade on a SEF that is subsequently rejected from clearing?

If your trade failed to clear due to a clerical or operational error, you can submit a new trade with terms and conditions that match the terms and conditions of the original trade (ie, old terms, new trade) via any method of execution. The trade must be re-submitted as quickly as technologically practicable after receipt of notice of the rejection by the DCO, but, in any event, no later than one hour from the issuance of the notice.

If your trade was rejected from clearing for any other reason (or a trade resubmitted pursuant to the process above is again rejected from clearing), the trade is determined to be *void ab initio* (ie, void at its inception), and therefore may not be re-submitted for clearing.

### 2.7: How do I execute a block or package transaction on a SEF?

Blocks:

- Block trades may be executed away from a SEF platform, or currently may be executed on a SEF via an RFQ to one. A pre-trade credit check is required for blocks<sup>49</sup>. The block trade is subject to *void ab initio* requirements, as described in Q&A 2.6 above.
- Trades that meet the block threshold enjoy a public dissemination delay of 15 minutes<sup>50</sup>.

<sup>44</sup> Although it is ISDA's understanding that the equivalence determination implies that EU trading rules would not apply on a SEF, ESMA has not yet issued final confirmation that pre-trade transparency requirements would not apply to SEF trades

<sup>45</sup> It is anticipated that the CFTC will amend the current SEF rules to allow for more flexible methods of execution. See CFTC Chairman J. Christopher Giancarlo, Keynote Address of Chairman J. Christopher Giancarlo before FIA Annual Meeting, Boca Raton, Florida, available at <http://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo40>

<sup>46</sup> CFTC Regulation 1.73

<sup>47</sup> CFTC Letter No.15-67 (December 21, 2015)

<sup>48</sup> CFTC Staff Guidance on Swaps Straight-Through Processing (September 26, 2013)

<sup>49</sup> Currently, there are no technological capabilities to do a pre-trade credit check of blocks executed away from the SEF platform

<sup>50</sup> CFTC Regulation 43.5(d)

Packages:

Generally, packages where one component is MAT must be executed on a SEF via the required methods of execution<sup>51</sup>. However, the CFTC has issued time-limited no-action relief, which has temporarily allowed certain packages to be executed off-SEF or via any method offered by the SEF:

- MAT components of packages where one or more other components is a new issuance bond may be executed off-SEF. If executed on a SEF, they may be executed via any method offered by the SEF.
- MAT components of packages where one or more other components is a futures contract may be executed off-SEF. If executed on a SEF, they may be executed via any method offered by the SEF.
- MAT components of packages where one or more other components is a swap that is non-MAT and not subject to mandatory clearing must be executed on a SEF, but may be executed via any method offered by the SEF.
- Packages where one component is MAT and the other is a non-swap instrument must be executed on a SEF, but may be executed via any method offered by the SEF.
- Packages where one component is MAT and the other is a non-CFTC swap must be executed on a SEF, but may be executed via any method offered by the SEF<sup>52</sup>.

### **2.8: Will the CFTC or SEFs monitor trading on a SEF?**

Both. SEFs are required to establish trading, trade processing and participation rules. SEFs

are required to have the capacity to detect, investigate and enforce those rules<sup>53</sup>. In addition, SEFs may refer to the CFTC, or the CFTC on its own<sup>54</sup> can bring an enforcement action for more egregious trade violations.

## **Clearing Considerations**

### **2.9: Assuming my trade is subject to the EU clearing mandate (or voluntarily cleared), under which clearing model (principal or agency) do I have to clear my trade?**

The answer to this question depends on whether you are clearing house trades or customer trades.

For house trades, you may clear directly as a clearing member (assuming you are a direct clearing member). For customer trades, you can clear via the principal-to-principal model, as long as your broker does not have the relevant US nexus that would require it to register as an FCM. Your US counterparty may be required to clear its trade via the agency model (ie, US FCM model).

