

OVERVIEW AND COMPLEXITY OF CHANGING REGULATORY REQUIREMENTS

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Structure of Newedge

- Newedge Group SA is a global broker in derivatives and equities and over-the-counter products.
- Newedge conducts business in 14 countries.
- It is a French organization lead regulated by the Autorité Contrôle de Prudentiel.
- Newedge UK Financial Limited is authorized and regulated by the Financial Conduct Authority (FCA).
- Newedge USA LLC is regulated by the CFTC, NFA, CME, SEC, FINRA and FRB (as a subsidiary of a bank.)

Business of Newedge

- Newedge USA, LLC ("NUSA") is registered in the US as a futures commission merchant ("FCM"), broker-dealer ("BD") and swap dealer ("SD"). It is not registered as a bank or an asset manager.
- NUSA acts as an executing and clearing broker for securities, futures and swaps transactions. NUSA also acts as an executing broker (i.e., swap dealer) with respect to uncleared OTC derivatives activities. The bulk of NUSA's transactions/revenue is based on its execution and clearing activities involving futures and options on futures.
- Although NUSA confines its activities primarily to agency brokerage, given its registrations and the broad scope of its activities within the brokerage space, it is and has been subject to many new regulatory developments in the US, including Dodd Frank Title VII (relating to OTC derivatives) and the CFTC's enhanced customer protection rules and the obligations under the European Markets Infrastructure Regulation as well as the obligations of other regulators addressing OTC clearing and reporting obligations.

Increasing Compliance and Regulatory Obligations

- In October 2013 in US, CFTC alone issued over 900 pages in new regulatory obligations as final rules.
- At same time other regulators are also initiating major regulatory changes.
- Newedge has dedicated team to assess each final rule for impact to various Newedge entities and for implementation.

New Regulatory Obligations

- The CFTC recently finalized sweeping changes to its customer protection rules. These rules impact NUSA directly as an FCM. The rules go into effect in three primary phases, with the first phase being 14 January 2014, the second being 2 July 2014 and the third being 14 November 2014.
- Among other things, the rules will require FCMs to:
 - provide additional general disclosures to customers regarding the safety of segregated funds;
 - provide additional specific disclosures to customers regarding risks specific to the FCM (relating to, for example, proprietary trading, leverage, customer concentrations, etc.);
 - provide information on their websites regarding net capital, excess net capital, segregated funds, residual funds in segregated accounts, certain balance sheet information;
 - provide additional reports to the CFTC (some of which are already required by the CME and NFA) such as daily segregation computations, investments of customer funds, etc.;
 - implement extensive risk management procedures, and particularly with respect to their activities relating to the computation and segregation of customer funds;
 - provide look-through viewing access to depository accounts to the CFTC;
 - collect customer margin deficiencies by COB on T+1 as of 14 November 2014;
 - take a capital charge for unresolved margin deficiencies (arising one day after a call is issued) as of 14 November 2014.
- The most significant item was the so-called residual interest requirement, which had required, in proposed form, for FCMs to collect all required margin on futures and options from customers as of the time the FCMs met their margin calls with the DCOs. This proposed requirement met with substantial industry resistance and so a compromise was reached. For the next year, no change; as of 14 November 2014, margin must be collected by COB T+1, after three years the CFTC will conduct a study to determine whether any further changes need to be made and, if no further changes are made, the original proposal will go into effect by the end of 2018.

Dodd-Frank and Implications

- Dodd-Frank is incredibly complex and the obligations apply in the US and have an impact outside of the US.
- NUSA is primarily impacted by Title VII of Dodd Frank, which relates to the reporting, clearing and execution of OTC derivatives. Over the past year or so, NUSA has implemented numerous SD requirements with respect to its OTC derivatives execution business (which consists exclusively of FX and a small number of agricultural swaps), including those relating to: books and records; portfolio reconciliation; portfolio compression; trading relationship documentation; external business conduct rules; real-time and end-of-day reporting; historical reporting, etc.
- Among other things, implementing these rules with respect to its OTC derivatives customers has required NUSA to adhere to the August 2012 ISDA DF Protocol and the March 2013 ISDA DF Protocol with respect to such clients, join the DTCC as a swap data repository participant, and enter into agreements with TriOptima to conduct its reconciliation and compression activities.
- Newedge also has a registered SD in the UK, Newedge UK Financial Ltd. ("NUK"), which is subject to all applicable DF SD requirements with respect to its US customers.
- NUSA has also participated in the formulation of certain Dodd Frank rules and requirements, either directly with the CFTC or through its membership in industry associations such as FIA and ISDA. Newedge UK also participated through the Futures and Options Association in the UK.

