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ESMA Advice on Third-Country Equivalence Under EMIR, II

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On 3 September, ESMA published its first technical advice to the European Commission on the equivalence of the [US](#) and [Japanese](#) derivatives frameworks to the EU rules. On 2 October, ESMA supplemented its technical advice with complete equivalence findings on [Australia](#), [Switzerland](#), [Hong Kong](#), [Singapore](#), [Canada](#), [South Korea](#) and [India](#). The advice is not the final EU statement on the equivalence of these regimes, because the European Commission is charged with adopting legislative acts on equivalence. Once it has considered ESMA's advice, the Commission has the discretion (not apparently limited to concerns about financial services) to declare equivalence. Broadly speaking, several countries' rules on derivatives have been considered equivalent, but this is subject to market participants agreeing to apply European standards, where higher.

Equivalence

Under the European Market Infrastructure Regulation ("EMIR")¹ the European Commission may adopt implementing acts declaring that the legal, supervisory and enforcement arrangements of a non-EU country are equivalent to the requirements in EMIR. For a central counterparty ("CCP") or trade repository ("TR") established in a non-EU country to provide their services in the EU, an equivalence decision is one of the requirements that must be fulfilled before the European Securities and Markets Authority ("ESMA") will grant access of the CCP or TR to EU investors. Equivalence decisions on other obligations under EMIR have the effect that if one party to a derivative trade is established in a non-EU country and the contract is subject to EMIR, the counterparties may choose to follow the non-EU country's equivalent regime instead of EMIR.

¹ Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories.

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The European Commission requested ESMA to provide its technical advice on the equivalence of certain non-EU countries which host large derivatives markets, to assist the Commission in formulating its equivalence decisions. The scope of the advice covers the recognition of non-EU CCPs and TRs, and for some countries only, the clearing obligation, reporting obligation, non-financial counterparties (“NFCs”), portfolio reconciliation, dispute resolution, portfolio compression and margin requirements. In early September, ESMA published its advice on the US and Japanese regimes as well as advice on the regimes for CCPs for Australia, Hong Kong, Singapore and Switzerland.² ESMA has now published its complete advice for these jurisdictions, in addition to advice for the regimes in Canada, South Korea and India. Advice relating to Dubai has been postponed.

Both the Commission and ESMA have stated that ESMA’s technical advice should not be construed as “prejudging” the European Commission’s final decision on equivalence. The advice is, nevertheless, a clear indication of those areas where equivalence decisions are likely to be forthcoming. ESMA’s advice is that almost all of the countries studied have effective supervisory regimes for the derivatives markets. Stumbling blocks for more unqualified equivalence decisions remain. For example the Australian, Hong Kong and Swiss regulatory regimes are still in the process of being finalised and rules on margin requirements still need to be finalised in many countries. As such, any equivalence decision will remain pending until a proper assessment is made of the final rules in these jurisdictions.

Some of the requirements came into effect on 15 September 2013, in response to which many industry participants have adhered to the [ISDA 2013 EMIR portfolio reconciliation, dispute resolution and disclosure protocol](#).

For more information on the steps corporates and funds should be taking for EMIR compliance you may refer to our client publication, [Alert: Actions required in light of Derivative Reforms](#). For more information on EMIR and related legislation in other jurisdictions you may refer to the following: [Alert: ESMA consults on Extraterritoriality, OTC Derivatives Regulation and Extraterritoriality III](#), and [The Revised EU and US Regulatory Frameworks for Commodity Derivatives](#).

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² This note updates our previous note “ESMA Advice on Third-Country Equivalence Under EMIR” published on 5 September 2013.

The matrix below summarises the key outcomes of ESMA’s technical advice for the US, Japan, Australia, Hong Kong and Switzerland. The advice for Canada, South Korea and India follows.