As a practical matter, as noted in Q&A 1.13, dually registered CCPs that offer both an FCM clearing model and a principal-to-principal model would facilitate one leg being cleared via the FCM model and the other leg being cleared via the principal model.

### **2.10: Will my CCP follow the timing outlined in US rules or EU rules when accepting or rejecting a trade for clearing?**

The US and EU time frames are aligned<sup>55</sup>. Both the US DCOs and EU CCPs/DCOs must accept or reject a trade within 10 seconds after receiving the relevant information from the trading platform.

<sup>51</sup> As noted above, ISDA understands that the US trading rules will be changed in the near future to permit any method of execution on a SEF. The methods in which packages and blocks are executed on a SEF may therefore change in the near future

<sup>52</sup> CFTC Letter No.17-55 (Oct. 31, 2017)

<sup>53</sup> CFTC Regulation 37.200(b), 37.203, 37.206

<sup>54</sup> CFTC Regulation 37.503

<sup>55</sup> CFTC Staff Guidance on Swaps Straight-Through Processing (September 26, 2013)

## Reporting Considerations

### 2.11: Do US real-time reporting (post-trade transparency) rules apply to my trade?

Yes. SEFs are required to send the relevant details of your trade to an SDR for real-time public dissemination<sup>56</sup>.

### 2.12: Do EU post-trade transparency obligations (real-time reporting) apply to my trade?

No. You do not have to comply with the post-trade transparency requirements when executing your trade on a SEF at this time. ESMA does not require EU firms to systematically republish information in the EU about transactions concluded on trading venues outside the EU that are subject to transparency provisions similar to those applicable to EU trading venues, and has produced an opinion considering US real-time reporting obligations as ‘similar’ for those purposes<sup>57</sup>.

### 2.13: Is my trade subject to US regulatory reporting?

For US regulatory reporting purposes, the obligation is on the SEF to report your trade to an SDR<sup>58</sup>.

### 2.14: Is my trade subject to EU regulatory reporting?

Yes. Since there is no reporting equivalency, your obligations to report your trade in the EU will continue to apply, even when you execute your trade on a SEF. As an EU entity, you may have obligations to report your trade to a trade repository registered or recognized under EMIR in T+1 (per EMIR reporting rules) and/or to report your trade to the relevant NCA in T+1

(per MIFIR reporting rules)<sup>59</sup>. The cross-border application of MIFIR transaction reporting in this context may be problematic for EU firms, as they may not currently be set up to route their SEF trades falling within the regime to their relevant NCA.

<sup>56</sup> CFTC Regulation 43.3(a)(2)

<sup>57</sup> This determination is under ongoing review. If ESMA ever considered the US regime not to be similar, firms subject to MIFID II would be required to make public the price, size and time of transactions executed on a SEF. See Determining Third-Country Trading Venues for the Purpose of Transparency under MIFID II/MIFIR, available at [https://www.esma.europa.eu/sites/default/files/library/esma70-154-165\\_smsc\\_opinion\\_transparency\\_third\\_countries.pdf](https://www.esma.europa.eu/sites/default/files/library/esma70-154-165_smsc_opinion_transparency_third_countries.pdf)

