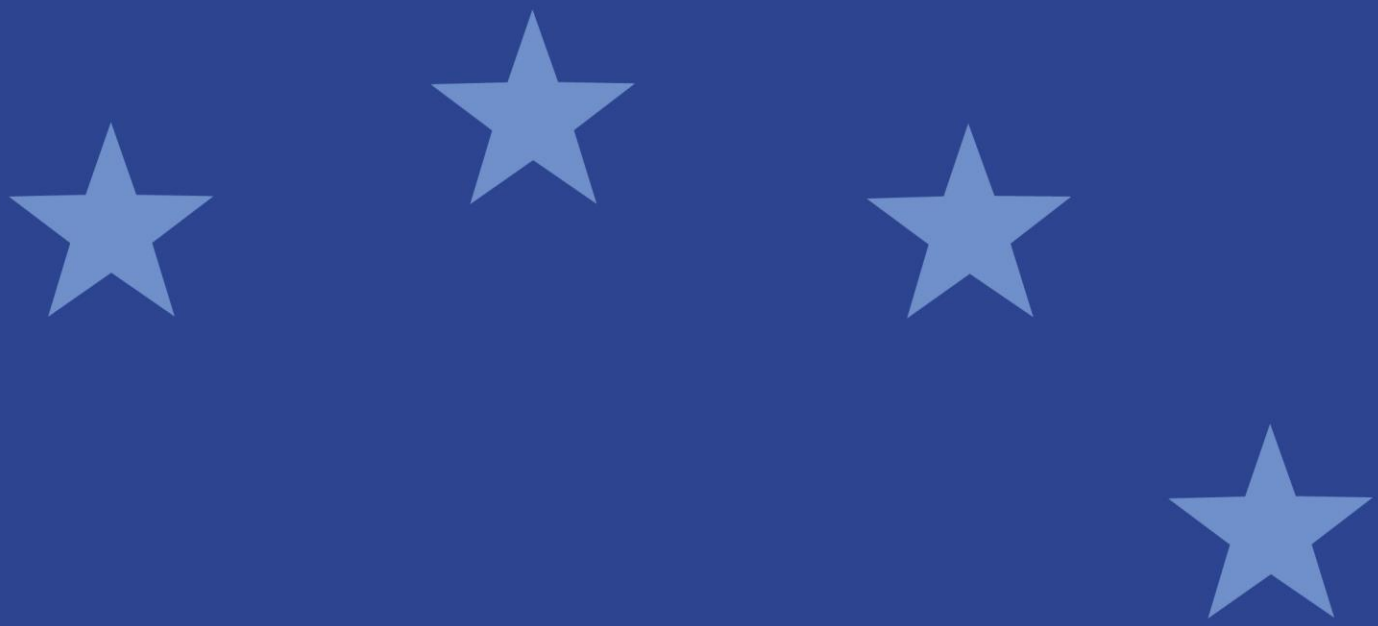
esma European Securities and Markets Authority

Final Report

Draft technical standards on the Clearing Obligation – Interest Rate OTC Derivatives



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Acronyms used

AIF	Alternative Investment Fund
AIFM	Alternative Investment Fund Manager
AIFMD	Alternative Investment Fund Managers Directive (Directive 2011/61/EU)
CCP	Central Counterparty
CDS	Credit Default Swap
CFD	Contract for difference
Class+	Class of OTC derivatives subject (or proposed to be subject) to the clearing obligation
CRR	Capital Requirement Regulation – Regulation (EU) 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012
EMIR	European Market Infrastructures Regulation – Regulation (EU) 648/2012 of the European Parliament and Council on OTC derivatives, central counterparties and trade repositories
ESA	European Supervisory Authorities
ESMA	European Securities and Markets Authority
ESRB	European Systemic Risk Board
ETD	Exchange Traded Derivatives
FC	Financial Counterparty
FRA	Forward Rate Agreement
FX	Foreign Exchange
IRS	Interest Rate Swap
LEI	Legal Entity Identifier
MiFID	Markets in Financial Instruments Directive – Directive 2004/39/EC of the European Parliament and the Council
MTF	Multilateral Trading Facility
NCA	National Competent Authority
NDF	Non-Deliverable Forward
NFC	Non-Financial Counterparty
NFC+	Non-Financial Counterparty subject to the clearing obligation, as referred to in Article 10(1)(b) of EMIR
OIS	Overnight Index Swap
OTC	Over-the-counter
Q&A on EMIR	Questions and Answers on the implementation of EMIR available on ESMA's website
RTS	Regulatory Technical Standards

RTS on OTC Derivatives	Commission Delegated Regulation (EU) No 149/2013
RTS on CCP	Commission Delegated Regulation (EU) No 153/2013
SPV	Special Purpose Vehicle
TR	Trade Repository
UCITS Directive	Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS)

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 (RTS) in relation to the clearing obligation.

