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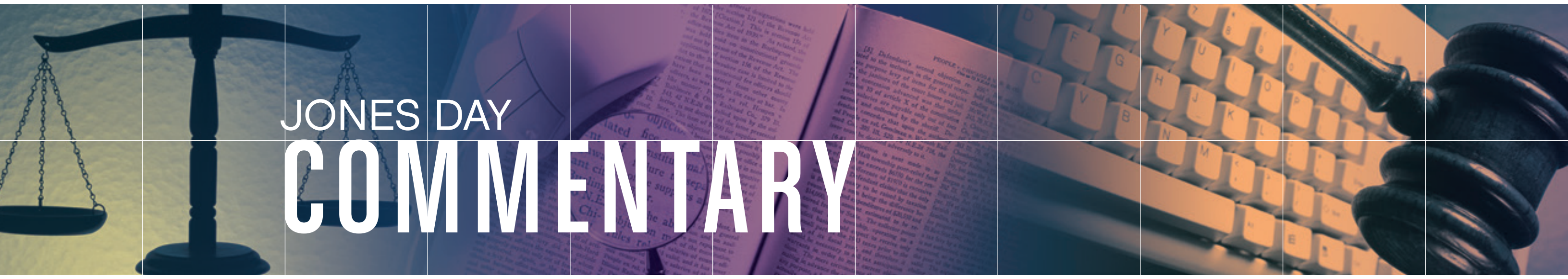


EMIR—DRAFT RTS ON EXTRATERRITORIAL APPLICATION

On November 15, the European Securities and Markets Authority ("ESMA") published its Final Report, "Draft technical standards under EMIR on contracts with a direct substantial and foreseeable effect within the Union and non-evasion" ("RTS").[1] The RTS set out the extraterritorial application of the clearing obligation and the risk mitigation techniques of EMIR to OTC derivatives contracts entered into between non-European counterparties.

SCOPE OF APPLICATION

The RTS deal exclusively with the extraterritorial application of EMIR to non-EU counterparties in relation to the clearing obligation (Article 4(1)(a)(v) EMIR) and the risk mitigation techniques (Article 11(12) EMIR). They do not deal with the circumstances in which provisions other than Article 4 and 11 EMIR should apply to non-EU counterparties.

The extraterritorial application of EMIR to non-EU counterparties is further to be distinguished from cases where:

- one of the counterparties is established in the European Union and is subject to EMIR, which indirectly affects the non-EU counterparty, e.g., because the EU counterparty requests the non-EU counterparty to contractually agree on certain dispute resolution techniques in order to be EMIR compliant; and

- one of the counterparties is established in a country for which the European Commission has adopted an implementing act declaring it to be "equivalent" to EMIR, so that compliance with the third-country rules is deemed to be compliance with EMIR, and the RTS would not apply.

It should be noted that the European Commission has not yet adopted any such equivalent measure that would limit the scope of application of the RTS. In light of ESMA's advice on third-country equivalence setting a high hurdle for third-party equivalence, it also remains to be seen to what extent third-country equivalence will actually be granted. In relation to the U.S., the Commodity Futures Trading Commission's

1 *Available at* http://www.esma.europa.eu/system/files/2013-1657_final_report_on_emir_application_to_third_country_entities_and_non-evasion.pdf.

("CFTC") most recent advice on application of Dodd-Frank to cross-border scenarios published on November 14 (see *Jones Day Commentary*, "Application of Dodd-Frank Requirements to Swap Between Non-U.S. Swap Dealers and Non-U.S. Counterparties") may result in additional uncertainty. The CFTC's advice apparently caught the European Commission by surprise, and despite the No-Action letter published by the CFTC in relation thereto shortly thereafter on November 26 it is not clear how it will affect the agreement on the "Common Path Forward" that the CFTC and the European Commission had reached during the summer.