Dodd-Frank and Implications

- Keeping abreast of Dodd Frank developments has been a time-consuming task. Significant DF rules that have not yet been finalized include: uncleared margin requirements for SDs; capital requirements for SDs; mandatory clearing requirements for products in commodities, FX and equities; Volcker (NUSA is subject to Volcker given its affiliation with SG and CA-CIB in New York); and certain SEF-related rules.
- On the cleared swap side, NUSA currently clears IRS products on CME and LCH Clearnet (including LCH SwapClear), and is considering clearing CDS and FX products as well during 2014. NUSA is not currently registered as a security-based SD nor does it have plans to do so at this time. However, as a US BD, NUSA has the ability to clear security-based swaps from a regulatory perspective, but does not do so currently.
- Some of the current open issues relating to Dodd Frank include, among others: (a) the CFTC's cross-border guidance; i.e., will the CFTC expand the scope of non-US SD's DF requirements or rely on mutual recognition of comparable jurisdictions; (b) FCM requirements regarding trades executed on SEFs, and; (c) FCM/SD requirements under the Volcker rule.

EMIR and Implications

- Newedge is also subject to the European Market Infrastructure Regulation ("EMIR"). EMIR is roughly equivalent to Title VII of Dodd Frank, in that it establishes requirements relating to the reporting, execution and clearing of OTC derivatives. EMIR's reporting requirements also extend to ETDs, and its segregation and portability requirements involve ETDs and cash products as well.
- The Newedge affiliate primarily impacted by EMIR is Newedge UK Financial Ltd. ("NUK"). NUK is a limited investment firm under MiFID, is governed by the FCA, and conducts a variety of execution and clearing brokerage services involving different asset classes and products for institutional customers.
- EMIR requirements can be divided broadly into four categories: reporting; risk mitigation; segregation, and; mandatory clearing. The reporting requirements (for both ETD and OTC) go into effect on 12 February 2014; the risk mitigation requirements (which include confirmation, portfolio reconciliation, portfolio compression and dispute resolution) have already gone into effect for the most part; the segregation requirements will go into effect first upon Nasdaq OMX's re-authorization, currently scheduled for December 2013, and; the first mandatory clearing requirements are likely to go into effect during 2Q 2014.

EMIR and Implications

- NUSA itself will be impacted by EMIR in a number of ways.
- First, as a counterparty to NUK on uncleared OTC derivatives, NUSA is subject to EMIR risk mitigation requirements (there is no inter-group exemption from the EMIR risk mitigation requirements except as to the exchange of collateral, and then only upon regulatory approval).
- Second, NUSA, as a direct clearing member of two EU CCPs (LCH Clearnet and ICE Clear Europe) is required to offer its EU customers that clear through such CCPs a choice of an EMIR compliant ISA or OSA. Since such account types are not compatible with CFTC rules and the US Bankruptcy Code, such accounts will have to be moved to NUK.
- Third, NUSA will no longer be able to clear affiliate proprietary accounts on such CCPs given that under CFTC rules such accounts are considered house accounts, while under EMIR rules such accounts are considered customer accounts.
- Finally, NUSA is considering whether to provide, in conjunction with NUK, its EU customers with delegated reporting services since such customers are subject to EMIR reporting requirements in regards to their US derivatives activities even though NUSA itself (as a non-EU firm) is not subject to such reporting requirements.

Cross Border Conflicting Regulations

- Because of DF NUSA was required to become a member of certain European Clearing Houses.
- ESMA has indicated that under EMIR clearing members of European Clearing Houses must offer individual segregation.
- Under US Rules, US FCM cannot legally offer individual segregation as it would be a preference for one client over another.
- ESMA has indicated US FCM must offer individual segregation to European clients.