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| 11 July 2014|2014/800 Reply Form |

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| Reply form to the Consultation Paper on the Clearing Obligation under EMIR (no. 2) |
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| Date: 11 July 20142014/800 Reply Form |

Responding to this paper

The European Securities and Markets Authority (ESMA) invites responses to the questions listed in the Consultation Paper on the Clearing Obligation under EMIR (n0. 2), published on ESMA’s website.

Comments are most helpful if they:

* respond to the question stated;
* contain a clear rationale; and
* describe any alternatives ESMA should consider.

To help you navigate this document more easily, bookmarks are available in “Navigation Pane” for Word 2010 and in “Document Map” for Word 2007.

ESMA will consider all comments received by **18 September 2014.**

All contributions should be submitted online at [www.esma.europa.eu](http://www.esma.europa.eu) under the heading ‘Your input - Consultations’.

How to use this form to reply

Please note that, in order to facilitate the analysis of the responses, ESMA will be using an IT tool that does not allow processing of responses which do not follow the formatting indications described below.

Therefore, in responding you are kindly invited to proceed as follows:

* use this form to reply and send your response in Word format;
* type your response in the frame “TYPE YOUR TEXT HERE” and do not remove the tags of type <ESMA\_QUESTION\_1> Your response should be framed by the 2 tags corresponding to the question; and
* if you have no response to a question, do not delete the tags and leave the text “TYPE YOUR TEXT HERE” between the tags.

Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publically disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESMA’s rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESMA’s Board of Appeal and the European Ombudsman.

Data protection

Information on data protection can be found at [www.esma.europa.eu](http://www.esma.europa.eu) under the heading ‘Legal Notice’.

Who should read this paper

All interested stakeholders are invited to respond to this consultation paper. In particular, responses are sought from financial and non-financial counterparties of OTC derivatives transactions which will be subject to the clearing obligation, as well as central counterparties (CCPs).

# General information about respondent

|  |  |
| --- | --- |
| Name of respondent | European Banking Federation |
| Are you representing an association? | Yes |
| Activity | Banking sector |
| Country/Region | Europe |

# Introduction

**Please make your introductory comments below:**

<ESMA\_COMMENT\_1>

TYPE YOUR TEXT HERE

<ESMA\_COMMENT\_1>

# The clearing obligation procedure

Question 1: Do you have any comment on the clearing obligation procedure described in Section 1?

<ESMA\_QUESTION\_1>

We are pleased to see that ESMA has decided to group derivatives in to five asset classes and consult based on this categorisation. Indeed, this will help market participants to assess the effects of any clearing obligations on a more systemic and comprehensive basis.

It is not clear from the description of the clearing obligation procedure how ESMA intends to present draft regulatory technical standards for different asset classes. Accordingly, we call on ESMA to clarify whether there will be one RTS on the clearing obligation, which will be modified each time ESMA determines that a new class of derivatives should be subject to the clearing obligation, or whether separate, standalone, RTS will be proposed. We would specifically welcome the attempt to capture all classes notified by (authorised and future authorised) CCPs belonging to the same type of asset class in a single consultation – and consequently, also one single regulatory technical standard (RTS) on the clearing obligation for such asset class. As set out under item 12 et seq., it would be clearly desirable to avoid that several RTS would have to drafted and consulted and – even more importantly, that several RTS with a similar material scope were to be adopted successively. The operational implementation of the clearing obligation would become even more complex and challenging, if clearing obligations in respect of certain products belonging to the same asset class were to become effective at different times over a period of time with varying or overlapping phase-in periods or dates of application of the frontloading requirement.

Regarding any potential changes, whereby products not currently subject to clearing obligations in the future might be re-assessed and assigned a clearing obligation, it is essential that this is communicated in due time ahead of any change.

<ESMA\_QUESTION\_1>

# Structure of the credit derivatives classes

Question 2: Do you consider that the proposed structure for the untranched index CDS classes enables counterparties to identify which contracts are subject to the clearing obligation as well as allows international convergence? Please explain.

<ESMA\_QUESTION\_2>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_2>

# Determination of the classes of OTC derivatives to be subject to the clearing obligation

Question 3: In view of the criteria set in Article 5(4) of EMIR, do you consider that this set of classes addresses appropriately the systemic risk associated to credit OTC derivatives?

Given the systemic risk associated to single name CDS, would you argue that they should be a priority for the first determination as well? Please include relevant data or information where applicable.

<ESMA\_QUESTION\_3>

We agree that the prioritised products appropriately address systemic risk.