In this context ESMA consulted stakeholders on two occasions: a discussion paper was published on 12 July 2013 and a consultation paper including a first version of the draft RTS was published on 11 July 2014. This consultation paper proposed a clearing obligation for certain interest rate classes of OTC derivatives.

This report includes the final version of the draft Regulatory Technical Standards (RTS) that are submitted to the European Commission for endorsement.

Contents

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

The first section provides explanations on the procedural aspects of the clearing obligation. Section 2 provides clarifications on the structure of the classes of OTC derivatives that are proposed for the clearing obligation and addresses the specific nature of covered bond derivatives as well as the functioning of the public register for the clearing obligation. Section 3 covers the determination of the interest rate classes of OTC derivatives that should be subject to mandatory clearing. Section 4 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 5 provides explanations on the approach considered for frontloading and the definition of the minimum remaining maturities of the contracts subject to it.

Finally, Sections 6 and 7 provide feedback on the proposal included in the consultation paper regarding some OTC derivatives classes that ESMA is proposing not to submit to mandatory clearing at this stage. Section 8 includes feedback on other issues that were raised during the consultation.

Next steps

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

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 authorisation. 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[1].

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. This final report follows the publication on 11 July 2014 of a consultation paper on the clearing obligation, proposing some interest rate OTC derivative classes to be subject to the clearing obligation. After the review of the 51 responses received to this consultation, the draft regulatory technical standards were amended as presented in Annex II of this final report.

5. The proposals presented in the consultation paper were broadly supported by stakeholders. This final report develops further in the next sections the moderate changes made to take into account the range of feedback, and provides a number of clarifications mainly on the clearing obligation procedures as requested by stakeholders.

[1] 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

1. The clearing obligation procedure

1. 1. The bottom-up approach

Question 1 of the consultation paper

1. The clearing obligation procedure of Article 5(2), the 'bottom-up' approach, is triggered every time a European CCP is authorised to clear a class of OTC derivatives under Article 14 (initial authorisation) or Article 15 (extension of activity) of EMIR. The procedure is also triggered by the recognition of a third-country CCP by ESMA in accordance with Article 25 of EMIR.

2. This procedure implies that potentially, depending on the date of authorisation of the CCPs, ESMA could submit separate draft RTS on the clearing obligation after each CCP authorisation. ESMA has determined that this process would be inadequate, as stakeholders would need to answer to numerous consultations potentially running in parallel.

3. Therefore ESMA has aimed at grouping, to the extent possible, the analysis of the notified classes of OTC derivatives in a minimal set of consultation papers, and at least to group them per asset-class, where an asset-class, in accordance with market practice, is understood as one of the five following categories: (1) interest rate, (2) credit, (3) foreign-exchange, (4) equity and (5) commodity.

4. Respondents to the consultation have either not commented on the grouping approach or have been supportive of it. There have been a few comments on the procedure but they did not question this grouping approach.

5. Table 1 below provides an overview of the European CCPs that are authorised, or in the process of being authorised, with an indication of the asset-class that they clear[2]. For the authorised CCPs, the information on the cleared asset-classes is based on the formal notifications to ESMA under Article 5(1) whereas for the CCPs that are not yet authorised, the information on the cleared asset-classes is based on the notifications received by ESMA in March 2013 in accordance with Article 89(5), as well as on information gathered by ESMA. Therefore it should be understood that for those non-authorised CCPs, the scope of the cleared asset classes may be subject to changes.

6. In line with the consultation paper, following the grouping approach described in paragraph 3, the final report is proposing a clearing obligation on interest rate OTC derivatives only and as a result is proposing a single draft RTS on the clearing obligation of interest rate OTC derivative classes. It is based on both the analysis detailed in the consultation paper on the clearing obligation No.1 and the associated responses received through the consultation process.

