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| 1 October 2014|ESMA/2014/1185 Reply Form |

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| Reply form for the Consultation Paper  On the Clearing Obligation under EMIR (no. 3) |

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| Date: 1 October 2014  ESMA/2014/1185 Reply Form |

Responding to this paper

The European Securities and Markets Authority (ESMA) invites responses to the specific questions listed in the ESMA Consultation Paper - Clearing Obligation under EMIR (no. 3), published on the ESMA website.

Responses are most helpful:

1. if they respond to the question stated;
2. contain a clear rationale, including on any related costs and benefits; and
3. describe any alternatives that 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.

Responses must reach us by **6 November 2014**.

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

Instructions

Please note that, in order to facilitate the analysis of the responses, you are requested to use this file to send your response to ESMA so as to allow us to process it properly. Therefore, please follow the instructions described below:

1. use this form and send your responses in Word format;
2. do not remove the tags of type < ESMA\_CA3\_QUESTION\_1> - i.e. the response to one question has to be framed by the 2 tags corresponding to the question; and
3. if you do not have a response to a question, do not delete it and leave the text “TYPE YOUR TEXT HERE” between the tags.

Publication of responses

All contributions received will be published following the end of the consultation period, unless otherwise requested. **Please clearly indicate by ticking the appropriate checkbox in the website submission form if you do not wish your contribution to be publicly disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure.** Note also that 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 is reviewable by ESMA’s Board of Appeal and the European Ombudsman.

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# General information about respondent

|  |  |
| --- | --- |
| Are you representing an association? | Yes |
| Activity: | Banking sector |
| Country/Region | Germany |

# Introduction

**Please make your introductory comments below:**

<ESMA\_CO3\_COMMENT\_1>

The German Banking Industry Committee (GBIC, Deutsche Kreditwirtschaft), which represents more than 2,000 banks in Germany, welcomes the opportunity to comment on the Consultation Paper on the clearing obligation under EMIR (No. 3) regarding the draft regulatory technical standards concerning non-deliverable forwards (NDF).

The central objective of the future regulatory technical standards (RTS) defining the precise scope of the clearing obligation thus has to be the development of clear, unambiguous rules circumscribing the types of transactions and counterparties covered by the obligation and the precise point in time where the obligations become effective for a counterparty.

As already stated in our comments to the previous consultations, we largely concur with ESMA’s approach. However, we would like to point out our main concerns regarding the clearing of NDFs and the general issues of a “de-listing” process, as well as the qualification of counterparties.

* NDFs should not be subject to the clearing obligation at all

Given the low liquidity of the European NDF market, in particular with respect to contracts settled in USD, we do not think that such products should be subject to the clearing obligation. This argument is further supported by the fact that only one CCP has been authorised to clear such products and that only 2 of its 20 clearing members offer clearing services to clients.

* Process for quick “de-listing” of products subject to clearing obligation.

We note that ESMA considers itself to be bound by the Level I regulation and not to have any power and/or possibilities to “de-list” a class of derivatives from the clearing obligation if the latter seems no longer appropriate (e.g. due to a drop in liquidity). We nevertheless would like to point out that it is of paramount importance to establish workable and efficient processes for suspending the clearing obligation if such obligation is no longer appropriate – and this must be possible already before this issue can be addressed in the EMIR review. This is especially true for NDFs which do not constitute a comparable liquid market as IRS. Given the low liquidity of NDFs settled in USD in Europe, we would like to ask ESMA not to set up any clearing obligation for such products, at least as long as there is no process in place which allows for immediate de-listing.

* Qualification of counterparties as categories 1, 2, 3 and 4

We understand that ESMA wants to qualify the categories of counterparties on the basis of their sophistication and experience in clearing assessed at a global level rather than at the level of each asset class. We do, however, think that this is neither an appropriate nor a realistic approach: In particular with respect to the clearing obligation as regards NDF it is not possible to conclude that the clearing membership with one CCP offering clearing for a different class of derivatives (such as interest rate derivatives) is an adequate indication of the required sophistication for the clearing of NDF (see also our comments to Question 6).

We also once again would like to point out that the approach of classifying all clearing members of a CCP as category 1 for all types of derivatives even where this would mean that the relevant counterparty would be subject to the clearing obligation in respect of a class of derivatives which it is not able to clear via its CCP is a very strong disincentive to set up a clearing membership any earlier than absolutely necessary.

<ESMA\_CO3\_COMMENT\_1>

## The clearing obligation procedure

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

<ESMA\_CO3\_QUESTION\_1>

TYPE YOUR TEXT HERE

<ESMA\_CO3\_QUESTION\_1>

## Structure of the non-deliverable forward derivatives classes

##### Do you consider that the proposed structure for the FX NDF classes enables counterparties to identify which contracts are subject to the clearing obligation?