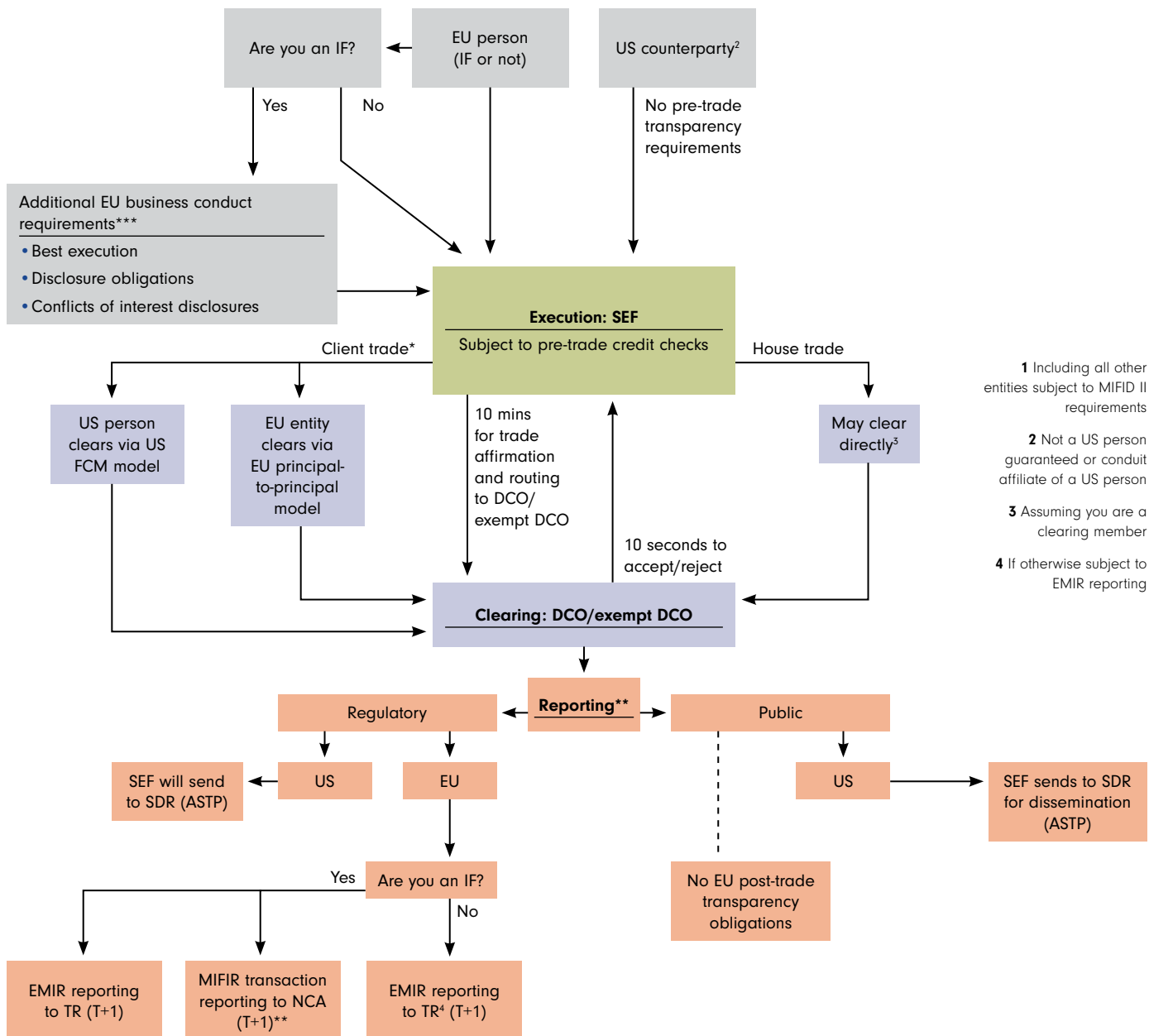
<sup>58</sup> CFTC Regulation 45.3(a)

<sup>59</sup> See supra note 35 and accompanying text



## SEF Execution Order Flow

EU person (investment firm (IF)<sup>1</sup> or not)



- 1** Including all other entities subject to MIFID II requirements
- 2** Not a US person guaranteed or conduit affiliate of a US person
- 3** Assuming you are a clearing member
- 4** If otherwise subject to EMIR reporting

## Compliance Issues

\*No mutual recognition of US and EU clearing rules → two separate clearing models

\*\*MIFIR transaction reporting may be problematic for EU firms as they may not be set up to route their SEF trades falling within the regime to their relevant NCA

\*\*\*EU best execution and business conduct rules may continue to apply

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## ABOUT ISDA

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has more than 900 member institutions from 68 countries. These members comprise a broad range of derivatives market participants, including

corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives

market infrastructure, such as exchanges, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: [www.isda.org](http://www.isda.org). Follow us on Twitter @ISDA.