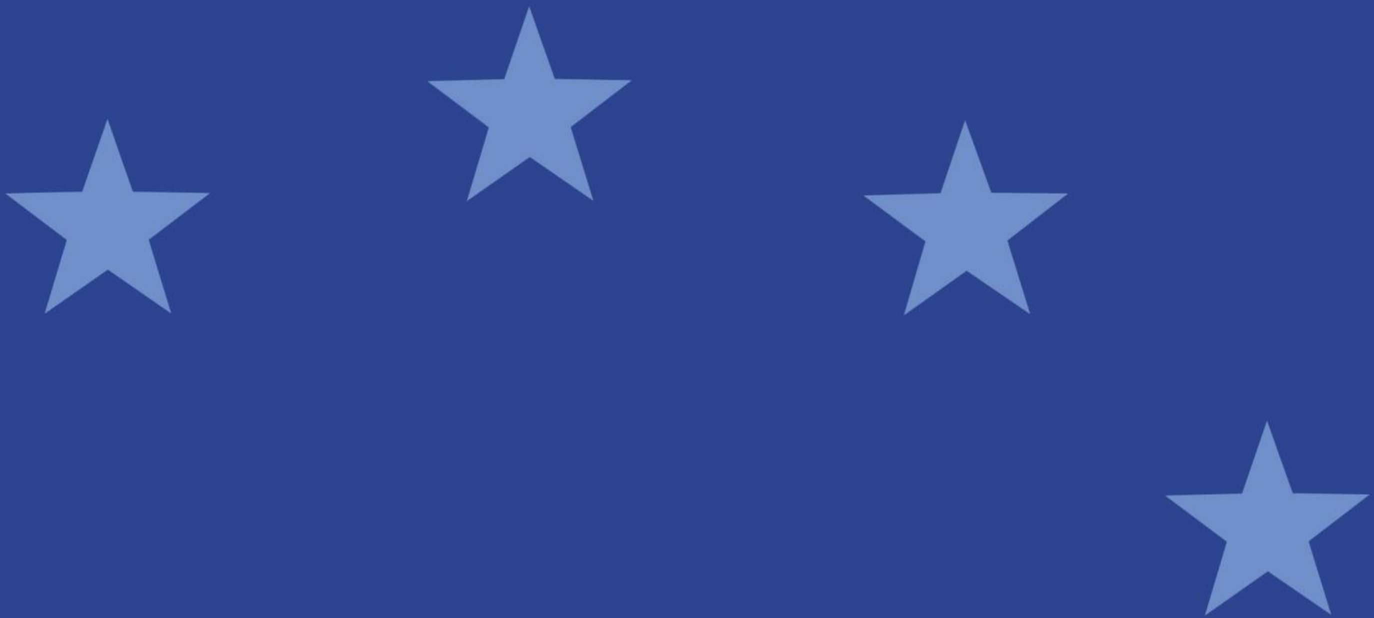
Final Report

Draft technical standards on the Clearing Obligation – Credit Derivatives



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1 Executive Summary

Reasons for publication

Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC Derivatives, CCPs and Trade Repositories (EMIR) requires ESMA to develop draft regulatory technical standards (RTS) in relation to the clearing obligation.

In this context ESMA consulted stakeholders with a discussion paper[1] and four consultation papers. The first consultation paper on the clearing obligation for OTC derivatives covered interest rate derivative denominated in EUR, GBP, JPY and USD[2] , the second one covered credit default swap (CDS)[3] , the third one covered foreign exchange non-deliverable forward[4] (NDF) and the fourth one covered interest rate derivative classes denominated in CZK, DKK, HUF, NOK, PLN and SEK[5].

The first RTS on the clearing obligation for certain classes of OTC interest rate derivatives denominated in EUR, GBP, JPY and USD were adopted by the European Commission on 06 August 2015[6].

This final report on the clearing obligation is covering certain classes of credit derivatives. It includes the final version of the draft RTS that are submitted to the European Commission for endorsement.

Contents

This final report incorporates the feedback received to the consultation on the CDS classes and explains the reasons for reflecting or not the stakeholders proposals to the draft RTS. It follows the same structure as the consultation paper.

Section 3 provides explanations on the procedural aspects of the clearing obligation. Section 4 provides clarifications on the structure of the classes of OTC credit derivatives that are proposed for the clearing obligation. Section 5 covers the determination of the classes of OTC credit derivatives that should be subject to mandatory clearing. Section 6 presents the approach for the definition of the categories of counterparties, and the proposals related to the dates from which the clearing obligation should apply per category of counterparty. Section 7 provides explanations on the approach considered for frontloading and the definition of the minimum remaining maturities of the contracts subject to it.

Next Steps

This final report is submitted to the European Commission for endorsement of the draft RTS presented in Annex III. From the date of submission the European Commission should take the decision whether to endorse the RTS within three months.

[1] 2013/ESMA/925 Discussion Paper on the Clearing Obligation published on 12 July 2013
[2] 2014/ESMA/799 Consultation Paper, Clearing Obligation under EMIR no.1 published on 11 July 2014
[3] 2014/ESMA/800 Consultation Paper, Clearing Obligation under EMIR no.2 published on 11 July 2014
[4] 2014/ESMA/1185 Consultation Paper, Clearing Obligation under EMIR no 3 published on 1 October 2014
[5] 2015/ESMA/807 Consultation Paper, Clearing Obligation under EMIR no.4 published on 11 May 2015
[6] The publication of the adoption of the first RTS on the Clearing Obligation is available at: http://ec.europa.eu/finance/index_en.htm

Acronyms used

AIF	Alternative Investment Fund
CCP	Central Counterparty
CDS	Credit Default Swap
DTCC	Depository Trust and Clearing Corporation
EEA	European Economic Area
EMIR	European Market Infrastructures Regulation (Regulation (EU) 648/2012)
ESMA	European Securities and Markets Authority
ESRB	European Systemic Risk Board
FX	Foreign Exchange
IRS	Interest Rate Swap
ISDA	International Swaps and Derivatives Association
LEI	Legal Entity Identifier
MiFID	Markets in Financial Instruments Directive (Directive 2004/39/EC)
NCA	National Competent Authority
NDF	Non-Deliverable Forward
OTC	Over-the-counter
RTS	Regulatory Technical Standards
RTS on OTC Derivatives	Commission Delegated Regulation (EU) No 149/2013
TR	Trade Repository
UCITS Directive	Undertakings for Collective Investment in Transferable Securities Directive (Directive 2009/65/EC)

2 Introduction

1. With the overarching objective of reducing systemic risk, the European Market Infrastructure Regulation ("EMIR") introduces the obligation to clear certain classes of OTC derivatives in Central Counterparties (CCPs) that have been authorised (for European CCPs) or recognised (for third-country CCPs) under the EMIR framework. Ensuring that the clearing obligation reduces systemic risk requires a process of identification of classes of derivatives that should be subject to mandatory clearing.

2. The clearing obligation procedure shall begin when a CCP clearing OTC derivatives is authorised under EMIR, or when ESMA has accomplished a procedure for recognition of a third-country CCP set out in EMIR Article 25. It has therefore started in Q1 2014 following the first CCPs authorisations. The list of CCPs that have been authorised to clear OTC derivatives, and the classes for which they are authorised, are available in the public register[7].

3. In accordance with Article 5 of EMIR, ESMA shall develop and submit to the European Commission for endorsement draft technical standards specifying:

   (a) the class of OTC derivatives that should be subject to the clearing obligation referred to in Article 4;

   (b) the date or dates from which the clearing obligation takes effect, including any phase in and the categories of counterparties to which the obligation applies; and

   (c) the minimum remaining maturity of the OTC derivative contracts referred to in Article 4(1)(b)(ii).

4. The present final report follows the publication on 11 July 2014 of a consultation paper on the clearing obligation proposing some OTC credit derivative classes to be subject to the clearing obligation. The consultation closed on 18 September 2014 and ESMA received 35 responses.

5. This final report on Credit Default Swap (CDS) is the second final report on the clearing obligation that ESMA submits to the European Commission. In view of the strong interactions between the various papers and regulatory technical standards (RTS) on the clearing obligation in different asset classes, this paper should be read in conjunction with:

   — the first final report on the clearing obligation published on 01 October 2014 and covering OTC interest rate derivative classes denominated in EUR, GBP, JPY, USD (the "G4 currencies")[8].

   — the letter from the Commission to ESMA of 18 December 2014 indicating its intention to endorse with amendments the draft RTS;

   — the related ESMA opinion of 29 January 2015[9];

[7] The Public Register for the Clearing Obligation under EMIR is available under the post-trading section of : http://www.esma.europa.eu/page/Registries-and-Databases

[8] 2014/ESMA/1184 Final Report, Clearing Obligation under EMIR no. 1 published on 1 October 2015

[9] 2015/ESMA/223 Opinion on the draft regulatory technical standards published on 29 January 2015

— the publication on 6 August 2015 of the adopted first draft RTS on the clearing obligation covering the interest rate OTC derivative classes denominated in the G4 currencies[10].

6. The present final report is thus building on (a) the documents and consultations related to the first draft RTS on OTC interest rate derivative classes denominated in the G4 currencies as well as on (b) the consultation on OTC credit derivative classes, including the review of the 35 responses.

7. The first final report covering the interest rate OTC derivative classes denominated in the G4 currencies already integrated and addressed the feedback from the 51 responses to the first and related consultation. This second final report does not repeat the analysis of the first one where the feedback is consistent. Instead, this final report addresses new feedback as well as feedback that is specific to the OTC credit derivative classes.

8. In summary, the proposals presented in the consultation paper on CDS were broadly supported by stakeholders. This final report develops further in the next sections the changes made to take into account the range of feedback and provides a number of clarifications as requested by stakeholders. The resulting draft RTS are included in Annex III.

3 The clearing obligation procedure

The submission of new classes (Question 1 of the consultation paper)

9. The first final report on the clearing obligation already detailed the large consensus for ESMA to proceed with the *grouping approach* to the extent possible, i.e. to produce a single consultation paper per asset class, where an asset-class is understood to be one of the five following: interest-rate, credit, equity, commodity and foreign-exchange. This approach was also supported in the responses for this set of classes covering the OTC credit derivatives asset class[11].

10. In line with the analysis and the consultation, ESMA has determined that some OTC credit derivatives classes should be subject to the clearing obligation. These new classes constitute the second set of classes to be subject to the clearing obligation that ESMA submits to the European Commission following the first set covering OTC interest rate derivatives denominated in EUR, GBP, JPY and USD (the G4 currencies). The present final report is thus addressing how additional classes get added to the clearing obligation, in terms of structure of the sequential RTS.

11. First of all, the process to determine additional classes, or to remove some, has been explained in the first final report as well as in the consultation paper no.4 on FX non-deliverable forwards (NDF). Indeed, ESMA can use the bottom-up approach, the top-down approach as well as the review of the current scope and, following further analysis and consultations where appropriate, determine a different scope for the clearing obligation. In particular, classes previously not determined to be subject to the clearing obligation can be added later under appropriate justifications. The overarching principle being the reduction of systemic risk, the set of classes subject to the clearing obligation can evolve and ESMA will continue to analyse classes and consult accordingly. In line

[10] The publication of the adoption of the first RTS on the clearing obligation is available at: http://ec.europa.eu/finance/index_en.htm

[11] This approach was also supported in the responses related to the set of NDF classes as reported in the feedback statement (2015/ESMA/234) published on 4 February 2015.

with this principle, in the present case, the new set of classes to be subject to the clearing obligation has been determined following the bottom-up approach.

12. Several respondents to the four consultations on the clearing obligation have requested some clarification on the way in which the different sets of classes subject to the clearing obligation would be reflected in the technical standards: would all the classes belong to the same technical standards, or each set of classes form new technical standards?

13. A few respondents compared the two following approaches: either new and standalone RTS enter into force following each clearing obligation determination (hence several RTS on the clearing obligation would coexist), or an amended version of the RTS is issued after each clearing obligation determination (hence there would be only one RTS on the clearing obligation, but it could be amended several times). There was no particular consensus for either approach in the responses.

14. Many linked the choice of the approach with regards to the RTS to its impact on the definition of categories, the phase-in, etc. However, to ensure the specificities of new classes and the feedback from subsequent consultations are properly taken into consideration, the RTS approach for each new set of classes or change in scope will be derived from the desired policy choices, not the other way around.