<ESMA\_CO3\_QUESTION\_2>

The German Banking Industry Committee (GBIC, Deutsche Kreditwirtschaft), which represents more than 2,000 banks in Germany, welcomes the reliance on the “bottom-up” approach which is key to ensure that only products which are actually cleared by authorised or recognised CCPs are being subjected to the clearing obligation. This is particularly relevant considering that the product specifications applied by CCPs which determine the type of transactions which are ultimately clearable by the CCP are more detailed and cover more features than the characteristics to be used in Annex I to the RTS. However, ESMA should consider that only transactions which fully conform to these specifications applied by the CCPs are accepted for clearing by CCPs. Transactions which contain features not covered by these specifications of a CCP cannot be cleared in this form. ESMA should therefore ensure that the product specification in the RTS is not broader than the product specification applied by the CCPs. Otherwise, some products will be subject to the clearing obligation, even though they cannot be cleared by a CCP. The consequence would be a *de facto* ban on trading such products. In this context, it is also important that the RTS should not refer to the point in time when a CCP is authorised, but to the point in time the contract is entered into. Otherwise, if a CCP is authorised to clear certain products and later decides not to clear such product any longer, the clearing obligation would still apply. In particular, Art. 5(6) of EMIR would not apply in such scenario, because Art. 5(6) only applies “If a class of OTC derivative contracts no longer has a CCP which is authorised or recognised to clear those contracts”. Therefore, we propose that the clearing obligation should only be imposed with respect to derivatives which can actually be cleared at the time the transaction is entered into. With respect to frontloading, the relevant point in time should be the time when the derivative would have to be cleared, i.e. if a derivative cannot be cleared at the end of the frontloading period, it cannot be subject to the clearing obligation.

<ESMA\_CO3\_QUESTION\_2>

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

##### In view of the criteria set in Article 5(4) of EMIR, do you consider that the determination of this class addresses appropriately the objective of reduction of the systemic risk associated to NDF derivatives?

<ESMA\_CO3\_QUESTION\_3>

We, the German Banking Industry Committee (GBIC, Deutsche Kreditwirtschaft), which represents more than 2,000 banks in Germany, do not think that it is appropriate to subject NDFs to the clearing obligation in order to reduce systemic risk associated with them. In this context, we do not think that the data presented by ESMA on the trading volume and liquidity of the suggested NDF provides a convincing basis for the introduction of a clearing obligation. Such data is taken from sources such as DTCC and BIS, which refer to the global market as a whole. Such sources do therefore not reflect the differences between the European market on the one side and the American and Asian markets on the other side. Even the data presented by ESMA in tables 5, 6 and 7 regarding the volumes and currencies of NDFs cleared by LCH does not adequately reflect to what extent European counterparties enter into NDFs settled in USD, because such data refers to all trades cleared by LCH, irrespective of whether the NDFs were entered into by European or by non-European counterparties. We are not aware of any statistical data on the volume of USD settled NDFs entered into by European counterparties. However, we think that among European counterparties the percentage of NDFs settled in EUR is much higher (and the percentage of NDFs settled in USD is therefore much lower) than the data presented by ESMA suggests. Therefore, the trading volume and liquidity of NDFs settled in USD and with currency pairs being mainly Asian or south American currencies as the first leg and the USD as the second leg, is lower than the data presented by ESMA suggests. And even based on this rather not representative data, ESMA has found out in its survey that NDFs only account for a very small share of the OTC FX derivatives market, which itself only accounts for 9.9% of the total OTC market (Table 3 of the consultation paper). Given the fact that NDFs represent only a very small volume of the OTC derivatives market, we are of the view that NDFs should not be subject to the clearing obligation at all.

Again, as already set out in our response to the first and the second consultation paper on the clearing obligation, we share ESMA’s concerns over the fact that the definition of the classes of derivatives subject to the clearing obligation by way of a RTS severely limits the possibility to implement any necessary subsequent adjustments, such as excluding a class of products which has become ineligible for clearing (de-listing of no longer clearable products), in a sufficiently timely manner. These concerns are particularly relevant in connection with NDFs because as a consequence of a change in the legal environment, in particular the removal of constraints on convertibility, the liquidity in a sub-class of NDFs may drop. Due to the low volumes and said changes establishing a clearing obligation could lead to unintended consequences. Market participants might decide to avoid the costs for implementation by resigning the hedge of existing risks. Certain NDF subject to a clearing obligation might not be relevant any more at the time on-boarding to CCP-clearing is completed. We thus support ESMA’s proposal that the revised EMIR should explicitly authorise ESMA to suspend the clearing obligation with respect to classes or sub-classes of derivatives for which a clearing obligation is no longer appropriate.