7. Following the grouping approach, the consultation paper presented the analysis of all the classes of interest rate OTC derivatives that ESMA had been notified of at the time of publication of the consultation paper, irrespective of the date of such notifications. These were the OTC interest rate classes cleared by Eurex Clearing AG, KDPW_CCP, LCH.Clearnet Ltd and Nasdaq OMX Clearing AB. CME Clearing Europe Limited has been authorised since and its classes have been notified to ESMA. Although the interest rate OTC derivative classes cleared by CME Clearing Europe Ltd had not been notified at the time of the publication of the consultation paper, its classes were also covered in the

[2] The detail of the classes that the CCPs are authorised to clear is available in the "Public Register for the Clearing Obligation under EMIR" , available under the post-trading section of : http://www.esma.europa.eu/page/Registries-and-Databases

consultation paper No.1 given the overlap[3] with the classes cleared by the four other EU CCPs. The final report thus covers all the OTC interest rate derivative classes that those five EU CCPs are authorised to clear.

Table 1: Asset-Classes cleared by European CCPs

#	CCP Name	Country	Authorised on	RTS Deadline	OTC Interest Rate	OTC Credit	OTC Commodity	OTC Equity	OTC FX
1	Nasdaq OMX	Sweden	18-Mar-14	18-Sep-14	1			1	
2	KDPW_CCP	Poland	08-Apr-14	18-Oct-14	1				
3	Eurex Clearing AG	Germany	10-Apr-14	12-Oct-14	1				
4	LCH.Clearnet SA	France	22-May-14	22-Nov-14		1			
5	European Commodity Clearing (ECC)	Germany	11-Jun-14	11-Dec-14			1		
6	LCH.Clearnet Limited	UK	12-Jun-14	12-Dec-14	1		1	1	1
7	CME Clearing Europe Limited	UK	4-Aug-14	4-Feb-15	1		1		
8	LME Clear Limited	UK	3-Sept-14	3-Mar-15			1		
9	ICE Clear Europe Limited	UK				1			1
10	OMI Clear	Portugal					1		
11	Holland Clearing House	Netherlands						1	
	Number of CCP per asset class				**5**	**2**	**6**	**3**	**2**

Legend:

Some classes proposed to be subject to the clearing obligation in this final report	Classes proposed not to be subject to the clearing obligation	Classes not covered by this final report	Classes not yet notified (CCP not authorised)

[3] The comparison of what each CCP is authorised to clear is available in the "Public Register for the Clearing Obligation under EMIR". The classes cleared by CME Clearing Europe Limited are also cleared by one or more other CCPs, with the main differences being some long maturities between 50 and 51 years or between 30 and 31 years depending on the index, as well as MXN denominated swaps, none of which the analysis indicated as a priority for the clearing obligation.

1. 2. The clearing obligation going forward

8. The final report contains a single draft RTS on the clearing obligation for interest rate OTC derivative classes. This is the first submission of classes to the European Commission but it may be followed by one or more other submissions proposing to add classes to the scope of the clearing obligation.

9. A few respondents have commented on that aspect, asking for information on how the next set of classes could be added. The following paragraphs describe how the clearing obligation will evolve from that first submission. Additionally, a few other respondents asked how the second and potentially other submissions will be framed with regards to the corresponding draft RTS.

10. As for the format of the following draft RTS, it is too premature to say how the second RTS will be submitted, whether it will be amendments to the first one or the submission of a new RTS. Indeed, the policy choices are not yet finalised, the second consultation just ended, the responses are being carefully reviewed and will be taken into consideration for the second final report on the clearing obligation and the resulting RTS approach. In any case, the legal force of any of the two possibilities will make no difference.

11. With regards to how the scope can change, to start with, the bottom-up approach can lead to further classes becoming subject to the clearing obligation. As detailed in paragraphs 2 and 3, as new CCPs get authorised or go through an extension of activity, the new notifications of OTC derivative classes these CCPs are authorised to clear are reviewed and, when not previously covered, trigger the clearing obligation procedure.

12. This was for instance the case with the second consultation paper on the clearing obligation published in parallel to the first consultation paper, which covered credit derivative classes notified to ESMA. It may also be the case for OTC derivatives from other asset classes. The same process would occur, meaning that the analyses presented in the consultation paper and the responses to the consultation would feed into the final report proposal for the corresponding classes. Similarly, the recognition of third country CCPs can also lead to additional classes to be considered for the clearing obligation, also involving a consultation process.