15. From the points of view of timing and clarity to stakeholders, ESMA considers that the standalone approach is the most appropriate for this second draft RTS. For this reason new draft RTS covering only the CDS classes are presented in Annex III. Indeed, the draft RTS on OTC interest rate derivative classes has now been endorsed by the European Commission but is still under review with the European Parliament and the Council. It could create confusion for stakeholders if amendments to RTS that have not yet entered into force were proposed in parallel. Decoupling the two RTS seems the most appropriate approach with regard to their approval cycle.

16. Finally, one of the main advantages of the other approach, i.e. to include all the classes subject to the clearing obligation in the same RTS, was to have all the classes subject to the clearing obligation in a single regulation, (a) for ease of reference and (b) for consistency in the requirements beyond the scope of classes, i.e. with regard to the definition of the categories, the applicable timing, etc. With regard to (a), in practice, the amendments to the RTS would still be presented independently, and not necessarily consolidated in a single document. Instead, the benefits of having all the classes in one central place are achieved by the use and the maintenance of the Public Register for the clearing obligation introduced under the EMIR framework. In relation to (b), consistency can still be achieved across multiple RTS, as is the case between the draft RTS on CDS classes presented in Annex III and the RTS on interest rate swaps (IRS) classes adopted by the European Commission.

17. In summary, the use of separate RTS for the CDS and the IRS classes enables a clearer and more efficient approval process for the respective RTS, while not having to compromise on the policy choices.

4 Structure of the credit derivative classes

Question 2 of the consultation paper

18. A large majority of respondents to the consultation paper had no particular comments or communicated broad support with regards to the proposed structure of the credit derivative classes to be subject to the clearing obligation, i.e. untranched index CDS classes. In particular, several respondents commented on their support referring to two specific aspects:

- that the seven characteristics enable to identify which derivative contracts need to be cleared as they are in line with the taxonomy used by market participants; and
- that the set of characteristics is consistent with the approach taken in other jurisdictions, facilitating international convergence.

19. Beyond the large consensus on the set of characteristics, further comments were made that ESMA considers separately below. They include comments on the 5 year tenor, the change in the International Swaps and Derivatives Association (ISDA) documentation and the specific case of UCITS.

Definition of the 5 year tenor

20. Some respondents commented on the definition of one of the characteristics, the maturity. For OTC the interest rate derivative classes, this characteristic refers to a range of maturities, going from a few days up to a maximum maturity, typically years, capturing every trade in that window. However for the OTC credit derivative classes, in line with the increased standardisation in the CDS market and the associated liquidity described in the consultation paper, only a few specific maturity dates are traded. Those maturities are referred to as tenors or pillars in reference to the CDS curve.

21. The consultation paper included the analysis of the notified classes and the respective maturity levels. This led to the confirmation that most of the liquidity was concentrated on the 5 year tenor. A few respondents highlighted that the 5 year tenor does not necessarily mean that the maturity for the trade is exactly 5 calendar years from the trade date. Indeed, the CDS market is anchored on a few maturity dates, the International Monetary Market dates (IMM dates) mentioned in the consultation paper. When a new series of an index is rolled out, it is associated to specific maturity dates. This is the case for all the traded tenors, including the 5 year tenor discussed in this paper.

22. As a result, when a new iTraxx Main or Crossover series is introduced, the 5 year tenor does not correspond to a maturity of 5 calendar years, instead it typically corresponds to 5 calendar years and 3 months. As the series remains “on-the-run” (i.e. it is the series issued most recently) , the date on which new trades of the on-the-run series mature remains the same, and the time to maturity mechanically reduces from 5 calendar years and 3 months as the trading days pass by.

23. Therefore, the clearing obligation is not targeting the rolling 5 calendar year maturity but instead the IMM date in about 5 years at the time of issuance of the new series corresponding to the date of the convention in the market. All 5 year iTraxx indices for a given series will share the same maturity date. In line with this, some respondents suggested that the classes of CDS should be described with the word “tenor” instead of “maturity”. And last but not least, the word “tenor” is also used in other jurisdictions.

24. As a result, to ensure that all market participants interpret consistently the requirement to be the maturity date generally referred to in the market and to facilitate international convergence, the reference to “maturity” in the table of the draft RTS is replaced by a reference to the “tenor”.

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25. In addition, a recital is added to explain the choice of including the tenor to the list of characteristics used to define the class, instead of the maturity. Indeed, the usual characteristic in EMIR to deal with the length of time of a contract is typically the maturity. However, the use of the maturity is not required to define a class of OTC derivatives in EMIR. Instead the definition of the class of derivatives in Article 2(6) of EMIR lists the minimum characteristics to be used and confirms additional ones can be included. Therefore, the tenor, which corresponds to market practice in the credit derivatives market, can be used as an additional characteristic to define the CDS classes.

New ISDA 2014 documentation

26. The consultation paper detailed the various documents and standards successively adopted by market participants to standardise CDS contracts as the market evolves. Paragraph 31 of the consultation paper mentioned the new 2014 documentation issued by ISDA in February 2014.

27. The 2014[12] version of the ISDA credit derivatives definition is indeed the latest set of documents that was rolled out, it corresponds to an important update and amendment of the definitions from 2003. The new documentation includes several new terms including terms related to some financial reference entities with the introduction of a credit event triggered by a bail-in for example, terms related to some sovereign names with the introduction of the settlement of a credit event by delivery of certain assets that the sovereign debt is converted into, as well as the establishment of standardised reference obligations per reference entity and seniority.

28. The implementation of this new documentation required operational and legal changes. Market utilities and infrastructure providers introduced some new technology and amended some operational processes. Counterparties were given a time window with the possibility to participate to the Protocol to adopt the new documentation standards and amend some of their legacy transactions.

29. As a result, contracts can be concluded under the old documentation, the new documentation or a mix of the two depending on the index, its underlying reference entities and series. Markit maintains a grid detailing which documentation applies to which indices[13] for all the indices they manage. With regards to the two iTraxx indices and corresponding series discussed in the consultation paper and in the final report, the new index series launched after 20 September 2014 fall under the new definitions, while the previous series are accepted under a mix of the two definitions.

30. CCPs clearing the two iTraxx indices have participated in this industry initiative, they have maintained integration with the updated infrastructure and support the new documentation. As a result, the contracts entered into under the new documentation regime continue to be clearable at the CCPs covered in the consultation paper, in line with the Industry standard practice.

31. A few respondents commented on this new documentation and suggested that the documentation under which the contracts are concluded was added as a new characteristic of the CDS class.

[12] The ISDA webpage dedicated to the new 2014 documentation is available at the following link: http://www2.isda.org/asset-classes/credit-derivatives/2014-isda-credit-derivatives-definitions/

[13] The grid published on 29 September 2014 by Markit with regards to the applicable documentation for each index is available at the following link: http://www.markit.com/en/products/data/indices/credit-and-loan-indices/itraxx/news.page

32. The characteristics used in the definition of a class serve the purpose of distinguishing between contracts that are subject to the clearing obligation and contracts that are not. With the bottom-up approach, all the contracts which will become subject to the clearing obligation, including those subject to the frontloading obligation, will be contracts that have been concluded under the new documentation regime (applicable documentation depending on the index and the series), which is what is accepted by the CCPs. The documentation is thus not required as an additional characteristic.

33. Therefore, ESMA has not modified the draft RTS in this respect.

UCITS specific clauses

34. Several respondents indicated that certain requirements applicable to UCITS funds may create an impediment to the clearing obligation applicable to those funds. In particular, they mentioned that, to comply with the UCITS requirements, the documentation of the OTC contracts concluded by certain funds contains a clause which prevents them to receive loans. They also mentioned a second clause, the close out clause, which entitles the fund to a right of unilateral termination.

35. With regards to the first aspect, a few respondents provided feedback about UCITS and some equivalent alternative investment funds (AIFs) not being allowed to acquire loans under their regulation, making them a restricted delivery party. Although, under certain standard CDS contracts, physical delivery is a possible fall back settlement method. In this case, under physical delivery, a loan may be required to be delivered or received. In order to address this conflict, in the case of CDS transactions with a restricted delivery party when physical settlement applies, an additional provision in the ISDA[14] documentation was developed and has been used by UCITS and their counterparties. This provision helps UCITS not to receive loans and provides for cash settlement instead.

36. Some respondents suggested to explicitly exclude from the classes subject to the clearing obligation the contracts that are concluded with this provision. Others encouraged ESMA to work with the national competent authorities (NCAs) to allow UCITS to deliver or receive loans. Finally others suggested encouraging CCPs to accept contracts concluded with such clauses and to maintain the clause.

37. The second aspect of the comments related to a close out clause used by UCITS funds, a unilateral termination right. A few respondents referred to the requirement for UCITS to be in a position to close any OTC transactions they entered into at any time, i.e. having the ability to require from the counterparty to terminate the trade at any time at the request of the UCITS at fair value.

38. The level 1 requirement is in Article 50.1(g)(iii) of the UCITS Directive. It requires that the OTC derivative contracts 'can be sold, liquidated or closed by an offsetting transaction at any time at their fair value at the UCITS' initiative'. The close out clause has typically been included in the UCITS derivative contracts to comply with this requirement. It is to be noted that ESMA published

[14] The link to ISDA's announcement of the additional provision is available at the following link: http://www2.isda.org/news/isda-publishes-additional-provisions-relating-to-credit-derivative-transactions-with-a-restricted-delivery-party-where-physical-settlement-applies

on 22 May 2015 an opinion including this aspect in Section 3.2 in order to raise it to the attention of the European Commission[15].

39. Respondents that commented on this clause proposed the same types of approach as with the previous provision as detailed in paragraph 36 above, i.e. to exclude from the classes subject to the clearing obligation the contracts that are concluded with this provision, or that CCPs could be encouraged to accept contracts with this clause and maintain it.

40. In both cases, with these two provisions, the feedback indicated that these specificities needed to be taken into account when determining the classes to be subject to the clearing obligation so that UCITS would remain compliant with both EMIR and UCITS specific requirements.

41. However, under EMIR, the clearing obligation mandate focuses on identifying which classes should be cleared rather than modifying specific requirements applicable to certain counterparties. In this case, the determination process for the clearing obligation is not intended to amend requirements applicable to UCITS, in particular obligations coming from the UCITS Directive. In line with this principle, in EMIR, there are no specific conditions that are envisaged for UCITS. The general rules apply to them, the draft RTS has thus not been amended.

[15] 2015/ESMA/880 Opinion on the impact of Regulation 648/2012 on Articles 50(1)(g)(iii) and 52 and of Directive 2009/65/EC for over–the-counter financial derivative transactions that are centrally cleared

5 Classes of OTC derivatives to be subject to the clearing obligation

Question 3 of the consultation paper

42. Following the analysis of the criteria as defined in EMIR, ESMA proposed in the consultation paper to subject certain OTC credit derivative classes to the clearing obligation. The classes were untranched indices with European corporate name underlyings and are listed below in Table 1:

Table 1: CDS classes proposed for the clearing obligation in the consultation paper

Type	Sub-Type	Geographical Zone	Reference Index	Settlement Currency	Series	Tenor
Index CDS	Untranched Index	Europe	iTraxx Europe Main	EUR	11 onwards	5Y
Index CDS	Untranched Index	Europe	iTraxx Europe Crossover	EUR	11 onwards	5Y

43. The large majority of respondents to the consultation provided broad support for the index classes detailed above. The respondents who explained further the reasons of their agreement with the scope converged around two main reasons:

- the set of classes chosen for the implementation of the clearing obligation allowed to address appropriately the systemic risk associated to the notified credit derivative classes; and
- the set of classes was consistent for the largest part with the clearing mandates in other jurisdictions allowing international convergence.

Single names not included in the first scope

44. In addition, Question 3 of the consultation paper singled out the single name CDS classes and whether they should also be considered for the clearing obligation in addition to the index CDS. There as well, there was broad support not to subject them to the clearing obligation at this stage. The majority of respondents who supported the proposed scope also clarified they agreed with the suggested approach from ESMA, i.e. concentrate on rolling out the clearing obligation to indices only as far as the OTC credit derivative classes are concerned.

45. While not disagreeing with the above, some suggested some ideas for when single names could be considered. A few commented on looking at the constituents of the liquid indices first before looking at less liquid single names and some suggested looking at single names on financial reference entities first, notably CDS on reference entities being systemically important banks.