COUNTRY	US	JAPAN	AUSTRALIA	HONG KONG	SINGAPORE	SWITZERLAND
Clearing obligation	<p>Equivalent, however the clearing obligation should be disapplied only if:</p> <p>(a) the product subject to the clearing obligation in the EU is also subject to the clearing obligation in the US; and</p> <p>(b) the entity in the US is a non-exempted entity, or, if exempted, it would benefit from an equivalent exemption in the EU.</p> <p><u>Intragroup transactions:</u></p> <p>In view of the establishment of an equivalent regime for the clearing obligation and for risk mitigation techniques (see below requirements which are part of the EMIR risk mitigation rules), ESMA advises that transactions between EU and US entities in the same group should benefit from the intragroup exemption.</p>	<p>Equivalent, however the requirement should be disapplied only if:</p> <p>(a) the product subject to the clearing obligation in the EU is also subject to the clearing obligation in Japan; and</p> <p>(b) the counterparty in Japan is a non-exempted entity, or, if exempted, it would benefit from an equivalent exemption in the EU.</p>	<p>Equivalent, however the requirement should be disapplied only if:</p> <p>(a) the product subject to the clearing obligation in the EU is also subject to the clearing obligation in Australia; and</p> <p>(b) the counterparty in Australia is a non-exempted entity, or if exempted it would benefit from an equivalent exemption if established in the EU.</p>	<p>Hong Kong is still in the process of finalising its regulatory regime, ESMA is therefore not in a position to perform a conclusive analysis of the equivalence of the clearing obligation.</p> <p>ESMA stands ready to receive a new mandate from the Commission in order to provide this advice when progress has been made finalising the Hong Kong regime.</p>	<p>Not covered by mandate.</p>	<p>Switzerland is still in the process of finalising its regulatory regime, ESMA is therefore not in a position to perform a conclusive analysis of the equivalence of the clearing obligation.</p> <p>ESMA stands ready to receive a new mandate from the Commission in order to provide this advice when progress has been made finalising the Swiss regime.</p>
Timely confirmation	<p>Equivalent, however the requirement should be disapplied only if:</p> <p>(a) the relevant transaction is executed between a EU counterparty and a Swap Dealer (“SD”) or Major Swap Participant (“MSP”) subject to the Commodity Futures Trading Commission (“CFTC”)</p>	<p>Not equivalent. There are no legally binding requirements on timely confirmation.</p>	<p>Not equivalent. There are no legally binding requirements on timely confirmation.</p> <p>However, Australia’s regulators have indicated that the Australian regime would evolve and guidance related to risk mitigation techniques would converge with the EU relevant rules. As such, ESMA has</p>	<p>Hong Kong is still in the process of finalising its regulatory regime, ESMA is therefore not in a position to perform a conclusive analysis of the equivalence of risk mitigation techniques, including timely confirmation.</p> <p>ESMA stands ready to receive a new mandate from the Commission in</p>	<p>Not covered by mandate.</p>	<p>Switzerland is still in the process of finalising its regulatory regime, ESMA is therefore not in a position to perform a conclusive analysis of the equivalence of risk mitigation techniques, including timely confirmation.</p> <p>ESMA stands ready to receive a new mandate from the Commission in</p>