The RTS envisage a scenario where both counterparties are established outside of the EU in a non-equivalent third country. In that case, they will be subject to the clearing obligation and the risk mitigation techniques under EMIR only if:

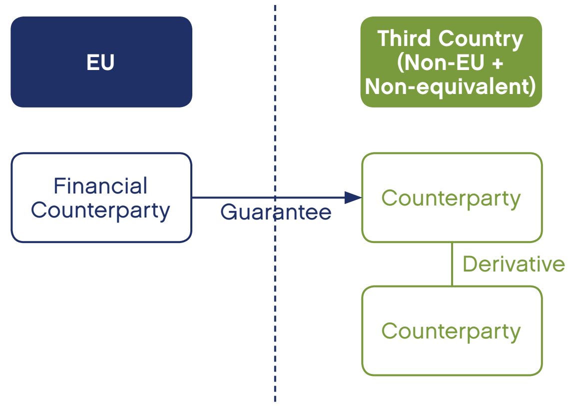
- the counterparties would be subject to those obligations had they been established in the EU, i.e., if each of them is either a financial counterparty or a nonfinancial counterparty (each as defined in EMIR) exceeding the clearing threshold in Article 10(3) EMIR (a so-called "NFC+"); and

- the OTC derivative contract(s) entered into between them either has "direct, substantial and foreseeable effect within the Union" or the imposition of EMIR obligations is "necessary or appropriate to prevent the evasion of any provision" of EMIR.

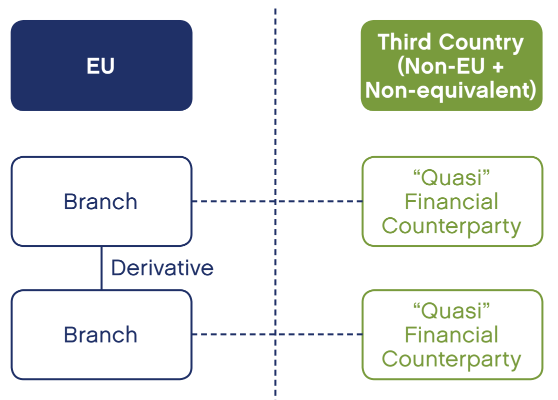
DIRECT, SUBSTANTIAL AND FORESEEABLE EFFECT

According to the RTS, OTC derivatives contracts have a direct, substantial and foreseeable effect when:

1. **Guaranteed by an EU financial counterparty**, i.e., at least one counterparty benefits from a guarantee provided by a financial counterparty established in the EU in relation to its liability under OTC derivatives contracts for an aggregated notional amount of €8 billion or 5 percent of the OTC derivatives exposure of the EU financial counterparty (whichever is lower); or



2. **Entered into through EU branches of financial counterparties**, i.e., the non-EU counterparties would qualify as financial counterparties were they established in the EU and entered into the OTC derivatives contract through their EU branches.



During the consultation of the RTS, the inclusion of OTC derivatives contracts entered into through EU branches had been broadly accepted by market participants. In contrast, however, the scope of the "guarantee" concept was subject to a number of comments.

GUARANTEE CONCEPT

Fortunately, when compared with the previous draft RTS published by ESMA in July (the "July RTS"), the revised RTS (and the report relating thereto) now provide for a number of welcome clarifications.

In relation to the guarantee, the revised RTS provide:

- Confirmation that non-guaranteed subsidiaries, currencies, and contractual provisions are not relevant;
- A definition of "guarantee" to exclude CDS or letters of credit;
- Clarification that the guaranteeing financial counterparty must be established in the EU;
- Specification of the times at which the guarantee threshold needs to be monitored (rather than an ongoing monitoring obligation);
- Clarification that the guarantee threshold is not calculated on a group level but on an entity level;
- Clarification that OTC derivatives contracts entered into before the date of application of the RTS are outside scope but are relevant for the calculation of the guarantee threshold;
- Clarification that OTC derivatives contracts that are entered into after the application of the RTS but before a guarantee was issued are caught; and
- A six-month phase-in period.

However, ESMA refuses to change the basis for the calculation of the threshold from a "gross" to a "net" basis, arguing for consistency with the calculation of the exemption for initial margin requirements suggested by the Basel Committee.

EU BRANCH CONCEPT

In relation to the EU branch concept, the RTS clarify that only EU branches of counterparties are relevant, if the counterparty would qualify as a financial counterparty if it were established in the EU.

ANTI-EVASION

As regards anti-avoidance, the RTS envisage that it is necessary or appropriate to prevent the evasion of any provision of EMIR if an OTC derivatives contract has as its primary purpose the avoidance of the application of any provision of EMIR. The presumption included in the July RTS that the existence of specific examples was presumed to be considered an evasion has been removed, and a more flexible criteria-based approach (not ideal but supported by market participants as more practicable) has been adopted.

NEXT STEPS

The draft RTS were submitted to the European Commission for endorsement on November 15. The European Commission has three months, ending on February 15, 2014, to endorse, at which point the RTS will be submitted for approval to the European Parliament and the European Council.

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