46. The feedback from the ESRB converges with ESMA's analysis and the responses to the consultation and agrees that the scope for the clearing obligation for now should be indices only. The ESRB also states that other classes should not be ruled out for the future and that further analysis would allow to determine if other classes should then become subject to the clearing obligation, including single name CDS potentially. Yet, their response also indicates that in their view a successful implementation of the first phase of the clearing obligation is a pre-condition before considering an extension of the clearing obligation.

47.Nonetheless, beyond this broad agreement with regards to the scope, some respondents commented further on certain aspects of the classes. This includes comments on the series as well as international convergence.

Approach with the inclusion of series

48.A few respondents commented on how to determine the series to be included in the scope of classes subject to the clearing obligation. In particular, some indicated that as new series are rolled out and become the new on-the-run series, while off-the-run series gradually mature, liquidity also generally concentrates on the most recent series, if not mainly on the on-the-run one.

49.This is broadly consistent with the analysis in the consultation paper and the feedback from the discussion paper. This is taken into consideration in the final determination of which series are included.

50.First of all, given the choice of mandating only the 5 year tenor for both indices, it means several of the series for that tenor have already expired and one or more additional ones are expected to expire as well by the time the RTS enter into force. Series 14 will expire on 20 December 2015 and series 15 on 20 June 2016. At the time of the consultation, some respondents had suggested including series 14 onwards while a few others suggested series 17 onwards to capture a more concentrated volume.

51.Beyond the analysis of the criteria detailed in the consultation paper, ESMA is also of the view that the determination of the series included in the draft RTS needs to reflect the timing of when the clearing obligation is expected to start and to some extent the phase-in. As a result, the draft RTS was modified to include only Series 17 and onwards.

52.Secondly, a few other respondents mentioned that alternatively, the clearing obligation could include only the on-the-run index, or, could include the on-the-run index as well as the previous one or two off-the-run series. One rationale for this proposal was to target the most liquid series on a rolling basis while the need for ESMA to have the means to swiftly suspend a class from the clearing obligation has not been addressed, and potentially use this approach temporarily in the interim.

53.While understanding the benefits of the second approach, defining a rolling scope introduces some variability that was not envisaged, one day a series is in scope and the next day it no longer is. In addition, if only one or two series are included it could create the conditions for avoidance of the clearing obligation under certain circumstances. Indeed, if only the on-the-run series was required to be cleared, counterparties could easily avoid the clearing obligation by systematically entering into transactions on the older series only, which outcome should be avoided. Thirdly, the decision on which series are no longer mandated would be in some part dependent on the third party provider issuing new series and thus outside the RTS process. Finally, the approach envisaged in the consultation paper, i.e. including a series and all the new series onwards, is also used in other jurisdictions.

54.As a conclusion, since this approach allows a greater international convergence and was supported by most respondents, the draft RTS was not modified in this respect.

Strengthen further international convergence

55. As mentioned, many respondents communicated their support for the proposed set of classes referring to their consistency with the approach for the OTC credit derivative contracts that are mandated to be cleared in other jurisdictions. Yet, a few respondents flagged that it was not an exact match, highlighting the choice of series, tenors and the set of indices.

56. With regards to the set of indices, a few respondents noted that no CDX index was included. They indicated that certain CDX index could be appropriate for the clearing obligation and that some are mandated to be cleared in other jurisdictions. At the same time, the respondents acknowledged that these indices were not cleared by European CCPs but only by third country CCPs not yet recognised and therefore could not be considered for the bottom-up approach.

57. In addition, some respondents mentioned the absence of the iTraxx Europe HiVol in the European clearing mandate compared to the US one. Although supportive of international consistency where possible, ESMA is of the view that this index is not a priority for the clearing obligation under the European mandate as analysed in paragraph 60 of the consultation paper.

58. With regards to the choice of series, as discussed in paragraph 48, due to the difference in timing of the different clearing mandates, the respective choice of indices and tenors included in the mandates, some series have since expired. Yet, for the indices and tenors in common, there is large consistency between the European clearing obligation and the regulation in other jurisdictions in terms of the contracts captured.

59. Finally, with regards to the indices that the different jurisdictions have in common, the only difference in terms of tenors is on the 10 year tenor for the iTraxx Main Europe. ESMA is still of the opinion that this tenor is not a priority for the clearing obligation, for similar reasons as with the choice of which indices to include in the clearing obligation, in line with the analysis of the EMIR criteria developed in the consultation paper, and notably Table 12 of the consultation paper indicating the outstanding volume of trades on this tenor.

60. In conclusion, there is a significant overlap between the contracts captured under the clearing obligation and the equivalent contracts captured in the other jurisdictions, at this time the United States, in spite of the nuances between the different regulations in the respective definitions of the scopes.

61. In summary, compared to the version of the consultation paper, the only modification to the draft RTS in respect of the classes of OTC Credit derivatives relates to the adjustment of the series and the reference to “Tenor” instead of “Maturity”, as presented in Table 2 below.

Table 2: CDS classes presented in the draft RTS to be subject to the clearing obligation

Type	Sub-Type	Geographical Zone	Reference Index	Settlement Currency	Series	Tenor
Index CDS	Untranched Index	Europe	iTraxx Europe Main	EUR	17 onwards	5Y
Index CDS	Untranched Index	Europe	iTraxx Europe Crossover	EUR	17 onwards	5Y

6 Dates of application and categories of counterparties

6.1 CCPs and clearing members

Question 4 of the consultation paper

Number of CCPs and clearing members

62. There was good support for the analysis conducted in the consultation paper in the answers to Question 4 on the number of CCPs and clearing members available to clear a certain class. Nevertheless, a large number of stakeholders reiterated a feedback already collected after the publication of the discussion paper in the summer 2013 and the publication of the first consultation paper in July 2014. They commented on the need not to impose a clearing obligation unless there are at least 2 CCPs available to clear them. The most cited reasons for this are to avoid a situation of monopoly, the concentration of risk in a single market infrastructure and the inability to port to an alternative CCP in case of problems with the first one. As discussed in the final report on the clearing obligation for IRS, some suggested including in the RTS the condition that the clearing obligation is automatically removed in case the number of CCPs available to clear a specific class falls below 2.

63. There are two CCPs clearing the proposed CDS classes in Europe, ICE Clear Europe Ltd and LCH.Clearnet SA. In addition two US CCPs are also clearing them, ICE Clear Credit LLC and CME. At the time of publication of this final report, only one of the two EU CCPs is authorised and none of the two third country CCPs is recognised. Yet, it is expected that there will be two or more CCPs that counterparties can clear at in the near future. To take into account the fact that only one CCP is authorised at the time of publication of this final report, the dates of application of the clearing obligation have been adapted as explained in more detail in section 6.3 below.

64. Several respondents also commented on the need to have the right group of clearing members at the relevant CCPs to establish a clearing obligation, rather than considering only the number of them. ESMA agrees that the number, profiles and weights of the clearing members in the corresponding markets are important. As developed in the consultation paper, ESMA has determined it is the case for the OTC credit derivative classes proposed to be subject to the clearing obligation and the corresponding CCPs. Indeed, across the CCPs considered for these classes, most of the major market makers for these indices are clearing members, which clearing members are also the main providers of client clearing services, meaning they can both participate actively to the market dispersion in case of a default as well as provide access to clearing to counterparties.

Indirect Client Clearing

65. Echoing some responses to the first consultation paper, a few stakeholders urged ESMA to bear in mind the importance of indirect clearing: for some counterparties unwilling or unable to become direct clearing members or direct clients of clearing members, indirect clearing might be the only option to satisfy the clearing mandate.

66. In line with the analysis of the state of development of the OTC clearing market structure included in the consultation paper, ESMA is aware that, as of today, there does not appear to exist any offer for indirect client clearing. In this respect, ESMA has consulted on a revised RTS on indirect

clearing in the context of MIFID and once a solution can be found in that context, the two sets of RTS (under MiFID and under EMIR) will be aligned (i.e. amended provisions for the EMIR RTS) ensuring that indirect clearing offerings can be developed.

6.2 Categories of counterparties

Question 5 of the consultation paper

67. Responses to the second consultation paper are in line with the ones to the first consultation paper: the categories of counterparties were broadly supported but some stakeholders mentioned the need to see if now ex-Category 2 (the category presented as "Category 2" in the consultation paper on CDS) could benefit from a subdivision because it includes numerous counterparties with heterogeneous levels of sophistication and preparation towards central clearing. Specifically, several respondents mentioned the benefits in keeping the same approach for the interest rate OTC derivative classes and the OTC credit derivative classes.

68. Following the analysis of the responses received to the consultation paper on IRS, ESMA modified the approach related to the categories of counterparties. In the first RTS on the clearing obligation for IRS now endorsed by the European Commission, the categories of counterparties are defined as follows:

- Category 1 covers clearing members in the interest rate classes of OTC derivatives subject to the clearing obligation;
- Category 2 covers financial counterparties, and AIFs classified as non-financial counterparties, with significant level of activity in OTC derivatives (i.e. which belong to a group whose aggregate month-end average notional amount of non-centrally cleared derivatives for three months after the entry into force of the first RTS on the clearing obligation is above EUR 8 billion);
- Category 3 covers financial counterparties, and AIFs classified as non-financial counterparties, not included in Category 1 or 2;
- Category 4 covers non-financial counterparties not included in Category 1, 2 or 3.

69. For this final report on CDS classes ESMA has adopted the same approach with four categories of counterparties. Further elements which are specific to Categories 1, 2 and 3 are developed below.

Classification for Category 1 (clearing members): cumulative or per asset-class

70. With regards to the categories of counterparties, the main aspect which has an impact on the second set of classes is on the exact composition of Category 1. Beyond the fact that Category 1 captures clearing members, the question being addressed is whether this should be done on an asset class basis or whether it should be a cumulative approach.

71. Under the cumulative approach, a counterparty classified in Category 1 for one set of classes will stay in Category 1 for all subsequent classes subject to the clearing obligation, irrespective of whether this counterparty is a clearing member in the subsequent classes. Under the approach per asset class, only the clearing members of the classes of each RTS belong to Category 1 for the classes of this RTS.

72. As in the consultation paper no.1 on IRS, some responses to the consultation on CDS supported a classification of clearing members per asset-class. This means that the counterparties that are clearing members for IRS (resp. CDS) only are in Category 1 for IRS (resp. CDS) only.

73. Those respondents indicated that a clearing member on a particular asset class is not necessarily prepared to clear other asset classes as some technological and other operational issues will still need to be addressed and new legal terms and conditions will need to be put in place with a CCP before the entity becomes a clearing member in other asset classes.

74. The extra burden and complexity associated to this classification of counterparties per asset class, cited by ESMA as one reason to exclude this option, was not seen as problematic by those stakeholders who indicated they were ready to support it.

75. In response to this concern, as mentioned in the final report on the clearing obligation for IRS denominated in the G4 currencies, ESMA considers likely that the level of sophistication of a counterparty is best assessed overall rather than at the level of the asset-class, and therefore that it is reasonable that a Category 1 counterparty for IRS remains a Category 1 counterparty for the other asset classes. Indeed, even if this counterparty may not be a clearing member in e.g. CDS, its experience in clearing IRS would justify the application of the shortest phase-in for all the subsequent asset classes.

76. However, since the publication of the consultation paper on CDS, ESMA has collected and analysed CDS data collected by European Trade Repositories (TRs) under the EMIR reporting obligation (see the quantitative impact assessment below for more information on the data collected).

77. In particular, ESMA measured the volumes of non-cleared transactions in the CDS classes depending on the counterparties to the transactions to have a clearer idea of the impact of the approach for clearing members, either cumulative or asset class by asset class. As shown in Table 3 below, the non-cleared CDS volumes can be divided into three buckets depending on the two counterparties to the transactions:

- Trades concluded between two CDS clearing members: those transactions would switch to central clearing within 6 months of the entry into force under the two options;

- Trades concluded between two IRS clearing members, or between one IRS clearing member and one CDS clearing members: those transactions would switch to central clearing within 6 months of the entry into force only under the cumulative approach for classification of clearing members

- Other: transactions that would switch to central clearing during the phase-in of Category 2, 3 or 4.