13. Secondly, the scope of the clearing obligation can also evolve independently from the bottom-up approach. In particular, in the event that a class of OTC derivatives has not been declared to be subject to the clearing obligation under the bottom-up procedure triggered by a notification, ESMA may still, on the basis of its initial empowerment, propose a clearing obligation on the same class of OTC derivatives at a later point in time, in order to take into account e.g. market developments or other justifiable reasons. At the reverse, ESMA can also propose later a clearing obligation on a reduced set of classes for the same reasons. In both cases, the process could result in the submission to the European Commission of new draft RTS amending an already adopted RTS.

14. This process ensures that the overarching principle of the clearing obligation to reduce systemic risk is applied on an on-going basis and remains the primary objective. Being based on the publication or the amendment of an RTS, it allows time to take into account the entire range of considerations. An appropriate phase-in would look to provide enough time for counterparties to prepare for the corresponding changes[4].

[4] For the case of sudden and significant changes, the ability and the possibility to suspend quickly a class from the clearing obligation is covered in section 2. 3 of the final report.

15. The 'top-down' approach can also be used by ESMA. Recital 18 of EMIR explains that when an OTC derivative product is identified as suitable for clearing but not currently offered for clearing, ESMA can use this approach to investigate the reasons why it is not cleared by any CCPs. As a result, the top-down approach can also contribute to an extension of the clearing obligation scope.

2. Structure of the Interest rate derivative classes

2. 1. Characteristics to be used for interest rate derivative classes

Question 2 of the consultation paper

16. 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 interest rate derivative 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 in the market place, and
- that the set of characteristics is consistent with the approach taken in other jurisdictions, facilitating international convergence.

17. ESMA proposed to create one class of OTC derivative per product type, when product types are defined as follows:

- Fixed-to-float interest rate swaps (IRS), also referred to as plain vanilla IRS
- Float-to-float swaps, also referred to as basis swaps
- Forward Rate Agreements (FRA)
- Overnight Index Swaps (OIS)

18. In addition, within each of those product types, the following characteristics are used to further define the class: the floating reference rate, the settlement currency, the currency type (i.e. whether the contracts are based on a single currency or on multiple currencies), the maturity, the existence of embedded optionality and the notional amount type (constant, variable or conditional).

19. Beyond the large consensus on the set of characteristics, further comments were made that ESMA considers separately below. They include comments on conditional amounts, the definition of the scope of the clearing obligation and securitisation swaps.

Conditional amounts

20. Some respondents commented on the definition of conditional notional which was defined in the consultation paper, asking to carry it over to the RTS in order to clarify which notional types are part of the classes subject to the clearing obligation (the "Class+").

21. ESMA is of the view that including an explanation in the recitals is consistent with the intent to distinguish notional amounts for which the schedule is known upfront versus notional amounts bearing some optionality and having a dependency on something that is not set at the time of the trade transaction. The difference in the two types of notional amounts is an important characteristic. Indeed, conditional notional amounts that can vary over time, but which schedule is undefined at the time of execution of the trade, increase the complexity for CCPs in terms of pricing and risk

management of the related contracts. Taking this into account, the notional types included in the class+ definition are the constant and variable notional amounts and not the conditional ones.

22. Accordingly, a related explanation has been added in the recital of the draft RTS.

Definition of the scope of the clearing obligation

23. Several respondents commented on defining further the scope of the clearing obligation, namely increasing the ability to determine which contracts have to be cleared and which ones do not have to be. The structure detailed in paragraphs 17 and 18 used to define the classes subject to the clearing obligation contains seven characteristics, but the product specifications or the contractual terms of the interest rate swaps that can be cleared by CCPs contain many more attributes than the seven characteristics. The consultation paper covered this point and indicated possible additional characteristics such as the floating rate tenor, the payment frequency, the reset frequency of the floating leg or the day count fraction. Some respondents mentioned some of these as well as others such as the start date, the type of stubs or break clauses.

24. To achieve the objective of identifying unambiguously the classes subject to the clearing obligation, the responses concentrated around two approaches:

- Option 1: reflect in the RTS that the classes determined to be subject to the clearing obligation have been determined from the bottom-up approach, or
- Option 2: add further granularity in the definition of the classes in the RTS and/or the public register.

