ESMA/2013/926

Template for the Responses to the Discussion Paper on the Clearing Obligation under EMIR

How to use this template

This template is made available to stakeholders who wish to answer to ESMA’s Discussion Paper on the Clearing Obligation under EMIR, reference ESMA/2013/925.

ESMA wishes to encourage stakeholders to use the template in order to facilitate the analysis of the responses to this consultation. However, ESMA will duly consider all answers irrespective of the format under which they are submitted.

When not commenting on a specific question or section, please kindly delete the corresponding references (i.e. “Question x”, “Answer y”, “Comments on paragraphs x to y”).

The final submission of your answer in word format is preferred.

1. Respondent

Name: German Insurance Association - ID Number 6437280268-55

Country: Germany

Category: please use the table below

|  |  |
| --- | --- |
| **Category** | **Please select** |
| Audit/Legal/Individual |  |
| Banking sector |  |
| Central Counterparty |  |
| Commodity trading |  |
| Government, Regulatory and Enforcement |  |
| Insurance and Pension | X |
| Investment Services |  |
| Non-financial counterparty subject to EMIR |  |
| Regulated markets/Exchanges/Trading Systems |  |
| Other Financial service providers |  |

1. Introduction – General comments

The German Insurance Association appreciates ESMA’s decision of publishing a discussion paper on the clearing obligations under EMIR at this early stage and welcomes the opportunity of contributing its views in this respect.

Comments on paragraphs 1 to 6:

We have no comments as regards paragraphs 1 to 6.

# 1. Procedure for the determination of the classes to be subject to the clearing obligation

Comments on paragraphs 7 to 17:

We have no comments as regards paragraphs 7 to 17.

# 2. CCP-cleared classes of OTC derivatives

Comments on paragraphs 18 to 30:

We have no comments as regards paragraphs 18 to 30.

## 2.1 Credit derivatives

Comments on paragraphs 31 to 39:

We have no additional comments as regards paragraphs 31 to 39.

Question 1 (Series for Index CDS):

Please indicate your preference between the options presented. Do you believe that the possibility for a new series to exhibit low liquidity is a risk worth being considered when defining the classes of Index CDS? Under Option C, which criteria do you believe are relevant and how should they be calibrated?

Answer 1:

We would prefer Option A followed by Option B.

The risk of low liquidity for the on the run series is very low. Market participants roll positions into the new series and create liquidity in particular once the series starts trading on 20.3 or 20.9.

The drawbacks of Option C are already mentioned and include “the series to fall in and out of the clearing obligation at an inappropriate frequency”.

Question 2 (Index CDS):

Do you consider that the main characteristics of Index CDS are adequately captured by the proposed structure? Are there any other variables which you consider as relevant in the context of the clearing obligation?

Answer 2:

Yes, the characteristics are adequately captured.

Question 3 (Index CDS):

Do you have preliminary views on the specific items within those classes which would be the best candidates for the clearing obligation, taking into consideration the overarching aim of reducing systemic risk and the criteria defined in Article 5(4) of EMIR?

Answer 3:

We believe, the on the run series tenor 5-year are most relevant.

Comments on paragraphs 41 to 44:

We have no additional comments as regards paragraphs 41 to 44.

Question 4 (Single name CDS):

Please indicate your preference between the options presented. In relation to Option B, which geographical zones would you define, i.e. how could the currencies be grouped in geographical zones? What is the standard market practise in this respect?

Answer 4:

We would prefer Option A.

For Option B the geographical zones could be defined according to the index CDS market (Europe/North America/Emerging Markets).

Comments on paragraphs 45 to 50:

We have no additional comments as regards paragraphs 45 to 50.

Question 5 (Single name CDS):

Please indicate your preference between the options presented. Under Option C, which criteria do you believe are relevant and how should they be calibrated?

Answer 5:

We would prefer Option B.

Question 6 (Single name CDS):

Do you consider that the main characteristics of Single Name CDS are adequately captured by the proposed structure? Are there any other variables which you consider as relevant in the context of the clearing obligation?