Table 3: Volumes in non-cleared CDS Class+ - Breakdown per counterparties

	Volume - Trade Count	Volume - Notional Amount
Between 2 CDS Clearing Members	41.4%	49.5%
Between CDS/IRS Clearing Members*	16.3%	14.1%
Other	42.3%	36.3%
Grand Total	**100.0%**	**100.0%**

(*) includes transactions between two IRS clearing members and transactions between one CDS and one IRS clearing member

Source: European TR data, ESMA calculations

78. The European TR data indicates that almost half of the non-cleared volume in the CDS classes is executed between two CDS clearing members, while an additional 15% of this non-cleared volume would be brought more swiftly to CCPs under the cumulative approach for clearing members.

79. Therefore, even under the approach per asset-class, close to 50% of the non-cleared activity would be brought to CCPs during the first 6 months of application of the clearing obligation, on top of what is already voluntarily cleared. In addition, the cumulative approach would have the effect of requiring about 80 counterparties, representing roughly 15% of the non-cleared volumes of the CDS Classes+, to establish clearing arrangements within 6 months from the entry into force, which is not negligible.

80. In view of the above, the draft RTS was modified to reflect the choice of the approach per asset class. This was achieved by indicating that a counterparty should be included in Category 1 for the credit classes subject to the clearing obligation only if it is a clearing member in those credit classes. Therefore the counterparties that are clearing members only in the interest rate classes subject to the clearing obligation should be included (1) in Category 1 for those IRS classes (2) in Category 2 for the CDS classes proposed to be subject to the clearing obligation in this report.

<u>Categories 2 and 3</u>

81. In the endorsed RTS on the clearing obligation for IRS denominated in the G4 currencies, counterparties belong to Category 2 if they belong to a group whose aggregate month-end average notional amount of non-centrally cleared derivatives <u>for the three months following the date of publication of the RTS in the Official Journal</u> (excluding the month of publication) is above EUR 8 billion.

82. In the context of the consultation paper on the clearing obligation for IRS denominated in the CZK, DKK, HUF, NOK, PLN and SEK (the European Economic Area (EEA) currencies[16]), ESMA proposed that the dates for the assessment of the positions against the threshold are the same for both sets (G4 and EEA), to reduce the burden on counterparties. Under this approach, counterparties would perform the calculation only once to determine whether they belong to Category 2 or to Category 3 in respect of the two sets of IRS.

83. This proposal was generally supported by respondents to the consultation. ESMA is thus proposing to follow this approach with the RTS on CDS. This is reflected in the RTS presented in Annex III.

[16] 2015/ESMA/807 Consultation Paper, Clearing Obligation under EMIR no. 4

6.3 Dates on which the clearing obligation takes effect

Question 6 of the consultation paper

84. With regards to the implementation schedule for the clearing obligation, as with Question 5, a large part of the feedback received to the consultation on CDS was consistent with the one received to the consultation on IRS. This part of the feedback has already been analysed and taken into account as explained in detail in the final report on the clearing obligation for IRS.

85. Some comments were specific to the case of CDS classes: one respondent mentioned that the phase-in period for CDS should be longer because the number of CCPs clearing CDS is smaller than the number of CCPs clearing IRS. However more respondents had an opposite view: they considered that the phase-in periods should be shorter for CDS than for IRS because the market itself is smaller, and so is the number of counterparties to on-board.

86. In addition, as this was already the case for the previous consultations on the clearing obligation, many respondents raised the issue that the clearing obligation should not be imposed unless at least two CCPs are authorised to clear the relevant classes, which is currently not the case for the CDS classes.

87. Indeed at the time of publication of this paper, LCH.Clearnet SA is the only CCP that has been authorised to clear the CDS classes proposed in this draft RTS. While the concerns of stakeholders are reasonable in this respect, ESMA still expects that the authorisation of ICE Clear Europe (the second CCP currently clearing the same classes) occurs before, or shortly after, the RTS on the clearing obligation for CDS enters into force.

88. However, the fact that this second CCP is not authorised yet creates a source of uncertainty which should be appropriately taken into account. Besides, EMIR foresees that the number of CCPs clearing a certain class is one of the criteria that ESMA shall take into consideration when defining the dates on which the clearing obligation takes effect[17].

89. In accordance with this legal mandate, ESMA has added three months to the length of the phase-in period for Category 1, Category 2 and Category 3, which are therefore set at 9 months, 15 months and 21 months respectively.

90. The reason why ESMA is not proposing to modify the phase-in period for Category 4 is that the length of the phase-in period for this category of counterparties is already very long (3 years) and that non-financial counterparties are not typical users of credit default swaps.

91. As a result, the phase-in periods in the draft RTS have been modified as follows:

- Category 1: 9 months
- Category 2: 15 months
- Category 3: 21 months

[17] Article 5(5)(b): "whether more than one CCP already clear the same class of OTC derivatives.

— Category 4: 3 years

Dates of application of the clearing obligation for non-EU intragroup transactions

92. On 18 December 2014, the Commission sent a letter to ESMA indicating its intention to endorse with amendments the draft RTS establishing a clearing obligation for certain classes of OTC interest rate derivatives denominated in the G4 currencies.

93. One of the concerns raised by the Commission in relation to the original draft RTS submitted by ESMA on 1 October 2014 was the treatment on intragroup transactions concluded with non-EU counterparties.

94. More specifically, the Commission indicated its intention to provide some relief from the clearing obligation to EU counterparties entering into intragroup transactions with entities established outside the Union. Indeed, in the absence of equivalence decisions pursuant to Article 13 of EMIR, those transactions would not qualify as "intragroup transactions" as defined in Article 3 of EMIR and therefore, could not be exempted from the clearing obligation.

95. The Commission and ESMA have further worked together to come up with a solution to tackle this issue, which lead to a proposal that in now included in the RTS on the clearing obligation for OTC interest rate derivatives denominated in the G4 currencies endorsed by the European Commission on 6 August 2015.

96. The same approach is replicated in the draft RTS presented in Annex III of this paper. Article 3(2) of this draft RTS provides a deferred date of application under certain conditions for OTC derivative contracts concluded between two entities of the same group, one being established in the EU and the other one in a third-country without an equivalence decision.

97. Those non-EU intragroup transactions are also exempted from frontloading (see the sentence "and for transactions referred to in Article 3(2) of this Regulation concluded between financial counterparties" in Article 4(3) of the endorsed RTS, and replicated in the draft RTS presented in Annex III of this paper). Indeed, in the absence of such exemption, a transaction could theoretically become subject to the clearing obligation long after it was entered into, an outcome which has been described in several other papers on frontloading as undesirable mainly for reasons of pricing uncertainty.

7 Remaining maturity of the contracts subject to frontloading

Question 7 of the consultation paper

98. Frontloading and the associated definition of the minimum remaining maturity of the contracts attracted again a lot of attention. The comments all pointed in the same direction that ESMA should limit as much as possible the application of the frontloading requirement, especially for the category referred to as “Category 2” in the consultation paper. The feedback on frontloading was consistent with the concerns that stakeholders had raised when responding to the other consultations on the clearing obligation.

99. The approach regarding frontloading has significantly evolved since the publication of the CDS consultation paper. It was modified following the first consultation on IRS (as presented in the final report on the clearing obligation for IRS) and also after the delivery of the final report (see the 18 December 2014 letter from the Commission and the subsequent ESMA Opinion of 29 January 2015).

100. The provision on frontloading that is now included in the endorsed RTS on the clearing obligation for IRS denominated in the G4 currencies is the following:

- for counterparties in Categories 1 and 2, the minimum remaining maturity applicable to contracts concluded between (1) the date of entry into force of the RTS + [2/5 months] and; (2) the date of application of the clearing obligation for those counterparties, is 6 months.

- for the other contracts and counterparties, frontloading is dis-applied by setting the minimum remaining maturities at a high level (i.e. equal to the maximum maturity of the contracts subject to the clearing obligation).

101. The 2/5 month buffer for counterparties in Category 1 and 2 respectively is designed to:

- provide counterparties with an appropriate period of time to determine the category to which they belong before they potentially become subject to the frontloading obligation; and

- provide counterparties in Category 1 with an appropriate period of time to apply for the intragroup exemption before they become subject to the frontloading obligation.

102. This addition was proposed by the European Commission in its letter to ESMA from 18 December 2014 and incorporated in the ESMA opinion of 29 January 2015 on draft RTS on the clearing obligation for IRS denominated in the G4 currencies. This approach is now reflected in the first RTS on the clearing obligation for OTC interest rate derivatives denominated in the G4 currencies that was adopted by the European Commission on 06 August 2015.

103. Regarding the current RTS on CDS classes, it is proposed that the classification of counterparties between Category 2 and Category 3 is made on the same dates as the dates proposed in the first RTS, on IRS denominated in the G4 currencies, as explained in section 6.2 above.

104. As a result, counterparties from Category 2 and Category 3 will not necessarily need additional time after the date of entry into force of the RTS on CDS to determine the category of counterparties to which they belong, since this classification will already have been done (or at least, it will be possible to make this determination) during the three months following the entry into force of the first RTS on the G4 currencies. In other words, the reason (a) above to justify the need for additional time before frontloading starts to apply was valid for the first RTS but is no longer valid for the subsequent RTS, including the present RTS on CDS.

105. However, ESMA is proposing that the additional 3 month buffer that is applied to the standard phase-in to take into account the uncertainty around the timing for the authorisation or recognition decisions for the other CCPs (see paragraphs 84 to 89) is also applied to the frontloading start dates.

106. First of all, there can be price differentials for the same trade depending on the CCP where the trade is going to be cleared. Therefore not knowing if a CCP will have been authorised or recognised by the time of expiration of the applicable phase-in may impact counterparties at the time of execution. Counterparties would require more time to prepare for this possible scenario for when the frontloading period starts to apply.

107. During the frontloading period, contracts subject to the clearing obligation may still be cleared with any CCP on a voluntary basis, even with non-authorised/non-recognised ones. But once the clearing obligation takes effect (i.e. after the phase-in period), all contracts, including those mentioned in the previous sentence, will have to be cleared exclusively with authorised or recognised CCPs. Therefore, counterparties would need additional time to prepare for the possibility that their trades cleared with a non-authorised CCP would need to be cleared with an authorised one.

108. Taking all this into account, in the current RTS, frontloading starts to apply 5 months after the date of entry into force, both for counterparties in Category 1 and in Category 2 (as opposed to 2 months for counterparties in Category 1, and 5 months for those in Category 2, in the first RTS on IRS denominated in the G4 currencies). The 5 months corresponds to the time counterparties need to apply for the intragroup exemption before they become subject to the frontloading obligation as well as to the time they require to prepare for the contingent scenario of one of the CCPs they have been using is not yet authorised or recognised by the time of the frontloading start date.

109. Reference can also be made to the EMIR Review Report no.4[18], Section 4.2, for further information and proposals on frontloading made by ESMA to the European Commission in the context of the review of EMIR.

8 Other aspects related to the draft RTS not covered in the other sections

<u>Question 8 of the consultation paper</u>

[18] ESMA-2015-1254 - EMIR Review Report no.4 on other issues published on 13 August 2015.

110. A majority of respondents did not comment on additional possible amendments to the draft RTS, but some respondents did provide feedback on a few other topics related to the RTS. Yet, there was no new issue not covered in the previous sections of this final report or in the first final report. These comments have thus been taken into consideration with the changes mentioned earlier in the document or when ESMA is mirroring the language of the first RTS.

9 Annexes

9.1 Annex I - Legislative mandate to develop technical standards

Article 5 of Regulation (EU) No 648/2012

Clearing obligation procedure

2. Within six months of receiving notification in accordance with paragraph 1 [of Article 5] or accomplishing a procedure for recognition set out in Article 25, ESMA shall, after conducting a public consultation and after consulting the ESRB and, where appropriate, the competent authorities of third countries, develop and submit to the Commission for endorsement draft regulatory technical standards specifying the following:

(a) the class of OTC derivatives that should be subject to the clearing obligation referred to in Article 4;

(b) the date or dates from which the clearing obligation takes effect, including any phase in and the categories of counterparties to which the obligation applies; and

(c) the minimum remaining maturity of the OTC derivative contracts referred to in Article 4(1)(b)(ii).

Power is delegated to the Commission to adopt regulatory technical standards referred to in the first subparagraph in accordance with Articles 10 to 14 of Regulation (EU) No 1095/2010.