COUNTRY	US	JAPAN	AUSTRALIA	HONG KONG	SINGAPORE	SWITZERLAND
	jurisdiction; and (b) reporting of unconfirmed trades to EU competent authorities is not disapplied.		suggested that subject to receipt of a mandate from the Commission it may be advisable to review this part of the technical advice at a later stage.	order to provide this advice when progress has been made finalising the Hong Kong regime.		order to provide this advice when progress has been made finalising the Swiss regime.
Portfolio reconciliation	Equivalent, however the requirement should be disapplied only if: (a) where the transaction is between a financial counterparty or a NFC that is above the EMIR clearing threshold ("NFC+") and a SD or MSP, the SD or MSP apply the provisions applicable to transactions between SDs and MSPs; and (b) where the transaction is between a NFC that is below the EMIR clearing threshold ("NFC-") and a SD or MSP, the SD or MSP apply the provisions applicable to transactions to counterparties other than SD or MSP.	Not equivalent. There are no legally binding requirements on portfolio reconciliation.	Not equivalent. There are no legally binding requirements on portfolio reconciliation. However, Australia's regulators have indicated that the Australian regime would evolve and guidance related to risk mitigation techniques would converge with the EU relevant rules. As such, ESMA has suggested that subject to receipt of a mandate from the Commission it may be advisable to review this part of the technical advice at a later stage.	Hong Kong is still in the process of finalising its regulatory regime. ESMA is therefore not in a position to perform a conclusive analysis of the equivalence of risk mitigation techniques, including portfolio reconciliation. ESMA stands ready to receive a new mandate from the Commission in order to provide this advice when progress has been made finalising the Hong Kong regime.	Not covered by mandate.	Switzerland is still in the process of finalising its regulatory regime, ESMA is therefore not in a position to perform a conclusive analysis of the equivalence of risk mitigation techniques, including portfolio reconciliation. ESMA stands ready to receive a new mandate from the Commission in order to provide this advice when progress has been made finalising the Swiss regime.
Portfolio compression	Equivalent where the entity subject to the EMIR provisions on portfolio compression in the EU enters into transactions with a SD or MSP subject to the CFTC regime.	Not equivalent. There are no legally binding requirements on portfolio compression.	Not equivalent. There are no legally binding requirements on portfolio compression. However, Australia's regulators have indicated that the Australian regime would evolve and guidance related to risk mitigation techniques would converge with the EU relevant rules. As such, ESMA has suggested that subject to receipt of a mandate from the Commission it may be advisable to review this part	Hong Kong is still in the process of finalising its regulatory regime. ESMA is therefore not in a position to perform a conclusive analysis of the equivalence of risk mitigation techniques, including portfolio compression. ESMA stands ready to receive a new mandate from the Commission in order to provide this advice when progress has been made finalising the Hong	Not covered by mandate.	Switzerland is still in the process of finalising its regulatory regime, ESMA is therefore not in a position to perform a conclusive analysis of the equivalence of risk mitigation techniques, including portfolio compression. ESMA stands ready to receive a new mandate from the Commission in order to provide this advice when progress has been made finalising the Swiss

COUNTRY	US	JAPAN	AUSTRALIA	HONG KONG	SINGAPORE	SWITZERLAND
			of the technical advice at a later stage.	Kong regime.		regime.
Dispute resolution	Not equivalent.	Not equivalent. There are no legally binding requirements on dispute resolution.	Not equivalent. There are no legally binding requirements on dispute resolution. However, Australia's regulators have indicated that the Australian regime would evolve and guidance related to risk mitigation techniques would converge with the EU relevant rules. As such, ESMA has suggested that subject to receipt of a mandate from the Commission it may be advisable to review this part of the technical advice at a later stage.	Hong Kong is still in the process of finalising its regulatory regime, ESMA is therefore not in a position to perform a conclusive analysis of the equivalence of risk mitigation techniques, including dispute resolution. ESMA stands ready to receive a new mandate from the Commission in order to provide this advice when progress has been made finalising the Hong Kong regime.	Not covered by mandate.	Switzerland is still in the process of finalising its regulatory regime, ESMA is therefore not in a position to perform a conclusive analysis of the equivalence of risk mitigation techniques, including dispute resolution. ESMA stands ready to receive a new mandate from the Commission in order to provide this advice when progress has been made finalising the Swiss regime.
Effective supervisory and enforcement arrangements with respect to OTC derivatives	Broadly equivalent.	Equivalent.	Broadly equivalent.	Hong Kong is still in the process of finalising its regulatory regime, ESMA is therefore not in a position to perform a conclusive analysis of the equivalence of supervisory and enforcement arrangements with respect to OTC derivatives. ESMA stands ready to receive a new mandate from the Commission in order to provide this advice when progress has been made finalising the Hong Kong regime.	Not covered by mandate.	Switzerland is still in the process of finalising its regulatory regime, ESMA is therefore not in a position to perform a conclusive analysis of the equivalence of supervisory and enforcement arrangements with respect to OTC derivatives. ESMA stands ready to receive a new mandate from the Commission in order to provide this advice when progress has been made finalising the Swiss regime.
Bilateral margin and capital with respect to OTC derivatives	ESMA advises the Commission to suspend a decision on equivalence pending finalisation of the rules in both the EU and the US.	ESMA advises the Commission to suspend a decision on equivalence pending finalisation of the rules in the EU.	ESMA advises the Commission to suspend a decision on equivalence pending finalisation of the rules in the EU.	Hong Kong is still in the process of finalising its regulatory regime, ESMA is therefore not in a position to perform a conclusive analysis of the equivalence	Not covered by mandate.	Switzerland is still in the process of finalising its regulatory regime, ESMA is therefore not in a position to perform a conclusive analysis of the equivalence