Answer 6:

The proposed structure seems adequate.

Question 7 (Single name CDS):

Do you have preliminary views on the specific items within those classes which would be the best candidates for the clearing obligation, taking into consideration the overarching aim of reducing systemic risk and the criteria defined in Article 5(4) of EMIR?

Answer 7:

The 5-year tenor seems most relevant.

## 2.2 Interest rate derivatives

Comments on paragraphs 52 to 58:

We have no additional comments as regards paragraphs 52 to 58.

Question 8 (Interest rate derivatives):

Do you consider that the main characteristics of the interest rate derivatives are adequately captured by the proposed structure? Are there any other variables which you consider as relevant in the context of the clearing obligation?

Answer 8:

The following key characteristics might be missing from a trading perspective:

* In Table 8 (Fixed-to-float Class) and Table 9 (Basis swap Class):

- Tenor of floating rate (e.g. 3 month or 6 month),

- payment frequency (for floating and fixed leg),

- reset frequency for floating leg,

- day count fraction (e. g. Act/365, Act/360).

With regard to the distinction of captured products there might be room for interpretation. It might be for example unclear, if IRS with a spread on the floating rate would have to be cleared or not.

* In Table 11 (OIS Class):

- AUD OIS

* In Table 12 (Interest Rate Option Class):

From our perspective there might be room for interpretation, whether Interest Rate Swaptions would be captured or not. If it is intended to impose a clearing obligation on these products, it might be advisable to reflect this intention more clearly.

Question 9 (Interest rate derivatives):

Do you have preliminary views on the specific items within those classes which would be the best candidates for the clearing obligation, taking into consideration the overarching aim of reducing systemic risk and the criteria defined in Article 5(4) of EMIR?

Answer 9:

The main focus should be on IRS (Fixed-to float), OIS and eventually Interest Rate Swaptions. These are the most actively traded products in an insurance portfolio, but also from other real money investors. The main currencies are EUR, GBP and USD. Further important are CAD and AUD.

## 2.3. Equity derivatives

Comments on paragraphs 59 to 70:

We have no additional comments as regards paragraphs 57 to 70.

Question 10 (Equity derivatives):

Please indicate your preference between the options presented. Under Option D, which criteria do you believe are relevant and how should they be calibrated?

Answer 10:

Option A seems most preferable because a single name equity derivative is best identified by its underlying, i.e. the corresponding entity identifier of the underlying. Regarding the open definition of option D, CO could be based on a notional threshold of EUR 50 Mio. per single name equity derivative.

Comments on paragraphs 71 to 73:

We have no additional comments as regards paragraphs 71 to 73.

Question 11 (Equity derivatives):

Please indicate your preference between the options presented.

In relation to Option B, which geographical zones would you define, i.e. how could the currencies be grouped in geographical zones? What is the standard market practise in this respect?

Answer 11:

The settlement currency would represent the preferred primary key to define the respective class/category for equity derivatives, from our point of view. Geographical zones might be organized in the continental settings North America, South America, Europe, Africa, Asia and Australia.

Question 12 (Equity derivatives):

Do you consider that the main characteristics of Equity OTC derivatives are adequately captured by the proposed structure? Are there any other variables which you consider as relevant in the context of the clearing obligation?

Answer 12:

-/-

Question 13 (Equity derivatives):

Do you have preliminary views on the specific items within those classes which would be the best candidates for the clearing obligation, taking into consideration the overarching aim of reducing systemic risk and the criteria defined in Article 5(4) of EMIR?

Answer 13:

-/-

## 2.4. Foreign Exchange derivatives

Comments on paragraphs 75 to 78:

We have no additional comments as regards paragraphs 75 to 78.

Question 14 (FX derivatives):

Do you consider that the main characteristics of the FX derivatives are adequately captured by the proposed structure? Are there any other variables which you consider as relevant in the context of the clearing obligation?