9.2 Annex II - Cost-benefit analysis

9.2.1 Introduction

1. This impact assessment was conducted by ESMA while developing the regulatory technical standards ("RTS") on the clearing obligation, as foreseen by the clearing obligation procedure of Regulation (EU) 648/2012 (EMIR).

2. In accordance with the clearing obligation procedure, within 6 months of being notified that a CCP has been authorised to clear a class of OTC derivatives, ESMA shall develop and submit to the European Commission for endorsement draft RTS specifying:

   (a) the class of OTC derivatives that should be subject to the clearing obligation

   (b) the date or dates from which the clearing obligation takes effect, including any phase in and the categories of counterparties to which the obligation applies; and

   (c) the minimum remaining maturity of the OTC derivative contracts referred to in Article 4(1)(b)(ii) of EMIR (i.e. the contracts subject to frontloading).

3. It should be noted that this impact assessment only covers the technical options under the specific mandate of ESMA in respect of the clearing obligation, given that an impact assessment covering the general aspects of the clearing obligation has already been performed by the European Commission as part of the impact assessment of EMIR.

4. The impact assessment presents options that were considered by ESMA when developing the technical standard on the clearing obligation and covers the following issues:

   - which characteristics or variables of OTC derivative contracts should be used to describe the classes of OTC derivatives to be subject to the clearing obligation;
   - which is the best way to ensure a smooth and appropriately phased-in implementation of the clearing obligation; and
   - how to define the minimum remaining maturity of the contracts subject to frontloading in a manner that ensures a uniform and coherent application of EMIR and a level playing field for market participant.

5. The determination of the classes of OTC derivatives that should be subject to the clearing obligation has been presented both in quantitative and qualitative terms in the explanatory part of the consultation paper and is therefore not repeated in the impact assessment.

6. Since the publication of the consultation paper, it has been possible to proceed with an analysis of transactions reported to European trade repositories (TRs). The technical options presented in the tables of the qualitative impact assessment are therefore further supported by the analysis of TR data related to the categories of counterparties and the classes and scope of the clearing obligation.

9.2.2 Quantitative impact assessment

7. ESMA collected data on Credit derivatives from 3 registered trade repositories[19] ("TRs") between 1 March and 30 June 2014.

8. The results that were drawn from this dataset should take into account the fact that the time window covered is very close to the reporting obligation start date (18 February 2014). The on-going work from stakeholders, competent authorities and ESMA to enhance the quality of data reported to TRs is not yet fully reflected in the data sample.

9.2.2.1 Assumptions on the dataset

Data on the two iTraxx Indices subject to the clearing obligation

9. The dataset was filtered to include only transactions on the two iTraxx indices (iTraxx Europe Main and iTraxx Europe Crossover) that are proposed to be subject to the clearing obligation. This ensures that the population of counterparties that is analysed below is limited to those that will become subject to the clearing obligation in application of the RTS on CDS.

10. In addition, in Section 9.2.2.3 which relates to the volumes in the CDS classes subject to the clearing obligation, a larger data sample was used including all the reports on CDS indices, to compare the liquidity of those subject to the clearing obligation to the liquidity of the other indices.

Avoiding duplicated reports

11. In order to count each transaction only once, the dataset was filtered to remove all duplicated trade id. This was done both within each trade repository but also across trade repositories. This filter could not eliminate the risks that (1) the same transaction is reported erroneously with different trade ids and (2) different transactions are reported erroneously with the same trade id.

Intragroup transactions

12. Intragroup transactions are special in the sense that they usually represent the allocation of a larger transaction that one entity of the group has made in the market, at a global level, before splitting that transaction into intragroup transactions in accordance with the needs of the respective entities of the group. Therefore, although those intragroup transactions are not duplicated transactions as such, they are not relevant to assess the liquidity of the market and could introduce bias to the data analysis. In addition, intragroup transactions are not subject to the clearing obligation under some conditions.

13. Therefore, intragroup transactions were filtered out of the dataset for the analysis of the CDS market, using the dedicated flag to report them.

[19] The list of registered trade repositories is available on the ESMA website at http://www.esma.europa.eu/content/List-registered-Trade-Repositories

9.2.2.2 Counterparties active in the CDS Classes subject to the clearing obligation

Number of counterparties

14. The analysis of the counterparties was made both on the reporting counterparty and the other counterparty to the transactions. This was possible because the number of counterparties that reported (or were reported) without a legal entity identifier (LEI) was relatively low. They represented less than 4% of the volume of transactions both measured with trade count and notional amount (see Table 4).

15. The total number of counterparties which entered into transactions in the CDS classes covered by this final report was found to be around 1,700, of which 83% are EU counterparties. The EU counterparties accounted for more than 90% of the volume both as measured in trade count and notional amount.

16. It is interesting to note that, although the absolute number of counterparties reporting without an LEI is not negligible (around 10% out of the total number of counterparties), the associated volumes are much more limited (less than 4% of the total volumes). Hence it could well be that the actual number of counterparties without an LEI is inferior to the number shown (174) but simply the absence of LEI did not allow to appropriately eliminate duplicated entities.

Table 4: Counterparties active in the CDS Classes - Breakdown per geographical location

	Number of Counterparties	Number of Counterparties (%)	Volume - Trade Count	Volume - Notional Amount
EU	1,402	82.8%	90.3%	90.8%
Third-Country	117	6.9%	6.0%	5.1%
Undetermined (no LEI)	174	10.3%	3.6%	4.1%
Grand Total	**1,693**	**100.0%**	**100.0%**	**100.0%**

Source: EU Trade Repositories, ESMA calculations

CDS Volumes of Financial and Non-Financial counterparties

17. In relation to the definition of the counterparties and their respective phase-in periods, the TR dataset was used to determine the breakdown of volumes per type of counterparties using the classification that should be reported to trade repositories, i.e. financial or non-financial nature of the counterparties.

18. The data limitations with this exercise are linked to the fact that the information on the nature of the counterparty is only mandatory for the reporting counterparty. In addition there are a significant number of reports where this information was not reported even by the reporting counterparty. To reduce the number of incomplete reports in this respect, a simple treatment was performed consisting in automatically reclassifying the IRS and CDS clearing members as “Financial counterparty”.

19. The results are shown in Table 5 below. Not surprisingly, the volumes reported by financial counterparties significantly outweigh those reported by non-financial counterparties, with the former representing around 85% of the volumes and the latter less than 1%. The counterparties for which the status was not reported accounted for 13% and 15% of the volume as measured by notional amount and trade count respectively.

Table 5: Volumes of the non-cleared CDS Class+: Breakdown per type of counterparties

	Volume - Trade Count	Volume - Notional Amounts
Financial counterparties	84.1%	85.8%
Non-Financial counterparties	0.7%	0.6%
Blank*	15.2%	13.6%
Grand Total	**100.0%**	**100.0%**
(*) counterparties did not report the corresponding field		

Source: EU Trade Repositories, ESMA calculations

Clearing Members

20. The draft RTS includes the definition of the category of counterparties to which the clearing obligation should apply first: the clearing members. Two main options could be explored to determine how this clearing member category should be framed, depending on the classes for which the counterparties are clearing members:

— cumulative approach: Category 1 includes clearing members for any class subject to the clearing obligation, including the classes subject to the clearing obligation via a previous RTS. Under this approach, a counterparty classified in Category 1 for one set of classes stays in Category 1 for all subsequent classes subject to the clearing obligation, irrespective of whether this counterparty is a clearing member in the subsequent classes;

— approach per asset class: Category 1 includes only the clearing members of the respective classes of derivatives covered by the specific RTS. Under this approach, a counterparty classified in Category 1 for one set of classes may belong to Category 1 or to one of the other categories for subsequent classes subject to the clearing obligation, depending on the classes for which the counterparty is a clearing member;

21. Given that the RTS on CDS will be adopted after the RTS on IRS, the issue at stake here is whether the counterparties that are clearing members for IRS but not for CDS should belong to Category 1 (cumulative approach) or to one of the other categories (approach per asset class) for CDS.

22. The TR data were used to evaluate the volumes of transactions in the CDS classes (only on the two indices iTraxx Europe and iTraxx Europe Crossover) that would be brought to central clearing during the phase-in of category 1, under the two options.

23. As shown in Table 6 below, the TR data indicates that 41% of the non-cleared volumes as measured by trade count and 50% of the non-cleared volumes as measured by notional amount is executed between two CDS clearing members, while an additional 14-16% of this non-cleared volume is executed either between one IRS and one CDS clearing member, or between two IRS clearing members. Hence this 14%-16% share of the market would be brought to CCPs more swiftly to CCPs under the cumulative approach.

24. Those numbers generally support the view that the approach per asset class ensures that a significant share of the non-cleared volumes is brought swiftly to central clearing, hence achieving

the primary purpose of the clearing obligation, while not imposing disproportionate requirements for counterparties that are not clearing members in that asset class.

Table 6: Volumes in non-cleared the CDS Class+ - Breakdown per counterparties

	Volume - Trade Count	Volume - Notional Amount
Between two CDS Clearing Members	41.4%	49.5%
Between CDS/IRS Clearing Members*	16.3%	14.1%
Other	42.3%	36.3%
Grand Total	**100.0%**	**100.0%**

(*) includes transactions between two IRS clearing members and transactions between one CDS and one IRS clearing member

Source: EU Trade Repositories, ESMA calculations

Volume expected to be executed during the different phase-in periods

25. The draft RTS includes the definition of the categories and the associated dates from which the clearing obligation takes effect. Using TR data to look at the interconnectedness of counterparties is useful to validate further the approach. In particular, in the previous section, data was used to help define the categories, in particular category 1. Using this definition, TR data can be used to look at the proportion of trades between the main pairs of categories to estimate what would be the likely progression of the clearing obligation in the credit derivative market in Europe in terms of trade count and notional.

26. CDS trading is highly concentrated around a dozen or more global derivative dealers. Both the consultation paper as well as section 4 of the response from the ESRB already covered this aspect. The majority of these dealers were referred to as the G14 or G15 as part of their work with the OTC Derivatives Supervisors Group (ODSG)[20]. Looking at the two European CCPs clearing CDS classes, there is a large overlap between the G15 institutions and the clearing members of these two CCPs, thus category 1.

27. Table 7 indicates the volume of un-cleared trades between counterparties based on their categories. The figures confirm the importance of the dealers of category 1 for the credit derivatives market. Indeed, category 1 counterparties are a counterparty to almost all CDS trades, 99.7% and 99.9% in terms of trade count and notional respectively.

28. Table 7 indicates that half of the uncleared notional in the CDS classes proposed for the clearing obligation is traded between two counterparties of category 1, thus this trading volume would be brought into clearing with the first 6 month phase. The second half of the uncleared notional in the CDS classes is traded between a counterparty of category 1 and a counterparty of one of the other three categories. This volume of trade would thus be brought into clearing through the following phases, allowing for a gradual ramp-up of the clearing of CDS classes.

[20] A series of meetings was initiated in 2005 with representatives of the major over-the-counter (OTC) derivatives market participants, the G14 or G15, and their domestic and international supervisors, the ODSG, discussing risks inherent to the growing credit derivatives market, which led to a series of commitment letters including among other things timely confirmation targets and standardisation initiatives.