COUNTRY	US	JAPAN	AUSTRALIA	HONG KONG	SINGAPORE	SWITZERLAND
				of risk mitigation techniques, including bilateral margin and capital. ESMA stands ready to receive a new mandate from the Commission in order to provide this advice when progress has been made finalising the Hong Kong regime.		of risk mitigation techniques, including bilateral margin and capital. ESMA stands ready to receive a new mandate from the Commission in order to provide this advice when progress has been made finalising the Swiss regime.
NFCs	Note, ESMA has advised the Commission not to take a specific determination on equivalence for NFCs but to analyse the clearing obligation and risk mitigation requirements (in the above rows) also with respect to NFCs.		Note, the Australian regime does not specify the scope of application to persons but allows mandatory obligations to apply to any party to a derivatives transaction. Equivalence will depend on the legally binding determination of the Minister and Australian Securities and Investments Commission.	Hong Kong is still in the process of finalising its regulatory regime, ESMA is therefore not in a position to perform a conclusive analysis of the equivalence of NFCs. ESMA stands ready to receive a new mandate from the Commission in order to provide this advice when progress has been made finalising the Hong Kong regime.	Not covered by mandate.	Switzerland is still in the process of finalising its regulatory regime ESMA, is therefore not in a position to perform a conclusive analysis of the equivalence of NFCs. ESMA stands ready to receive a new mandate from the Commission in order to provide this advice when progress has been made finalising the Swiss regime.
CCP authorisation requirements	Equivalent, provided the CCP adopts legally binding internal policies, procedures, rules, models and methodologies which comply with certain requirements for CCPs under EMIR - ESMA identifies the following specific areas of requirements: For CCPs under the CFTC Derivatives Clearing Organisation ("DCO") regime: (a) Risk Committee; (b) Business continuity; (c) Margin;	Equivalent, provided the CCP adopts legally binding internal policies, procedures, rules, models and methodologies which comply with certain requirements for CCPs under EMIR - ESMA identifies the following specific areas of requirements: (a) Organisational; (b) Requirements for senior management and the Board; (c) Risk Committee; (d) Conflicts of interest; (e) Business continuity;	Equivalent (however see recognition of third country CCPs below).	Equivalent, provided the CCP adopts legally binding internal policies, procedures, rules, models and methodologies which comply with certain requirements for CCPs under EMIR - ESMA identifies the following specific areas of requirements: (a) Organisational; (b) Requirements for senior management and the Board; (c) Risk Committee; (d) Record keeping; (e) Conflicts of interest;	Equivalent, provided the CCP adopts legally binding internal policies, procedures, rules, models and methodologies which comply with certain requirements for CCPs under EMIR - ESMA identifies the following specific areas of requirements: (a) Organisational, (including governance, compliance, audit); (b) Requirements for senior management and the Board; (c) Risk Committee;	Equivalent.

COUNTRY	US	JAPAN	AUSTRALIA	HONG KONG	SINGAPORE	SWITZERLAND
	(d) Default fund;	(f) Participation;		(f) Business continuity;	(d) Record keeping;	
	(e) Other financial resources;	(g) Transparency;		(g) Outsourcing;	(e) Conflict of interest;	
	(f) Liquidity risk control;	(h) Segregation and portability;		(h) Participation;	(f) Business continuity;	
	(g) Default waterfall;	(i) Exposure management;		(i) Transparency;	(g) Outsourcing;	
	(h) Collateral;	(j) Margin;		(j) Segregation and portability;	(h) General conduct of business;	
	(i) Investment policy; and	(k) Default fund requirements;		(k) Exposure management;	(i) Participation; and	
	(j) Review of models, stress testing and back testing.	(l) Other financial resources;		(l) Margin;	(j) Margin.	
	For CCPs under the Securities and Exchange Commission ("SEC") regime:	(m) Liquidity risk control;		(m) Default fund;	The CCP must ensure that no changes are made to its internal policies, procedures, rules or methodologies in a way which would mean that it would no longer comply with the standards required by EMIR.	
	(a) Risk Committee;	(n) Default waterfall;		(n) Other financial resources;		
	(b) Business continuity;	(o) Collateral;		(o) Liquidity risk control;		
	(c) Outsourcing;	(p) Investment policy;		(p) Default waterfall;		
	(d) Segregation and portability;	(q) Default procedure;		(q) Collateral;		
	(e) Margin;	(r) Review of models, stress testing and back testing; and		(r) Investment policy;		
	(f) Default fund;	(s) Settlement.		(s) Default procedure;		
	(g) Other financial resources;	The CCP must ensure that no changes are made to its internal policies, procedures, rules or methodologies in a way which would mean that it would no longer comply with the standards required by EMIR.		(t) Review of models, stress testing and back testing; and		
	(h) Liquidity risk control;			(u) Settlement.		
	(i) Default waterfall;			The CCP must ensure that no changes are made to its internal policies, procedures, rules or methodologies in a way which would mean that it would no longer comply with the standards required by EMIR.		
	(j) Collateral;					
	(k) Investment policy;					
	(l) Default procedure; and					
	(m) Review of models, stress testing and back testing.					
	CCPs under the CFTC's regime for systemically important DCOs and Opt-In DCOs:					