Answer 14:

From a trading perspective it might be not perfectly clear, if FX Swaps (which are a combination of a FX Spot and a FX Forward and constitute the biggest volume within the FX market) would be covered by Table 15 or not. Additionally, it might not be certain from a practical point of view, what the term “cash settlement” means with regard to FX Transactions. The industry standard is physical delivery and pure cash settlement is not a commonly used settlement procedure (with the exception of NDF´s).

If only a narrow definition of cash settlement is intended, fixing procedure keys would need to be defined.

Question 15 (FX derivatives):

Do you have preliminary views on the specific items of the presented class which would be the best candidates for the clearing obligation, in view of the criteria to be assessed by ESMA, taking into consideration the overarching aim of reducing systemic risk and the criteria defined in Article 5(4) of EMIR?

Answer 15:

If is ESMA’s objective to cover the predominate part of all FX derivatives, it might not be achieved on the basis of the proposed classes set out in Table 14 and 15.

CSF´s are not a commonly used instrument within the industry. FX Forwards are almost exclusively settled by physical delivery. Moreover the currency pairs named in the tables are just a tiny fraction in comparison to the currency pairs traded within the FX market in total. Because of the multitude of currencies involved it might be useful to have the possibility to be flexible in the two currencies involved (and both require settlement possibilities). Even for cash settled FX trades the proposed settlement currencies seem not eligible in a European context, as a settlement in EUR needs to be covered.

This is different for NDF, where one of the currencies involved is non deliverable, cash settlement is conducted and the fixing procedure against EUR is already standardized by EMTA. Again, as the currencies named in Table 14 only cover a very small part of the traded currencies, most NDF´s could not be cleared.

## 2.5. Commodity derivatives

Comments on paragraphs 79 to 84:

We have no additional comments as regards paragraphs 79to 84.

Question 16 (Commodity derivatives):

What is in your view the best approach to specify the underlying assets within each OTC Commodity class?

Answer 16:

ISDA two level classifications are appropriate to categorize commodity contracts. A “one level” classification would be sufficient, i.e. index or specific commodity/product exposure.

Question 17 (Commodity derivatives):

Do you consider that the main characteristics of the Commodity derivatives are adequately captured by the proposed structure? Are there any other variables which you consider as relevant in the context of the clearing obligation?

Answer 17:

Part 1: Yes.

Part 2: No.

Question 18 (Commodity derivatives):

Do you have preliminary views on the specific items within those classes which would be the best candidates for the clearing obligation, taking into consideration the overarching aim of reducing systemic risk and the criteria defined in Article 5(4) of EMIR?

Answer 18:

Physically settled contracts should be cleared first, because of their potential influence on spot price.

# 3. Preliminary analysis of the readiness of asset classes vis-à-vis the clearing obligation

Comments on paragraphs 85 to 105:

We have no additional comments as regards paragraphs 85 to 105.

Question 19 (readiness of the classes):

Do you agree with this analysis?

Answer 19:

We fully agree.

# 4. Determination of the phase in, and the categories of counterparties to which the CO would apply

## 4.1. Dates, phase in, categories of counterparties

Comments on paragraphs 106 to 115:

We have no additional comments as regards paragraphs 106 to 115.

Question 20 (dates, phase in):

What would you consider to be the shortest delay to impose a clearing obligation to a class of OTC derivatives when there are several CCPs available? And when there is only one CCP available?

Please specify in your answer whether the cause of delay is due to operational issues (e.g. time for CCP/counterparties to be ready for the CO) and/or to market issues (e.g. time for a CCP to add a new product to its offering).

Answer 20:

If a number of CCPs should be available, the shortest delay should be determined themselves, because only the CCP will know, how long it will take to get in alignment with the requirements. We estimate this will take at least one and a half year. If there is only one CCP we see a huge concentration on risk and no competition. We estimate this will take at least up to two and a half years to give sufficient time to develop clearing services.

From a buy-side perspective a minimum time frame of one year should be foreseen in order to get ready for clearing a new product. At least all necessary tasks - particularly where external providers or a huge number of market participants are involved - should be carefully considered.

Question 21 (dates, phase in):

What would you consider to be a reasonable delay to allow CCPs which clear the same asset class or a similar Class+ to clear a new Class+?