Table 7: Volume of un-cleared trades of CDS Class+ - Breakdown per counterparties

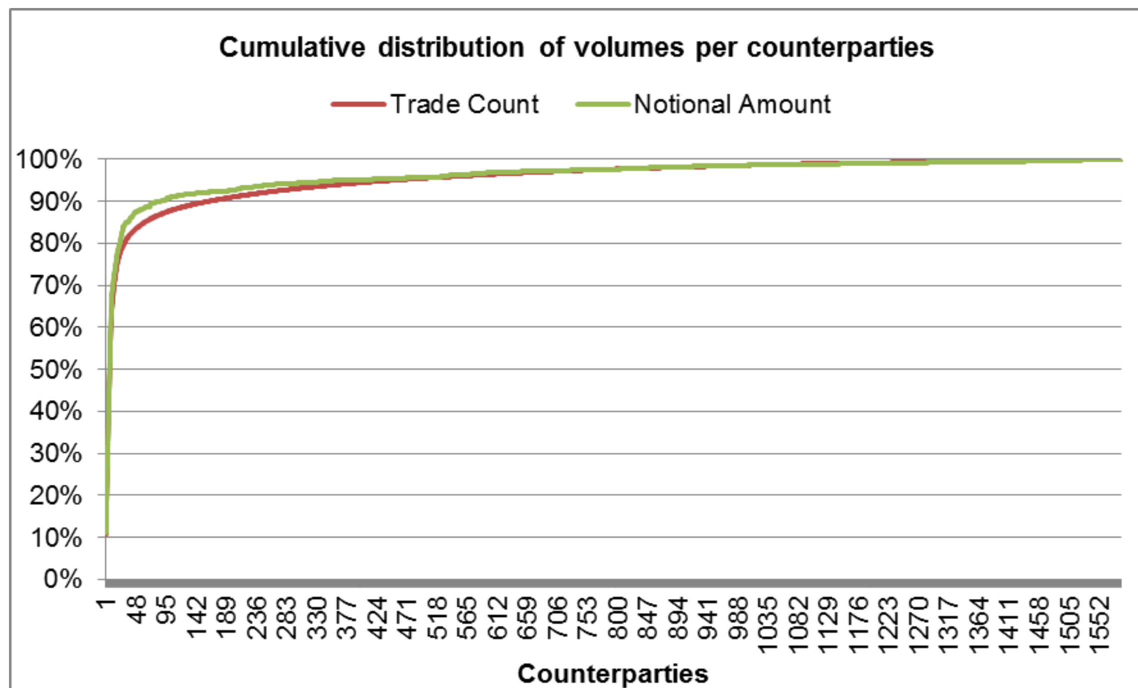
	Volume - Trade Count	Volume - Notional Amount
Between two CDS Clearing Members	41.4%	49.5%
Between one CDS Clearing Member and another counterparty	58.3%	50.3%
No CDS Clearing Member	0.3%	0.1%
Grand Total	**100.0%**	**100.0%**

Source: EU Trade Repositories, ESMA calculations

Distribution of volumes per counterparties

29. Another representation of this concentration of activity through a few counterparties, global derivative dealers of category 1, can be achieved by looking at the respective volume of each of the counterparties active in the CDS classes. Figure 2 illustrates this, it represents the distribution of trading volume of uncleared CDS classes ordered from the counterparty with the largest volume to the counterparty with the lowest volume.

Figure 1: Cumulative distribution of the volumes in the non-cleared CDS Class+



Source: EU Trade Repositories, ESMA calculations

30. Table 1Table 7 showed that category 1 entities are the two counterparties of the trades for half of the traded uncleared notional and one of the two counterparties for the trades for the second half, this adds up to more or less to category 1 entities being a counterparty to more or less three fourth of the traded uncleared notional. The shape of the cumulative distribution pictured in Figure 1 reflects this aspect with a sharp rise at the start due to the trading of the first and most active counterparties, category 1 counterparties.

31. Table 7 also shows that the cumulative distribution continues to rise beyond the category 1 counterparties and slowly reducing. But overall, the progression is more evenly distributed across the counterparties.

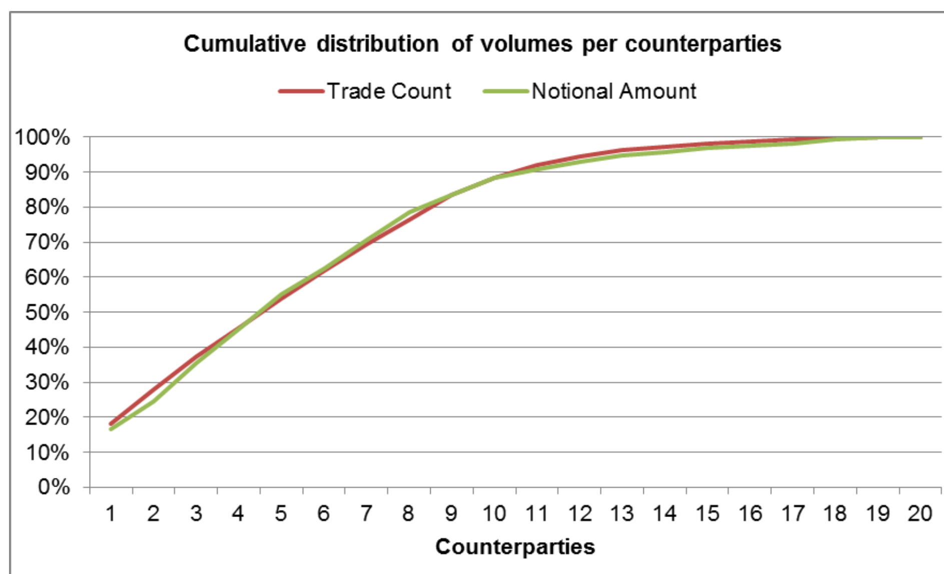
32. This further validates that the phase in presented in the draft RTS is expected to allow a gradual move to clearing across counterparties but with already a large part achieved through phase 1.

33. Furthermore, in addition to the important concentration of trading activity in the credit derivative market with the large dealers, the consultation paper also looked at their respective importance. In particular, with regards to the market dispersion criteria, the consultation paper indicated that none of these dealers had a market share significantly larger than the others. This is illustrated by the left part of Figure 1 or by Figure 2.

34. Figure 2 represents the cumulative distribution of the volume of uncleared trades in CDS classes proposed for the clearing obligation between counterparties of category 1. A zoom on the left part of Figure 1 and Figure 2 indicate similar results. The dozen largest and most active dealers have comparable trading activity in these classes and the corresponding progression of the cumulative distribution presented in Figure 2 is rather linear. However, beyond this first dozen clearing member and active dealers, the market share in terms of trading volume rapidly diminishes.

Figure 2: Cumulative distribution of the volume in the non-cleared CDS Class+

Only Trades between two CDS Clearing Members



Source: EU Trade Repositories, ESMA calculations

9.2.2.3 Volumes in the CDS Classes proposed for the clearing obligation

Comparison between the liquidity of the different indices

35. There are four main families of index CDS: iTraxx indices mainly on European entities, CDX indices mainly on US entities, LCDX (loan CDX) and MCDX (municipal CDX). A variable number of indices belong to each of these families, with variations on e.g. the geographical zone or the sector

of activity of the underlying entities, and on whether the underlying entities are corporate of sovereign bonds.

36. The TR data sample included transactions in 6 CDX indices and 22 iTraxx indices, as well as the LCDX and MCDX indices. Among those indices, four are currently offered for clearing by European CCPs: in addition to the two indices on which a clearing obligation is proposed (iTraxx Europe main and iTraxx Crossover), it is also possible to clear the iTraxx Europe Senior Financials and the iTraxx Europe HiVol.

37. Not surprisingly, the volumes are found to be higher on the iTraxx (mainly EU driven) than on the CDX (mainly US driven) family, with a breakdown of approximately 2/3 for the first and 1/3 for the second.

38. Going in more detail, the data on liquidity included in Table 8 below confirm the analysis laid down in the consultation paper for CDS: the two indices that are proposed to be subject to the clearing obligation are by far the most liquid of the CDS index market. The two of them together accounted for close to 50% of the total volume as measured by trade count during the study period. As regards the two other clearable indices, the data indicate that iTraxx Europe Senior Financials is the fourth most liquid of the iTraxx family, with close to 6% of the total volume, while the volume of the iTraxx Europe HiVol remained very low, at 0.1% of the total volume.

Table 8: Volumes in CDS indices – Breakdown per index

		Volume (trade count)
	CDX	**28.5%**
	CDX.NA.HY	14.5%
	CDX.NA.IG	10.6%
	CDX.EM	3.4%
	CDX.NA.IG.HVOL	0.0%
	CDX.EM.ex-EU	0.0%
	CDX.NA.IG.FIN	0.0%
	iTraxx	**67.2%**
subject to clearing obligation	iTraxx Europe Main	27.2%
subject to clearing obligation	iTraxx Europe Crossover	19.4%
	iTraxx Japan	6.1%
clearable in EU CCPs	iTraxx Europe Senior Financials	5.9%
	iTraxx Asia ex-Japan IG	4.4%
	iTraxx Australia	1.8%
	iTraxx Europe Sub Financials	1.4%
	iTraxx CEEMEA	0.4%
	iTraxx SovX Asia Pacific	0.2%
	iTraxx SovX Western Europe	0.2%
	iTraxx SovX CEEMEA ex-EU	0.1%
clearable in EU CCPs	iTraxx Europe HiVol	0.1%
	iTraxx SovX CEEMEA	0.0%
	iTraxx Europe Consumer Cyclical	0.0%
	iTraxx Europe Energy	0.0%
	iTraxx Europe Industrials	0.0%
	iTraxx Europe Consumers	0.0%
	iTraxx Europe Autos	0.0%
	iTraxx Europe TMT	0.0%
	iTraxx Europe Non-Financial	0.0%
	iTraxx Asia ex-Japan HY	0.0%
	iTraxx SDI-75	0.0%
	LCDX	**2.6%**
	LCDX.NA	2.6%
	MCDX	**1.7%**
	MCDX.NA	1.7%
	Grand Total	**100.0%**

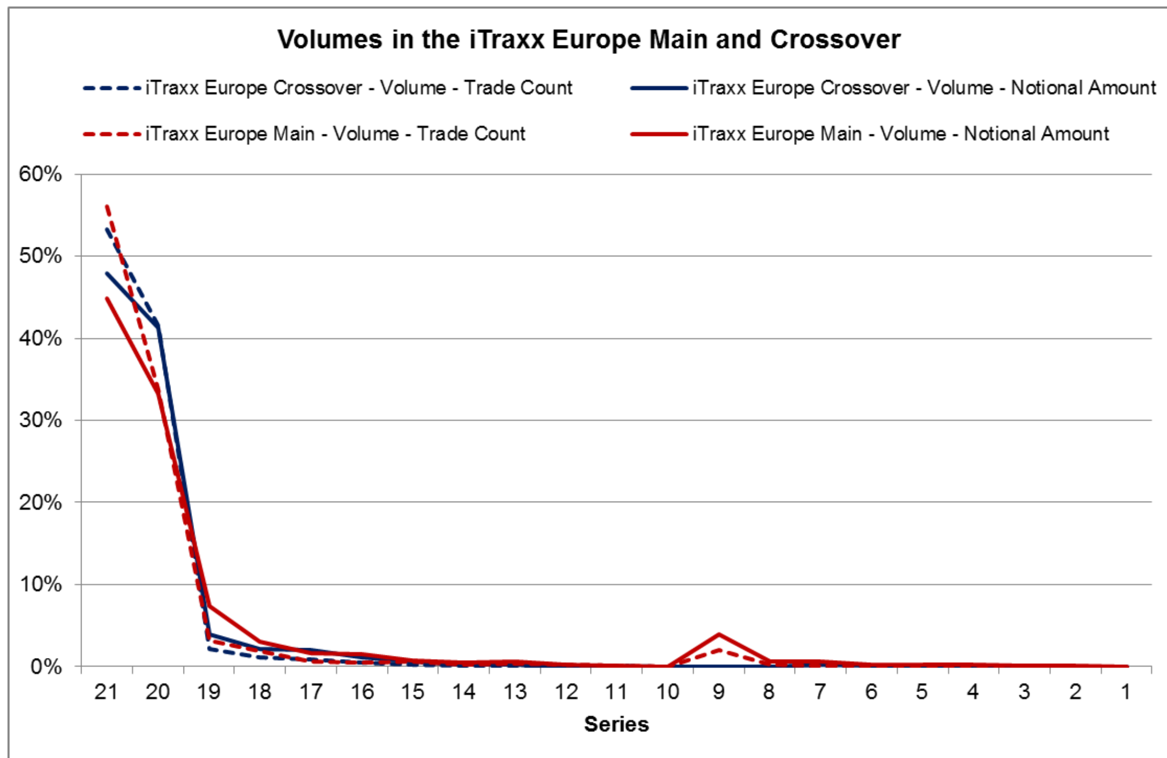
Source: EU Trade Repositories, ESMA calculations

Series

39. The consultation paper presented tables on the flow of trades in CDS classes proposed for the clearing obligation broken down by series number. It showed that the bulk of the activity is concentrated on the on-the-run series and the prior one or two series. Figure 3 maps the volume of uncleared trades in CDS classes and indicates the relative volume by series number. Using EU TR data, Figure 3 confirms this.

40. For the uncleared trades on the two iTraxx indices of the draft RTS and that have been reported to these TRs, the vast majority of the trading activity was mainly on the Series 20 and 21, the two most recent series at the time, and for a smaller part on Series 16 to 19. In addition, Series 9, which was also discussed in the consultation paper and has traditionally attracted more activity than other off-the-run series, here as well indicates some activity.