COUNTRY	US	JAPAN	AUSTRALIA	HONG KONG	SINGAPORE	SWITZERLAND
	<ul style="list-style-type: none"> (a) Risk committee; (b) Margin; (c) Default fund; (d) Other financial resources; (e) Default waterfall; (f) Collateral; (g) Investment policy; and (h) Review of models, stress testing and back testing. <p>The CCP must ensure that no changes are made to its internal policies, procedures, rules or methodologies in a way which would mean that it would no longer comply with the standards required by EMIR.</p>					
Effective system for recognition of CCPs authorised under the legal regime of a third country	Equivalent, however, the US authorities do not use the equivalent system on a long-term basis. In addition, the US authorities require CCPs authorised outside of the US to be subject to the direct jurisdiction of the SEC and the CFTC and the application of two sets of rules, which represents a departure from the third country CCP regime prescribed in EMIR.	Equivalent.	Equivalent (except for CCPs providing clearing services to the ASX listed equities market).	Equivalent.	Equivalent.	Equivalent.
Trade repository requirements	<p><u>Authorisation requirements:</u> Equivalent, provided the TR adopts legally binding internal policies, procedures, rules, models and methodologies which comply with EMIR</p>	ESMA's advice postponed (no Japanese TRs have yet indicated that they intend to apply for recognition under EMIR).	<p><u>Reporting obligation:</u> Broadly equivalent.</p> <p><u>Guarantee of professional secrecy:</u> Equivalent.</p>	Hong Kong is still in the process of finalising its regulatory regime for reporting to TRs, ESMA is therefore not in a position to perform a conclusive analysis and to deliver	<p><u>Authorisation requirements:</u> Equivalent, providing TRs have adopted internal policies, procedures and rules that constitute legally binding requirements ensuring the following:</p>	Not covered by mandate.

COUNTRY	US	JAPAN	AUSTRALIA	HONG KONG	SINGAPORE	SWITZERLAND
	<p>requirements relating to operational separation and collection of data on exposures (valuation and collateral).</p> <p><u>Reporting obligation:</u> Not equivalent. The reporting obligation of EMIR cannot be substituted with the reporting obligation of the US regime, which omits the requirement to report specific data on valuation of exposures and collateralisation of such exposures.</p> <p>However, where TRs adopt legally binding internal policies, procedures, rules, models and methodologies that ensure the collection of data on exposures (valuation and collateral) these should be taken into account under the recognition assessment.</p> <p><u>Reporting codes:</u> Broadly equivalent. Similar codes are expected to be used by EU and US TRs, also to ensure compliance with the general reconciliation and data aggregation obligations.</p> <p><u>Guarantee of professional secrecy:</u> Equivalent.</p> <p><u>Effective on-going supervision and enforcement:</u> Equivalent. Although the US regime does not provide specifically for TRs, the US</p>		<p><u>Effective ongoing supervision and enforcement:</u> Equivalent.</p>	<p>technical advice on this topic.</p> <p>ESMA stands ready to receive a new mandate from the Commission in order to provide this advice when progress has been made finalising the Hong Kong regime.</p> <p>It should however be noted that the absence of an equivalence assessment on TRs does not prevent the access of Hong Kong CPs to EU-based TRs authorised by ESMA. Neither does it prevent a Hong Kong branch of an EU entity reporting to a Hong Kong TR if so required by any other applicable law than EMIR.</p>	<p>(a) operational separation of ancillary services;</p> <p>(b) business continuity, in particular the existence of a second backup site;</p> <p>(c) position calculation by TRs;</p> <p>(d) no duplication of reports: require TR users to match data and the TR to validate reports upon receipt;</p> <p>(e) deadline to report: TR to be ready to receive reports one day after the execution of contracts, at the latest; and</p> <p>(f) disclosure to the public and to relevant authorities in a similar manner as prescribed under EMIR and the relevant technical standards.</p>	