Answer 21:

A reasonable delay would be one year.

Comments on paragraphs 116 to 119:

We have no additional comments as regards paragraphs 116 to 119.

Question 22 (dates, phase in):

What should be the assumption regarding market share which the CCP would have to be able to assume? Should it be requested that each CCP be able to handle the whole volume to tackle the worst case scenario?

Answer 22:

A CCP should comply with the standards set out and make sure that in any case significant volumes can be managed properly.

Question 23 (dates, phase in):

What should be the elements (e.g. number of transactions, increase in risks, number of active counterparties, new jurisdiction involved) for ESMA to investigate, after consulting the NCAs responsible for CCPs authorisation, on the ability of the relevant CCPs to handle the expected volume and to manage the risk arising from the clearing of the relevant class of OTC derivatives?

Answer 23:

Relevant elements should be: The number of transactions, risk scenarios under the estimated maximum volume cleared, the number of counterparties, the assessment on financial stability of the CCP and the respective members. Jurisdictions should also be part of the elements due to the fact that insolvency laws are spread along the different jurisdictions and for participants are difficult to assess.

Question 24 (dates, phase in):

Should there be a default period of [x] months whenever there is a need for a CCP to upgrade its service considering incompressible internal/external validation processes? If not, how to evaluate the time to upgrade services based on the result of the criteria assessment?

Answer 24:

A default period based approach might be too narrow.

Comments on paragraphs 120 to 128:

We have no additional comments as regards paragraphs 120 to 128.

Question 25 (categories of counterparties):

Please indicate your preference between the options presented. Would you rather use an option that is not detailed here? Under Options B and C, do you agree to base the clearing access approach on the asset class to which the counterparties have access? What should be the date on which clearing access/threshold calculation should be assessed?

Answer 25:

From our view Option C is preferable; the clearing access approach should be based on the respective asset class.

Question 26 (categories of counterparties):

What would in your view be the appropriate timeframe for counterparties with / without access to clearing in the relevant asset class?

Answer 26:

A minimum time frame of 12-18 months should be appropriate as long as market standards are given to set up the clearing obligation.

Comments on paragraphs 129 to 130:

We have no additional comments as regards paragraphs 129 to 130.

Question 27 (categories of counterparties):

Do you agree that a key factor to take into account when defining the phase in for the counterparties to comply with the clearing obligation will be the number of clearing members offering client clearing services? Is the client clearing capacity of the CCP also a relevant factor? What could be the other criteria?

Answer 27:

This is a valid key factor and should be taken into account particularly for CCPs which try to get in competition and implement offerings with respect to existing CCPs. Indeed client clearing is a limiting factor due to operational constraint, i.e. management of collateral of a huge number of segregated accounts under a fully physical segregation model which is one of the most used from our perspective.

## 4.2. Minimum remaining maturity of the OTC derivative contracts referred to in EMIR Article 4(1)(b)(ii)

Comments on paragraphs 131 to 135:

We have no additional comments as regards paragraphs 131 to 135.

Question 28 (remaining maturity):

What are your views regarding the calibration of the remaining maturity of the contracts to be subject to the CO? What criteria should ESMA take into account when defining it?

Answer 28:

We do not fully agree with ESMA´s view. The remaining maturity should be longer from our point of view. Frontloading should not apply due to the fact that these contracts will fall under the risk mitigation requirements currently assessed by BCBS-IOSCO (margin requirements for uncleared OTCs) anyway.

# 5. The clearing obligation in specific cases

## 5.1. Contracts concluded with Covered Bond issuers

Comments on paragraph 136 to 138:

We have no additional comments as regards paragraphs 136 to 138.

Question 29 (covered bonds):

Are there other specific features of the contracts concluded with covered bond issuers or with cover pools for covered bonds, to be considered by ESMA in the context of the clearing obligation?