25. The first option, consistent with the drafting of the consultation paper, consists in adding a second condition to the RTS to indicate that the choice of classes for the clearing obligation has been generated based on the analysis of the classes that the CCPs were authorised to clear. Following this approach, the RTS would indicate that a class would fall in the scope of the clearing obligation when it meets the seven characteristics and when this class is accepted by an authorised or recognised CCP.

26. The intention of the bottom-up approach is indeed to include in the clearing obligation only contracts that the CCPs accept to clear. Hence the clearing obligation should not lead to a trading ban on contracts that meet the seven characteristics of the RTS but that the CCPs do not clear because of some non-standards features. To clarify this intention, a reference to the bottom-up approach has been added to the Recitals.

27. On the same issue, a few comments were made raising concerns on what would happen if a new clearable feature was later introduced by a CCP, resulting in new contracts within the same class being accepted for clearing. They wondered whether the scope of the clearing obligation would thus become extended only by the decision of a CCP and outside the regulatory process.

28. ESMA agrees that the class+, and the contracts within them, should be determined via the RTS process rather than by the decision of a CCP. To reflect this objective the Recitals have been amended to explain that the selection of the mandatory classes covered only contracts that the authorised CCPs have accepted for clearing at the time of authorisation.

29. With regard to the second option, i.e. adding further characteristics on top of the seven characteristics of paragraphs 19 and 20 in the RTS or in the public register, or both, this reiterates some comments received to the discussion paper on the clearing obligation. Yet, more respondents to

the consultation paper commented in favour of the clarification introduced with option 1, linking the classes to the product specifications of contracts accepted for clearing, rather than for the addition of other characteristics under option 2. ESMA is of the opinion that option 1 provides legal certainty and that option 2 is not necessary.

30. Finally, this approach of defining the classes with these seven characteristics and a reference to what is accepted by the CCPs is consistent with what is being done in other jurisdictions for mandatory clearing. The recitals of the RTS were updated to reflect this approach in the definition of the classes subject to the clearing obligation.

Securitisation swaps

31. A few respondents raised the case of swaps entered into by securitisation or structured finance special purpose vehicles and other structured finance derivative transactions, otherwise referred to as "securitisation swaps". They explained that for the same reasons as envisaged for covered bonds, these swaps should not be made mandatory to clear, being tailored in terms of their cash flow schedule and their contractual terms. These respondents also explained that due to these bespoke aspects, they are not accepted for clearing by any CCPs, not being standard nor liquid enough.

32. First of all, securitisation swaps are generally designed such that the payments match the cash flow of the securitised portfolio or structure. In doing so, their notional amounts usually fall in the category of conditional notional amounts as detailed in paragraph 20 above. If securitisation swaps are subject to change in an unpredictable way because they are linked to the payment schedule of their underlying assets, this would make them fall outside the classes proposed for the clearing obligation in the draft RTS. Swaps that meet all the other six characteristics of the classes but that have a conditional notional are outside the scope of the clearing obligation.

33. Secondly, securitisation swaps generally include bespoke contractual terms that may include limited recourse provisions, specific break closes, requirements for transfers to a replacement counterparty triggered by a rating downgrade threshold breach, bankruptcy related provisions, etc. CCPs currently clear interest rate derivative classes that have standardised contractual terms, which has been the base for the bottom-up approach. As clarified in paragraph 28, classes that meet the seven characteristics but that no CCP accepts for clearing should not be subject to the clearing obligation.

34. Finally, while EMIR has specific references to covered bonds and derivatives used in this context, as detailed in the section on covered bonds, it is not the case for securitisation swaps. Therefore, specific conditions for this use of swaps are not envisaged. The general rules apply to them, the draft RTS lays out the conditions for when swaps need to be cleared or not, depending on whether the contracts meet the seven characteristics and are accepted for clearing.

2. 2. Covered bond derivatives

Question 3 of the consultation paper

35. The draft RTS included in the consultation paper introduced a number of conditions under which covered bond derivatives would not be subject to the clearing obligation. Those conditions derived from previous consultations with stakeholders and were to a large extent identical to the ones presented in the consultation paper on risk-mitigation techniques for OTC-derivative contracts not

cleared by a CCP[5], although some modifications were included to reflect the difference in the underlying requirements.