However, in the meantime, until such changes become implemented, it will be necessary that ESMA develops pragmatic and workable solutions for this problem by issuing clear guidance and recommendations. In addition to the solutions mentioned in item 66 of the first Consultation Paper – which would require ESMA to issue respective guidance to the CCPs or the competent authorities – this could also be addressed through a right to temporarily suspend the clearing obligation or at least a suspension of the enforcement of the clearing obligation in a situation where counterparties subject to the clearing obligation intend to enter into transactions in the timespan between the point in time where it has become apparent that a listed product is no longer clearable and the point in time of its “de-listing”. It is of paramount importance that ESMA takes a clear position on how to deal with this issue and that whatever approach ESMA chooses to follow, this decision should be made in a way market participants can rely on with legal certainty.

The introduction of a clearing obligation for an already rather illiquid class of derivatives should not be considered unless a clear process exists which permits an immediate de-listing of products where liquidity decreases further.

<ESMA\_CO3\_QUESTION\_3>

##### For the currency pairs proposed for the clearing obligation on the NDF class, do you consider there are risks to include longer maturities, up to the 2 year tenor?

<ESMA\_CO3\_QUESTION\_4>

TYPE YOUR TEXT HERE

<ESMA\_CO3\_QUESTION\_4>

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

##### Do you have any comment on the analysis presented in Section 4.1?

<ESMA\_CO3\_QUESTION\_5>

As already pointed out in the introductory remarks, the German Banking Industry Committee (GBIC, Deutsche Kreditwirtschaft), which represents more than 2,000 banks in Germany, strongly believes that a clearing obligation should not be considered unless more than one authorised/recognised CCP is able to provide clearing services. This not merely an issue of preventing monopolies (see our remarks on Question 6).

We strongly disagree with the conclusion reached by ESMA in paragraph 102 that “the number of clearing members seems sufficient to support the clearing obligation of the NDF classes proposed in the current determination”. In our view, it is not the number of clearing members, but the number of clearing members offering clearing services to clients which is critical. According to our information, only 2 out of the 20 clearing members of LCH offer any clearing services to clients. The fact that there is only one CCP clearing the NDFs classes proposed by ESMA, together with the fact that only two of its clearing members currently offer clearing services to clients, clearly creates quasi-monopoly and bottleneck issues. One might argue that the introduction of a clearing obligation may create incentives for further clearing members to offer such services. However, it is uncertain whether and how many further clearing members will offer such services. Even if more than two clearing members will offer clearing services, it is still likely that a considerable number of smaller financial institutions, which trade NDFs only on a small scale, will not be offered access to such services. In the quasi-monopoly and bottle-neck situation which would be created if ESMA’s proposals were implemented, a small number of clearing members are likely to focus their offering of clearing services to larger institutions which create a higher revenue.

In addition, the reference to three further CCPs in the US, Singapore and Hong Kong which clear some of the NDFs classes proposed by ESMA is not suitable to mitigate the quasi-monopoly and bottleneck issues which would arise. Firstly, it is uncertain whether such CCPs will be recognised by ESMA. Secondly, as shown in Table 11 of the consultation paper, not all of these CCPs clear all the NDF classes proposed by ESMA. Thirdly, it is uncertain whether (and how many) clearing members of these CCPs will offer clearing services. Fourthly, and most importantly, ESMA seems to grossly underestimate the legal, financial and operational burdens which European counterparties face when applying for membership with a non-European CCP or when negotiating clearing agreements with clearing members of such non-European CCPs. Even if European counterparties were finally successful in becoming clearing members or entering into such clearing agreements, this process would take a significant amount of time. Given that under ESMA’s proposal, entities falling into category 1 for any other asset class subject to the clearing condition would also fall into category 1 with respect to NDF clearing, such entities would only have six months to become clearing members with a non-European CCP or enter into clearing agreements with clearing members of such CCPs. This timeframe is clearly insufficient and would subject the affected entities to severe legal and operational risks and/or prevent them from entering into transactions which are required to hedge their risk positions.

We therefore strongly believe that ESMA should refrain from imposing a clearing obligation as long as there is only one authorised CCP and a very small number of clearing members offering clearing services.

<ESMA\_CO3\_QUESTION\_5>

##### Do you agree with the proposal to keep the same definition of the categories of counterparties for the NDF classes than for the credit and the interest rate classes? Please explain why and possible alternatives.