Answer 29

Almost all European covered bond legal frameworks allow derivatives in the cover pool with the purpose of hedging risks, essentially interest rate risks or currency mismatches that may arise from the usual activity of an issuer, and from fluctuation of interest and foreign exchange rates. These derivatives, which are mainly plain vanilla Cross Currency and Interest Rate swaps, are also designed to survive the issuer’s insolvency. In such a case, the source of payment will switch to the cover pool and the covered bond holders will need the hedging effect of the derivatives to continue to mitigate the risks of the cover pool. Hence, common master agreements are adapted or supplemented in order to ensure that the insolvency of the issuer does not qualify the counterparty to terminate the derivative contract.

Covered bond legislative frameworks in Europe provide for a particular risk mitigation technique. In some jurisdictions collateral posting is unilateral, i.e. the issuer never posts collateral for derivative whereas the counterparty (which benefits from a preferential claim over the cover assets) does when required.

Question 30 (covered bonds):

What would be the legal or technical challenge faced by covered bonds issuers and CCPs, if a clearing obligation was imposed on some of the OTC derivative contracts included in the cover pools of covered bonds?

Answer 30

It might be doubtful, whether cover derivatives could be cleared through CCPs. Our understanding is that, at present, CCPs are unable to differentiate between the derivative contracts of the insolvent issuing bank and those of the covered bond cover pool. Hence, either derivatives within the cover pool would be automatically terminated in the event of default of the covered bond issuer (making them more or less useless from a covered bond investor perspective) or derivatives in the cover pool of a covered bond would be ineligible to be cleared through a CCP (due to the fact that the derivative is designed to survive the insolvency of the issuing institution, whereas the standardised documentation requires that all derivatives be netted out at the time of the issuer’s insolvency).

As described above, collateral posting for cover pool derivatives is often unilateral. Unfortunately, this technique does not fit central clearing systems which require bilateral exchange of collateral and, therefore, impedes these privileged derivatives used for covered bond hedging purposes from being cleared through CCPs.

Question 31 (covered bonds):

Have CCPs developed solutions to be able to differentiate the derivative contracts of the issuer from those of the cover pool?

Answer 31

Our understanding is that, at present, CCPs are unable to differentiate between the derivative contracts of the insolvent issuing bank and those of the covered bond cover pool. Posting collateral by the issuer would increase the costs for the issuer (and would be reflected in the interest charge for public sector and mortgage borrowers) and would also result in a double protection of the counterparty as it still has access to the pool.

Question 32 (covered bonds):

Would an appropriate phase-in for these counterparties alleviate these challenges? If so, how?

Answer 32

From our point of view a phase-in period would not change abovementioned fundamental problems.

## 5.2. Foreign exchange OTC derivatives

Comments on paragraphs 139 to 140:

We have no additional comments as regards paragraphs 139 to 140.

Question 33 (FX derivatives):

Within the foreign exchange asset class, for which type of contracts do you consider that settlement risk is the predominant risk, and what criteria or characteristics should be used by ESMA to identify those contracts?

Answer 33:

-/-

## 5.3. Interaction of portfolio compression and the clearing obligation

Comments on paragraph 141:

We have no additional comments as regards paragraphs 141.

Question 34 (Portfolio compression):

Are there ways in which the imposition of the clearing obligation in the EU could hamper the effectiveness of compression services? If so, please provide evidence of the potential impact. Are there ways in which exclusions to the clearing obligation could be defined which alleviate the problem without creating opportunities for avoidance?

Answer 34:

-/-

## 5.4. How to withdraw a clearing obligation on a class or subset of it?

Comments on paragraphs 142 to 148:

We have no additional comments as regards paragraphs 142 to 148.

Question 35 (Modification of a Class+):

For which reason (other than the fact that a CCP does not clear it any longer) do you believe that the clearing obligation of a class - or subset of it - would need to be removed? Please focus on the risks which could stem from a clearing obligation on contracts which would no longer be appropriate for mandatory clearing and provide concrete examples.

Answer 35:

-/-

Question 36 (Modification of a Class+):

In case a clearing obligation would need to be reviewed, how crucial would be the time needed to dis-apply the clearing obligation?

Answer 36:

-/-