Furthermore, some small to medium sized general clearing members are considering their role as general clearing members. There are several reasons for this: the introduction of clearing obligations where one might need to establish clearing relationships to new CCPs, segregation requirements and new account structures, possible new organisational requirements under the MiFID II regime, capital requests and amendments to CCP rules following their EMIR authorisation and general consolidation trends as examples. Therefore ESMA should in its analysis of a future scenario also take into account the possibility of a lower number of general clearing members than today.

<ESMA\_QUESTION\_3>

# Determination of the dates on which the obligation applies and the categories of counterparties

## Analysis of the criteria relevant for the determination of the dates

Question 4: Do you have any comment on the analysis presented in Section 4.1?

<ESMA\_QUESTION\_4>

Whilst we note ESMA's analysis in paragraph 89 of the consultation paper that ESMA has no legal basis on which to refuse to launch a clearing obligation procedure solely on the ground that a class of derivatives is cleared by a single CCP, we believe that ESMA is entitled to take this into account in its determination of whether a class of derivatives should be subject to the clearing obligation.

We agree that the number of clearing members clearing a class of derivatives should be regarded as a vital part of ESMA's assessment of whether a clearing obligation should be imposed on that class. We would stress, however, that the number of clearing members for a class should be monitored on an ongoing basis to ensure that the continued imposition of the clearing obligation remains appropriate.

<ESMA\_QUESTION\_4>

## Determination of the categories of counterparties (Criteria (d) to (f))

Question 5: Do you agree with the proposal to keep the same definition of the categories of counterparties for the credit and the interest rate asset classes? Please explain why and possible alternatives.

<ESMA\_QUESTION\_5>

As mentioned in EBF’s response to the ESMA discussion paper on clearing obligation (Ref: EBF\_003888E), we understand that there is a need to differentiate between FCs as this concept is too broad and the entities it covers are very diverse. FCs should be further subdivided according to some objective criteria. However, EBF cannot express a preference for any of the options presented.

In order to avoid unreasonable and counterproductive results, the clearing obligation for category 1 institutions would, however, need to be expressly limited to the CCP and the types of transactions the relevant category 1 counterparty is member of. That is, a category 1 counterparty being member of CCP A in respect of IRS only, does not become subject to the clearing obligation for category 1 institutions in respect of (i) CDS transactions cleared by CCP a or CCP B or (ii) IRS transactions cleared by CCP B. They would thus only fall under the clearing obligation in respect of any transactions not cleared by the CCP they are actually a members of jointly with all other category 2 institutions.

A longer phase-in period is required for CDS as opposed to IRS. Indeed, there is substantial number of clearing members in IRS class which are not at the same time clearing members in credit class. They would have difficulties to establish clearing connectivity by June 2015.

As pointed out in the consultation paper, significantly fewer clearing members offer clearing services for credit derivatives than for IRSs. Although the market size for credit derivatives is smaller, we believe that the number of CDS clearing members is not sufficient to allow timely and orderly implementation of the clearing mandate by the Category 1 counterparties not being direct clearing members in CDS themselves and not having in place the CDS client clearing arrangements yet. Indeed, there is a large number of such small CDS traders who would currently fall under the Category 1 counterparties solely due to their direct clearing membership on IRS side. It would be impossible for these small CDS traders to become clearing members directly. Indeed, the number of banks which can become a member of any CDS CCP is very much limited to the very large banks, since the risk requirements, as well as the requirements during any default management process are much higher and restrictive than for the clearing of IRS. At the same time, such market participants may face difficulties in finding a clearing member who would accept clearing small volumes of CDS on their behalf. Indeed, the existing clearing members do not have obligation to accept clearing on their behalf and may turn their request down. Even if they are able to find clearing members, it seems difficult if not impossible to put in place the client clearing arrangements by June 2015. The on-boarding process is highly complex and time consuming. Massive demand for CDS client clearing within such a short period of time is likely to result in bottleneck situation which ESMA precisely tries to avoid through the phase-in provisions.

<ESMA\_QUESTION\_5>

## Determination of the dates from which the clearing obligation takes effect

Question 6: Do you consider that the proposed dates of application ensure a smooth implementation of the clearing obligation? Please explain why and possible alternatives.

<ESMA\_QUESTION\_6>

EBF agrees with ESMAs proposed dates for application. As mentioned in EBFs response to the ESMA discussion paper on clearing obligation (Ref: EBF\_003888E), phase in-periods between at least 6 months for counterparties with an access and at least 12 months for those without an access seem to be a minimum time period. The 12 month phase-in period is required in order to grant the relevant counterparties the necessary time for the establishment of the operational and legal framework for clearing, sufficient time for testing and analysis of technical compatibility, etc.

Without challenging the length of the proposed phase-in periods, we would like to stress that it would be operationally and legally difficult if not impossible for clearing members in IRS only to establish connectivity on the CDS side by June 2016. We therefore highlight the importance of disconnecting the Category 1 in CDS form Category 1 on IRS side as described above.