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	supervisory regime applicable to all regulated firms applies and is equivalent.					

The matrix below summarises the key outcomes of ESMA’s technical advice for South Korea and India.

Note, for South Korea and India ESMA’s advice was not requested in respect of the clearing obligation, timely confirmation, portfolio reconciliation, portfolio compression, dispute resolution, effective supervisory and enforcement arrangements, bilateral margin and capital, NFCs and TRs.

For Canada, ESMA found that Canada does not yet have in place legally binding requirements equivalent to the clearing obligation, timely confirmation, portfolio reconciliation, portfolio compression, dispute resolution, effective supervisory and enforcement arrangements, bilateral margin and capital and NFCs. Canada is still in the process of finalising its regulatory regime and is expected to have published its rules for public comment at the end of 2013, and have implemented them by the end of 2014. ESMA’s advice was not requested in respect of TRs or CCPs.

COUNTRY	SOUTH KOREA	INDIA
CCP authorisation requirements	<p>Equivalent, provided the CCP adopts legally binding internal policies, procedures, rules, models and methodologies which comply with certain requirements for CCPs under EMIR - ESMA identifies the following specific areas of requirements:</p> <ul style="list-style-type: none"> (a) Organisational; (b) Requirements for senior management and the Board; (c) Risk Committee; (d) Record keeping; (e) Shareholders and members with qualifying holdings (for CCPs other than Korean Exchange); (f) Information to competent authorities (for CCPs other than Korean Exchange); (g) Assessment of qualifying holdings (for CCPs other than Korean Exchange); (h) Conduct of business rules – general provisions (for CCPs other than Korean Exchange); (i) Participation; (j) Transparency; (k) Segregation and portability; (l) Margin; (m) Default fund; (n) Other financial resources; (o) Liquidity risk control; (p) Default waterfall; (q) Collateral; (r) Investment policy; (s) Default procedure; 	<p>Equivalent, provided the CCP adopts legally binding internal policies, procedures, rules, models and methodologies which comply with certain requirements for CCPs under EMIR - ESMA identifies the following specific areas of requirements:</p> <ul style="list-style-type: none"> (a) Organisational, including governance, compliance, audit etc; (b) Requirements for senior management and Securities and Exchange SEBI of India; (c) Risk Committee requirements for CCPs under Reserve Bank of India (“RBI”) supervision; (d) Record keeping; (e) Requirements for shareholders and members with qualifying holdings for CCPs under RBI supervision; (f) Requirements for the assessment of qualifying holdings for CCPs under RBI supervision; (g) Conflict of interest requirements for CCPs under RBI; (h) Business continuity; (i) Outsourcing; (j) General conduct of business requirements for CCPs under RBI supervision; (k) Participation; (l) Transparency; (m) Segregation and portability; (n) Exposure management requirements for CCPs under RBI supervision; (o) Margin; (p) Default fund; (q) Other financial resources;

COUNTRY	SOUTH KOREA	INDIA
	<p>(t) Review of models, stress testing and back testing; and (u) Settlement. The CCP must ensure that no changes are made to its internal policies, procedures, rules or methodologies in a way which would mean that it would no longer comply with the standards required by EMIR.</p>	<p>(r) Liquidity risk control; (s) Default waterfall; (t) Collateral; (u) Investment policy; (v) Default procedure; (w) Review of models, stress testing and back testing; and (x) Settlement. The CCP must ensure that no changes are made to its internal policies, procedures, rules or methodologies in a way which would mean that it would no longer comply with the standards required by EMIR.</p>
Effective system for recognition of CCPs authorised under the legal regime of a third country	Equivalent.	Not equivalent.

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This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

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