Figure 3: Volumes in the non-cleared iTraxx Europe Main and Crossover – Breakdown per series



Source: EU Trade Repositories, ESMA calculations

esma

9.2.3 Qualitative impact assessment

9.2.3.1 Structure of the OTC Credit derivatives classes

Policy Objective	**Determine the structure for the classes of OTC credit derivatives to be considered for the clearing obligation**
Option 1	Define classes with the main characteristics (product type, sub type, geographical zone, reference index, settlement currency, series and maturity) that make up these derivatives, including the reference of the first series after which all series are subject to the clearing obligation.
Option 2	Include only the most recent series (on-the-run) in the scope of the clearing obligation.
Option 3	Define each class with the same characteristics but submit a new RTS each time a new series is rolled out and is to be added to the classes.
Preferred Option	**Option 1**

Option 1	**Define classes with the main characteristics (product type, sub type, geographical zone, reference index, settlement currency, series and maturity) that make up these derivatives, including the reference of the first series after which all series are subject to the clearing obligation**
	Qualitative description
Benefits	The approach is simple. Those characteristics define precisely which index CDS is in scope. The three options presented here rely on the same set of characteristics and this set was supported by stakeholders in response to the discussion paper. But the difference between the three options is on how the series included are specified. With this first option, the first series is stated in the RTS and any subsequent series is included from the outset. This has the benefit of a) providing certainty on the scope of the clearing obligation with regards to the index series, and b) it is in line with the approach taken in other jurisdictions in a global OTC credit derivative market.
Costs to regulator	The simpler the classes are defined while still being meaningful, the simpler it will be to identify them and the least costly it will be for regulators to monitor and enforce compliance of counterparties with the clearing obligation. In this respect the options are sorted out from the least costly (Option 1) to the costliest (Options 2 and 3).
Compliance costs	The simpler the classes are defined while still being meaningful and the more aligned internationally, the simpler they will be identified internally by both counterparties to the trade and maintained in the control functions of their

	systems and processes for their on-going compliance checks. In this respect the options are sorted out from the least costly (Option 1) to the costliest (Options 2 and 3).

Option 2	**Include only the most recent series (on-the-run) in the scope of the clearing obligation.**
	Qualitative description
Benefits	With this second option, there is an automatic filter on the liquidity since the on-the-run series is usually the most liquid. Older series are automatically removed from the clearing obligation.
Costs to regulator	With a dynamic scope, it would introduce some uncertainty for counterparties that regulators would need to mitigate to ensure compliance at all times.
Compliance costs	Counterparties would be faced with uncertainty with regards to the scope of the clearing obligation, as this would change every time a new series is issued
Indirect costs	This option may encourage avoidance practise: counterparties could easily avoid the clearing obligation by systematically entering into transactions only on the off-the-run series.

Option 3	**Define each class with the same characteristics but submit a new RTS each time a new series is issued and is to be added to the classes.**
	Qualitative description
Benefits	With this third option, each new series would be added through the process of modifying an existing RTS. This would have the benefit of leaving time for counterparties to prepare for the new series being added to the clearing obligation scope. This would also enable not to add a series that does not exhibit enough liquidity.
Costs to regulator	This approach would have a slightly higher cost than option 1. Where in option 1, the new series are included from the outset, with option 3, companies would need to monitor when the RTS enter into force to activate and start using the new set of class+ to determine compliance. Regulators would need to take this additional factor in monitoring compliance.
Compliance costs	This approach would have a slightly higher cost than option 1. Where in option 1, the new series are included from the outset, with option 3, companies would need to monitor when the RTS enter into force to activate and start using the

	new set of class+ to determine compliance.
Indirect costs	This approach would bring a new series quite late in the clearing obligation. Given that many of these indices have a new series rolled out every 6 month it could be possible for a new series to become part of the class+ while no longer being the on-the-run and usually most active one, due to the length of the process for a new RTS to enter into force. As a result, this would not address systemic risk properly.

9.2.3.2 Definition of the categories of counterparties

Policy Objective	**Determine the categories of counterparties to which different phase-in would apply**
Option 1	The categories of counterparties for the OTC credit derivative classes are defined in the same way as the categories of counterparties for the OTC interest rate derivative classes.
Option 2	The categories of counterparties for the OTC credit derivative classes are defined in a different way than the categories of counterparties for the OTC interest rate derivative classes.
Preferred Option	**Option 1**

Option 1	**The categories of counterparties for the OTC credit derivative classes are defined in the same way as the categories of counterparties for the OTC interest rate derivative classes.**
	Qualitative description
Benefits	The way in which the categories of counterparties are defined for the OTC interest rate derivatives introduces some compliance costs related to the classification of counterparties. The approach of keeping the definition of the categories of counterparties in the RTS unchanged is the simplest one, as most counterparties will not need to re-assess the date from which the clearing obligation applies to them and to their counterparties. Counterparties will be able to leverage on the classification work already accomplished in relation with the first clearing obligation determination, for the interest rate classes.

Costs to regulator - One-off[21]	This is the baseline scenario and it is not expected to add specific costs to regulators or counterparties.
Compliance costs - One-off	This is the baseline scenario and it is not expected to add specific costs to regulators or counterparties.

Option 2	**The categories of counterparties for the OTC credit derivative classes are defined in a different way than the categories of counterparties for the OTC interest rate derivative classes**
	Qualitative description
Benefits	This option, which is more complex, adds the flexibility to better take into account the nature of the counterparties that are specifically active in the OTC credit derivative market.
Costs to regulator - One-off[22]	The costs would depend on the way such a new classification would be framed. In any case, this option would necessitate another round of counterparty classification on top of the one already performed in connection with the clearing obligation on OTC interest rate derivative market. This would necessarily add costs to regulators and counterparties.
Compliance costs - One-off	The costs would depend on the way such a new classification would be framed. In any case, this option would necessitate another round of counterparty classification on top of the one already performed in connection with the clearing obligation on OTC interest rate derivative market. This would necessarily add costs to regulators and counterparties.

[21] On-going costs are irrelevant with respect to phase-in.
[22] On-going costs are irrelevant with respect to phase-in.

9.3 Annex III - Draft Regulatory Technical Standards

COMMISSION DELEGATED REGULATION (EU) …/...

of XXX

supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on the clearing obligation

(Text with EEA relevance)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories[23], and in particular Article 5(2) thereof,

Whereas:

(1) The European Securities and Markets Authority (ESMA) has been notified of the classes of credit over the counter (OTC) derivatives that a central counterparty (CCP) has been authorised to clear. For each of those classes ESMA has assessed the criteria that are essential for subjecting them to the clearing obligation, including the level of standardisation, the volume and liquidity, and the availability of pricing information. With the overarching objective of reducing systemic risk, ESMA has determined the classes of credit OTC derivatives that should be subject to the clearing obligation in accordance with the procedure set out in Regulation (EU) No 648/2012.

(2) The tenor is one common and essential characteristic of OTC credit derivatives. It corresponds to a fixed date on which a credit derivative contract expires. This feature should be taken into account when defining the classes of credit OTC derivatives to be subject to the clearing obligation.

(3) Different counterparties need different periods of time for putting in place the necessary arrangements to clear the credit OTC derivatives subject to the clearing obligation. In order to ensure an orderly and timely implementation of that obligation, counterparties should be classified into categories in which sufficiently similar counterparties become subject to the clearing obligation from the same date.

(4) A first category should include both financial and non-financial counterparties which, on the date of entry into force of this Regulation, are clearing members of at least one of the relevant CCPs and for at least one of the classes of credit OTC derivatives subject to the clearing obligation, as those counterparties already have experience with voluntary clearing and have already established the connections with those CCPs to clear at least one of those classes.

[23] OJ L 201, 27.7.2012, p. 1.

Non-financial counterparties that are clearing members should also be included in this first category as their experience and preparation towards central clearing is comparable with that of financial counterparties included in it.

(5) A second and third category should comprise financial counterparties not included in the first category, grouped according to their levels of legal and operational capacity regarding OTC derivatives. The level of activity in OTC derivatives should serve as a basis to differentiate the degree of legal and operational capacity of financial counterparties, and a quantitative threshold should therefore be defined for division between the second and third categories on the basis of the aggregate month-end average notional amount of non-centrally cleared derivatives. That threshold should be set out at an appropriate level to differentiate smaller market participants, while still capturing a significant level of risk under the second category. The threshold should also be aligned with the threshold agreed at international level related to margin requirements for non-centrally cleared derivatives in order to enhance regulatory convergence and limit the compliance costs for counterparties. As in those international standards, whereas the threshold applies generally at group level given the potential shared risks within the group, for investment funds the threshold should be applied separately to each fund since the liabilities of a fund are not usually affected by the liabilities of other funds or their investment manager. Thus, the threshold should be applied separately to each fund as long as, in the event of fund insolvency or bankruptcy, each investment fund constitutes a completely segregated and ring-fenced pool of assets that is not collateralised, guaranteed or supported by other investment funds or the investment manager itself.

(6) Certain alternative investment funds ("AIFs") are not captured by the definition of financial counterparties under Regulation (EU) No 648/2012 although they have a degree of operational capacity regarding OTC derivative contracts similar to that of AIFs captured by that definition. Therefore AIFs classified as non-financial counterparties should be included in the same categories of counterparties as AIFs classified as financial counterparties.

(7) A fourth category should include non-financial counterparties not included in the other categories, given their more limited experience and operational capacity with OTC derivatives and central clearing than the other categories of counterparties.

(8) The date on which the clearing obligation takes effect for counterparties in the first category should take into account the fact that they may not have the necessary pre-existing connections with CCPs for all the classes subject to the clearing obligation. In addition, counterparties in this category constitute the access point to clearing for counterparties that are not clearing members, client clearing and indirect client clearing being expected to increase substantially as a consequence of the entry into force of the clearing obligation. Finally, this first category of counterparties account for a significant portion of the volume of credit OTC derivatives already cleared, and the volume of transactions to be cleared will significantly increase after the date on which the clearing obligation set out in this Regulation will take effect. Therefore, a reasonable timeframe for counterparties in the first category to prepare for clearing additional classes, to deal with the increase of client clearing and indirect client clearing and to adapt to increasing volumes of transactions to be cleared should be set at six months. Furthermore, the date on which the clearing obligation takes effect for counterparties in the first category should also take into account whether more than one CCP already clear the same class of OTC derivatives by the time this Regulation enters into force. In particular, an important number of counterparties seeking to establish clearing arrangements with the same CCP at the same time would mean that more time is required than when counterparties have the choice of several CCPs to establish their clearing arrangements with. Therefore, an additional period of three months should be granted to ensure an orderly implementation of the clearing obligation.

(9) The date on which the clearing obligation takes effect for counterparties in the second and third categories should take into account the fact that most of them will get access to a CCP by becoming a client or an indirect client of a clearing member. This process may require between 12 and 18 months depending on the legal and operational capacity of counterparties and their level of preparation regarding the establishment of the arrangements with clearing members that are necessary for clearing the contracts. Furthermore, the date on which the clearing obligation takes effect for counterparties in the second and third categories should also take into account whether more than one CCP already clear the same class of OTC derivatives by the time this Regulation enters into force. In particular, an important number of counterparties seeking to establish clearing arrangements with the same CCP at the same time would mean that more time is required than when counterparties have the choice of several CCPs to establish their clearing arrangements with. Therefore, an additional period of three months should be granted to ensure an orderly implementation of the clearing obligation.

(10) The date on which the clearing obligation takes effect for counterparties in the fourth category should take into account their legal and operational capacity, and their more limited experience with OTC derivatives and central clearing than other categories of counterparties.

(11) For OTC derivative contracts concluded between a counterparty established in a third country and another counterparty established in the Union belonging to the same group and which are included in the same consolidation on a full basis and are subject to an appropriate centralised risk evaluation, measurement and control procedures, a deferred date of application of the clearing obligation should be provided. The deferred application should ensure that those contracts are not subject to the clearing obligation for a limited period of time in the absence of implementing acts pursuant to Article 13(2) of Regulation (EU) No 648/2012 covering the OTC derivative contracts set out in Annex I to this Regulation and regarding the jurisdiction where the non-Union counterparty is established. Competent authorities should be able to verify in advance that the counterparties concluding those contracts belong to the same group and fulfil the other conditions of intragroup transactions pursuant to Regulation (EU) No 648/2012.