<ESMA\_QUESTION\_6>

# Remaining maturity and frontloading

Question 7: Do you consider that the proposed approach on frontloading ensures that the uncertainty related to this requirement is sufficiently mitigated, while allowing a meaningful set of contracts to be captured? Please explain why and possible alternatives compatible with EMIR.

<ESMA\_QUESTION\_7>

We welcome the clarification that contracts concluded with non-financial counterparties are not subject to frontloading obligation. We also greatly appreciate the decision to only apply frontloading to a limited number of contracts within Period B (between the publication in the Official Journal of the RTS and the date on which the clearing obligation takes effect (the date of application)).

The frontloading requirement will be not be less challenging for counterparties belonging to Category 2 than to those of Category 3. This is especially true if one takes into account the dimensions related to non-financial entities being within the scope of the clearing obligation. Most non-financials that had to start calculations regarding the clearing threshold in order to prove they were out of scope are larger companies with large derivative portfolios than many of the financial counterparties falling into Category 2 which would be subject to frontloading requirements regardless of their portfolio size. These challenges are similar to the once described in section 224, including the economic effect of switching collateral already posted relative to the maturity of the contract and also the difference on initial margin and variation margin posted under a bilateral set-up vs. a central clearing set-up. It will require significant legal and operational measures to meet the requirements for frontloading. For Category 2 counterparties it will be expected that OTC derivatives concluded during the “frontloading period” and subject to the clearing obligation will only be traded under conditions which largely reflect the central clearing set-up. For Category 2 counterparties that have not established access to relevant CCPs through a clearing broker this will mean illiquid markets and the risk of considerable friction.

We recommend, as a matter of legal certainty, that Period A should be set as the period between the notification of a class of derivatives to ESMA and the date of entry into force of the RTS introducing the clearing obligation for that class of derivatives. It should not, as the current drafting of the RTS mandates, end on the date the RTS is published in the Official Journal. This recommendation is in line with ESMA's proposal on frontloading to the European Commission in its letter dated 08 May 2014. It also reflects the Commission’s answer dated 08 July.

It is suggested that the frontloading requirement for Period B is also eliminated through further regulation of the remaining maturity period. The attempt to reduce the systemic effects through the frontloading requirement is addressed in the upcoming leverage ratio regulation. Absence of the frontloading requirement will therefore not lead to an increase in not-cleared OTC derivatives contract in the period leading up to the entry into force of the clearing requirement.

Members have expressed concern that the proposed approach might generate confusion when pricing CDS with Category 2 counterparties during Period B. The majority of these trades have a maturity profile of 3 to 5 years, and would therefore fall under the clearing obligation. Assuming a Category 2 counterparty enters into a CDS during Period B with a remaining maturity of greater than 12 month, then those CDS are at the time of execution bilaterally under an ISDA agreement or other standard master agreement which needs to be back-loaded once the clearing obligation starts. At this point in time the CDS would change under the relevant bilateral Master agreement to a clearing agreement which will change the valuation of the CDS and therefore makes it difficult to find a correct price at time of execution. This might lead to reduced liquidity.

In order to avoid the uncertainty arising from the frontloading requirement, Category 2 counterparties should be explicitly excluded from the frontloading requirement during the 18 month phase-in period. The minimum remaining maturity of contracts entered into during the phase-in period would then reflect the approach taken for Period A. A sufficient phase-in period would be required for Category 2 counterparties to establish clearing arrangements.

Ultimately, there is also some concern that the proposed provision in Art. 4(1) may result in uncertainties or misunderstandings and should therefore be clarified. We understand that this provision is meant to ensure that transactions with non-financial counterparties are not subject to any obligation to “frontload” transactions which have been entered into before the date of application of the clearing obligation for this class of counterparties, that is effectively exempt these transactions from frontloading in general. We fully agree that such exemption is merited. However, it should be considered to set this out more clearly to avoid uncertainties.

Likewise, in view of the fact that the understanding of maturity is of fundamental importance in this context, it could be considered to define the term or at least clarify that maturity is intended to capture any situation where the obligations under a transaction have been fully performed or the term of which has been completed or which have ended in any other manner.

<ESMA\_QUESTION\_7>

# Annex - Commission mandate to develop technical standards

# Annex - Draft Regulatory Technical Standards on the Clearing Obligation

Question 8: Please indicate your comments on the draft RTS other than those already made in the previous questions.

<ESMA\_QUESTION\_8>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_8>

# Annex - Impact assessment

Question 9: Please indicate your comments on the Impact Assessment.

<ESMA\_QUESTION\_9>

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<ESMA\_QUESTION\_9>