<ESMA\_CO3\_QUESTION\_6>

The German Banking Industry Committee (GBIC, Deutsche Kreditwirtschaft), which represents more than 2,000 banks in Germany, understands that ESMA is of the view that counterparties falling into category 1 for either of the classes of derivatives being subject to the clearing obligation, qualify as category 1 for all of the classes of derivatives subject to the clearing obligation. Consequently, transactions between counterparties which are both clearing members would become subject to the clearing obligation in the first phase. This would apply even if the counterparties in question are

* members of different CCPs (which may even be located outside the EU) clearing the same asset class (e.g. one being a member of CCP1 clearing IRS and one being a member of CCP2 clearing IRS),
* members of different CCPs which clear entirely different asset classes (e.g. one being a member of CCP clearing CDS the other being a member of a CCP clearing IRS), but also
* members of the same CCP but with respect to different asset classes (e.g. one being a clearing member of the CCP with respect to IRS, the other being a member of the same CCP but only with respect to CDS).

The same applies for category 2 counterparties which have access to client clearing at different CCPs and / or with regard to different asset classes.

ESMA argues that it is appropriate to assess the level of sophistication of a counterparty at the global level rather than at product level. We, however, strongly object to this view: The fact that a counterparty is a member of one CCP clearing a certain type of product cannot be seen as an indication of this counterparty being able to clear other products earlier than any other counterparty falling in the other categories. In fact many smaller and medium sized financial institutions have become clearing members for only one asset class. Under ESMA’s proposal, such institutions would be required to become clearing members or establish client clearing relationships with respect to all the other asset classes, even if they enter into transactions in such other asset classes on a small scale only. This will impose disproportional and unreasonable financial and operational burdens on them. Moreover, this approach works as a very strong incentive to delay a membership in a CCP as long as possible.

In addition, in particular with regard to NDFs – where clearing is currently only offered by one single CCP, access to the relevant CCP clearing NDF will be very limited.

In order to avoid unreasonable and counterproductive results, the clearing obligation for category 1 institutions should therefore have to be limited to the CCP and the types of transactions the relevant category 1 counterparty is member of, i.e. a counterparty should only fall into category 1 with respect to the specific asset classes and the specific authorized or recognized CCP where it is a clearing member.

Should ESMA uphold its “cross-asset” approach to the categorization of category 1 counterparties, it should at least consider to split category 1 into two sub-classes. The first sub-class could comprise the largest and globally active financial institutions among the clearing members and the second sub-class would comprise the other clearing members. A criteria to determine which institutions fall into each sub-category could be whether the relevant institution is qualified by the Financial Stability Board as a globally systemically important institution (SIFI). Such institutions are actually acting on a global or at least multi-jurisdictionally level and can be expected to seek access to CCPs in different countries, including non-EU countries. Moreover, due to their status as globally systemically important institutions, they are most relevant from a risk perspective.

Regarding the threshold test which ESMA proposes to distinguish between new category 2 and new category 3 entities, we would like to ask ESMA to provide clear guidance on how the threshold is to be calculated. For example, ESMA should provide guidance on how derivatives with a conditional notional amount are to be counted towards the threshold and whether intra-group transactions count towards the threshold.

We would also like to ask ESMA to provide clear guidance on how market participants should determine the category of their counterparties. In particular, it is important for market participants to be able to rely on representations given by their counterparties regarding such counterparty’s category. Due to the importance of this matter, we would like to ask ESMA to clarify this in the recitals of the RTS.

<ESMA\_CO3\_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\_CO3\_QUESTION\_7>

We mainly see problems with the suggested dates for those counterparties, which do not have a clearing connection to LCH.Clearnet yet and fall nevertheless under Category 1 and 2.

<ESMA\_CO3\_QUESTION\_7>

## Remaining maturity and frontloading

##### Do you have comments on the minimum remaining maturities for NDF?

<ESMA\_CO3\_QUESTION\_8>

In the view of the German Banking Industry Committee (GBIC, Deutsche Kreditwirtschaft), which represents more than 2,000 banks in Germany, the remaining maturity should refer to the date when the RTS enter into force, not to the date when they are published. The practical issue here is that the precise point in time when a contract will be cleared is important for the pricing of the relevant transactions. Since market participants do not know the precise day on which the RTS will be published there is a risk that they may enter into transactions not knowing that the RTS have been published in the meantime (for example, on the day of publication, but before the time the Official Journal is updated on the EU website). We therefore do not agree with ESMA’s view expressed in paragraph 139 of its Final Report on Draft technical standards on the Clearing Obligation – Interest Rate OTC Derivatives. ESMA should also consider that moving the relevant date from the date of application to the date of the entry into force would not give rise to any significant risk.

<ESMA\_CO3\_QUESTION\_8>

# Annex II - Draft Regulatory Technical Standards on the Clearing Obligation

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

<ESMA\_CO3\_QUESTION\_9>

TYPE YOUR TEXT HERE

<ESMA\_CO3\_QUESTION\_9>

# Annex III – Impact assessment

##### Please indicate your comments on the Impact Assessment.

<ESMA\_CO3\_QUESTION\_10>

TYPE YOUR TEXT HERE

<ESMA\_CO3\_QUESTION\_10>