(12) Unlike OTC derivatives whose counterparties are non-financial counterparties, where counterparties to OTC derivative contracts are financial counterparties, Regulation (EU) No 648/2012 requires the application of the clearing obligation to contracts concluded after the notification to ESMA that follows the authorisation of a CCP to clear a certain class of OTC derivatives, but before the date on which the clearing obligation takes effect, provided the remaining maturity of such contracts at the date on which the obligation takes effect justifies it. The application of the clearing obligation to those contracts should pursue the objective of ensuring the uniform and coherent application of Regulation (EU) No 648/2012. It should serve to seek financial stability and the reduction of systemic risk, as well as ensuring a level playing field for market participants when a class of OTC derivative contracts is declared subject to the clearing obligation. The minimum remaining maturity should therefore be set at a level that ensures the achievement of those objectives.

(13) Before regulatory technical standards adopted pursuant to Article 5(2) of Regulation (EU) No 648/2012 enter into force, counterparties cannot foresee whether the OTC derivative contracts they conclude would be subject to the clearing obligation on the date that obligation takes effect. This uncertainty has a significant impact on the capacity of market participants to accurately price the OTC derivative contracts they enter into since centrally cleared contracts are subject to a different collateral regime than non-centrally cleared contracts. Imposing forward-clearing to OTC derivative contracts concluded before the entry into force of this Regulation, irrespective of their remaining maturity on the date on which the clearing obligation takes effect, could limit counterparties' ability to hedge their market risks

adequately and either impact the functioning of the market and financial stability, or prevent them from exercising their usual activities by hedging them by other appropriate means.

(14) Moreover, OTC derivative contracts concluded after this Regulation enters into force and before the clearing obligation takes effect should not be subject to the clearing obligation until counterparties to those contracts can determine the category they are comprised in and the CCP available to clear those contracts, whether they are subject to the clearing obligation for a particular contract, including their intragroup transactions, and before they can implement the necessary arrangements to conclude those contracts taking into account the clearing obligation. Therefore, in order to preserve the orderly functioning and the stability of the market, as well as a level playing field between counterparties, it is appropriate to consider that those contracts should not be subject to the clearing obligation, irrespective of their remaining maturities.

(15) OTC derivative contracts concluded after the notification to ESMA that follows the authorisation of a CCP to clear a certain class of OTC derivatives, but before the date on which the clearing obligation takes effect should not be subject to the clearing obligation when they are not significantly relevant for systemic risk, or when subjecting those contracts to the clearing obligation could otherwise jeopardise the uniform and coherent application of Regulation (EU) No 648/2012. Counterparty credit risk associated to credit OTC derivative contracts with longer maturities remains in the market for a longer period than that associated to credit OTC derivatives with low remaining maturities. Imposing the clearing obligation on contracts with short remaining maturities would imply a burden on counterparties disproportionate to the level of risk mitigated. In addition, credit OTC derivatives with low remaining maturities represent a relatively small portion of the total market and thus a relatively small portion of the total systemic risk associated to this market. The minimum remaining maturities should therefore be set at a level ensuring that contracts with remaining maturities of no more than a few months are not subject to the clearing obligation.

(16) Counterparties in the third category bear a relatively limited share of overall systemic risk and have a lower degree of legal and operational capacity regarding OTC derivatives than counterparties in the first and second categories. Essential elements of the OTC derivative contracts, including the pricing of credit OTC derivatives subject to the clearing obligation and concluded before that obligation takes effect, will have to be adapted within short timeframes in order to incorporate the clearing that will only take place several months after the contract is concluded. This process of forward-clearing involves important adaptations to the pricing model and amendments to the documentation of those OTC derivatives contracts. Counterparties in the third category have a very limited ability to incorporate forward-clearing in their OTC derivative contracts. Thus, imposing the clearing of OTC derivative contracts concluded before the clearing obligation takes effect for those counterparties could limit their ability to hedge their risks adequately and either impact the functioning and the stability of the market or prevent them from exercising their usual activities if they cannot continue to hedge. Therefore, OTC derivative contracts concluded by counterparties in the third category before the date on which the clearing obligation takes effect should not be subject to the clearing obligation.

(17) In addition, OTC derivative contracts concluded between counterparties belonging to the same group can be exempted from clearing, provided certain conditions are met, in order to avoid limiting the efficiency of intragroup-risk management processes and therefore, undermine the achievement of the overarching goal of regulation (EU) No 648/2012. Therefore, intragroup transactions which fulfil certain conditions and which are concluded before the date on which the clearing obligation takes effect for those transactions should not be subject to the clearing obligation.

(18) This Regulation is based on draft regulatory technical standards submitted by ESMA to the Commission.

(19) ESMA has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits, requested the opinion of the Security and Markets Stakeholder Group established by Article 37 of Regulation (EU) No 1095/2010 of the European Parliament and of the Council[24], and consulted the European Systemic Risk Board.

HAS ADOPTED THIS REGULATION:

Article 1 - Classes of OTC derivatives subject to the clearing obligation

1. The classes of over the counter (OTC) derivatives set out in Annex I shall be subject to the clearing obligation.

Article 2 – Categories of counterparties

1. For the purposes of Articles 3 and 4, the counterparties subject to the clearing obligation shall be divided in the following categories:

(a) Category 1, comprising counterparties which, on the date of entry into force of this Regulation, are clearing members, within the meaning of Article 2(14) of Regulation (EU) No 648/2012, for at least one of the classes of OTC derivatives set out in Annex I of this Regulation, of at least one of the CCPs authorised or recognised before that date to clear at least one of those classes;

(b) Category 2, comprising counterparties not belonging to Category 1 which belong to a group whose aggregate month-end average of outstanding gross notional amount of non-centrally cleared derivatives for *[OP Please insert months; each of the three months which are included in Article 2(1)(b) of Regulation (EU) .../... establishing the clearing obligation for interest rate swaps denominated in EUR, GBP, JPY and USD]* is above EUR 8 billion and which are any of the following:

(i) Financial counterparties;

(ii) Alternative investment funds as defined in Article 4(1)(a) of Directive 2011/61/EU that are non-financial counterparties;

(c) Category 3, comprising counterparties not belonging to Category 1 or Category 2 which are any of the following:

(i) Financial counterparties;

(ii) Alternative investment funds as defined in Article 4(1)(a) of Directive 2011/61/EU that are non-financial counterparties;

[24] Regulation (EU) No 1095/2010 of the European Parliament and the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC (OJ L 331, 15.12.2010, p.84).

(d) Category 4, comprising non-financial counterparties that do not belong to Category 1, Category 2 or Category 3.

2. For the purposes of calculating the group aggregate month-end average of outstanding gross notional amount referred to in point (b) of paragraph 1, all of the group's non-centrally cleared derivatives, including foreign exchange forwards, swaps and currency swaps, shall be included.

3. Where counterparties are alternative investment funds as defined in Article 4(1)(a) of Directive 2011/61/EU or undertakings for collective investment in transferable securities as defined in Article 1(2) of Directive 2009/65/EC, the EUR 8 billion threshold referred to in point (b) of paragraph 1 of this Article shall apply individually at fund level.

Article 3 – Dates from which the clearing obligation takes effect

1. In respect of contracts pertaining to a class of OTC derivatives set out in Annex I, the clearing obligation shall take effect on:

(a) [*OP please insert date:* 9 months after the date of entry into force of this Regulation] for counterparties in Category 1;

(b) [*OP please insert date*: 15 months after the date of entry into force of this Regulation] for counterparties in Category 2;

(c) [*OP please insert date:* 21 months after the date of entry into force of this Regulation] for counterparties in Category 3;

(d) [*OP please insert date:* 3 years after the date of entry into force of this Regulation] for counterparties in Category 4.

Where a contract is concluded between two counterparties included in different categories of counterparties, the date from which the clearing obligation takes effect for that contract shall be the later date.

2. By way of derogation from points (a), (b) and (c) of paragraph 1, in respect of contracts pertaining to a class of OTC derivatives set out in Annex I and concluded between counterparties other than counterparties in Category 4 which are part of the same group and where one counterparty is established in a third country and the other counterparty is established in the Union, the clearing obligation shall take effect on:

(a) [*OP please insert date:* 3 years after the date of entry into force of this Regulation] in case no equivalence decision has been adopted pursuant to Article 13(2) of Regulation (EU) No 648/2012 for the purposes of Article 4 of that Regulation covering the OTC derivative contracts set out in Annex I of this Regulation in respect of the relevant third country; or

(b) The later of the following dates in case an equivalence decision has been adopted pursuant to Article 13(2) of Regulation (EU) No 648/2012 for the purposes of Article 4 of that Regulation covering the OTC derivative contracts set out in Annex I of this Regulation in respect of the relevant third country:

(i) 60 days after the date of entry into force of the decision adopted pursuant to Article 13(2) of Regulation (EU) No 648/2012 for the purposes of Article 4 of that Regulation covering the OTC derivative contracts set out in Annex I of this Regulation in respect of the relevant third country;

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(ii) The date when the clearing obligation takes effect pursuant to paragraph 1.

This derogation shall only apply where the counterparties fulfil the following conditions:

(a) The counterparty established in a third country is either a financial counterparty or a non-financial counterparty;

(b) The counterparty established in the Union is:

(i) A financial counterparty, a non-financial counterparty, a financial holding company, a financial institution or an ancillary services undertaking subject to appropriate prudential requirements and the counterparty referred to in point (a) is a financial counterparty; or

(ii) Either a financial counterparty or a non-financial counterparty and the counterparty referred to in point (a) is a non-financial counterparty;

(c) Both counterparties are included in the same consolidation on a full basis in accordance to Article 3(3) of Regulation (EU) No 648/2012;

(d) Both counterparties are subject to appropriate centralised risk evaluation, measurement and control procedures;

(e) The counterparty established in the Union has notified its competent authority in writing that the conditions laid down in points (a), (b), (c) and (d) are met and, within 30 calendar days after receipt of the notification, the competent authority has confirmed that those conditions are met.

Article 4 – Minimum remaining maturity

1. For financial counterparties in Category 1, the minimum remaining maturity referred to in point (ii) of Article 4(1)(b) of Regulation (EU) No 648/2012, at the date the clearing obligation takes effect, shall be:

(a) 5 years and 3 months for contracts entered into or novated before [*OP please insert date*: five months after the date of entry into force of this Regulation] that belong to the classes in Table 1 set out in Annex I;

(b) 6 months for contracts entered into or novated on or after [*OP please insert date:* five months after the date of entry into force of this Regulation] that belong to the classes in Table 1 set out in Annex I.

2. For financial counterparties in Category 2, the minimum remaining maturity referred to in point (ii) of Article 4(1)(b) of Regulation (EU) No 648/2012, at the date the clearing obligation takes effect, shall be:

(a) 5 years and 3 months for contracts entered into or novated before [*OP please insert date: five months after the date of entry into force of this Regulation*] that belong to the classes in Table 1 set out in Annex I;

(b) 6 months for contracts entered into or novated on or after [*OP please insert date: five months after the date of entry into force of this Regulation*] that belong to the classes in Table 1 set out in Annex I.

3. For financial counterparties in Category 3 and for transactions referred to in Article 3(2) of this Regulation concluded between financial counterparties, the minimum remaining maturity referred to in point (ii) of Article 4(1)(b) of Regulation (EU) No 648/2012, at the date the clearing obligation takes effect, shall be 5 years and 3 months.

4. Where a contract is concluded between two financial counterparties belonging to different categories or between two financial counterparties involved in transactions referred to in Article 3(2), the minimum remaining maturity to be taken into account for the purposes of this Article shall be the longer remaining maturity applicable.

Article 5 – Entry into force

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

For the Commission
The President
Jean-Claude Juncker

ANNEX

to the

Commission Delegated Regulation

supplementing Regulation (EU) N° 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on the clearing obligation

Credit OTC derivatives classes subject to the clearing obligation

TABLE 1: European untranched Index CDS

id	Type	Sub-type	Geographical Zone	Reference Index	Settlement Currency	Series	Tenor
B.1.1	Index CDS	Untranched Index	Europe	iTraxx Europe Main	EUR	17 onwards	5Y
B.1.2	Index CDS	Untranched Index	Europe	iTraxx Europe Crossover	EUR	17 onwards	5Y