36. Stakeholders welcomed the inclusion in the RTS of an Article taking into consideration the specific nature of covered bond derivatives, as required by Recital 16 of EMIR. Although indicating that the conditions as proposed generally reflect the issues at stake regarding central clearing for covered bond derivatives, they made suggestions of two types: some questioned the necessity of including conditions, and others made drafting proposals on those conditions.

37. Regarding the first point, several stakeholders are of the view that there should not be any condition on covered bond derivatives to be exempted from central clearing, because it is not technically possible to clear them. The main technical impediment as identified in the consultation paper is unilateral collateral posting which is embedded in the documentation in accordance with covered bond legal framework and credit rating agency criteria.

38. Regarding the second point, the comments on the 6 conditions included in the draft RTS are detailed below.

(a) they are not terminated in case of default of the covered bond issuer;

39. Several respondents suggested adding the word "insolvency-related" before the word "default. The reason is that the purpose of this restriction should be to avoid that the derivative is terminated as a result of the issuer's insolvency, not to prevent the counterparty from terminating upon other limited non-insolvency-related defaults, as this would conflict some credit rating agencies criteria. Indeed they indicate that there may be circumstances where the termination of the derivative is appropriate.

40. ESMA has modified condition (a) to take this element into consideration by referring to resolution and insolvency instead of default.

(b) the counterparty to the contracts, which counterparty is not the cover pool or the covered bond issuer, ranks at least pari-passu with the covered bond holders;

41. Respondents commented that the wording "which counterparty is not the cover pool or the covered bond issuer" should be amended because it would preclude the covered bond issuers from initially entering into swaps with the cover pool, which is common practice in the covered bond market. It was therefore proposed to delete the last part of the bloc "or the covered bond issuer".

42. The sentence "which counterparty is not the cover pool or the covered bond issuer" was not included in the draft RTS on risk-mitigation techniques for OTC-derivative contracts not cleared by a CCP, and aimed at further defining the term "derivative counterparty". However in view of the comments received, the original wording used in the draft RTS on risk-mitigation techniques for OTC-derivative contracts not cleared by a CCP was re-inserted.

(c) they are registered in the cover pool of the covered bond programme in accordance with national covered bond legislation;

[5] Draft regulatory technical standards on risk-mitigation techniques for OTC-derivative contracts not cleared by a CCP under Article 11(15) of Regulation (EU) No 648/2012 published on 14 April 2014 and available at https://www.eba.europa.eu/documents/10180/655149/JC+CP+2014+03+%28CP+on+risk+mitigation+for+OTC+derivatives%29.pdf

43. The proposals on this condition were in respect of the word "registered", because the concept of "registration" of a swap in the cover pool is not harmonised at European level. In some cases the segregation of the cover pool is achieved through the cover pool being held by a separate asset pool owner (a special purpose vehicle), which enters into the swaps. In this case the swap is not identified as forming part of the cover pool via a formal registration process.

44. ESMA acknowledges that the condition on a covered bond derivatives to be "registered" will not easily be fulfilled in all jurisdictions depending on the structure of the covered bond and has modified the drafting of condition (c) to take it into account.

(d) they are used only to hedge the interest rate or currency mismatches of the cover pool;

45. Respondents noted that this condition was different than the one included in the consultation paper on risk-mitigation techniques for OTC-derivative contracts not cleared by a CCP. Indeed in the consultation paper on the clearing obligation ESMA had sought to be more specific and to define with more certainty what was understood to be "hedging". Stakeholders did not dispute the second drafting including the reference to the "interest rate or currency mismatches". However they encouraged ESMA to ensure consistency between the two sets of RTS.

46. This was indeed the intention of the ESAs, which have analysed both the responses to the consultation on the clearing obligation and the responses to the consultation on risk-mitigation techniques for non-cleared OTC-derivative when drafting this new proposal, having in mind that the draft RTS on the clearing obligation is likely to be submitted to the European Commission before the draft RTS on risk-mitigation techniques.

(e) the covered bond programme to which they are associated meets the requirements of Article 129 of Regulation (EU) No 575/2013; and

47. Although supporting the principle of using a classification of covered bonds which is harmonised at European level, some stakeholders mentioned a preference for adding a reference to the UCITS Directive, either by replacing the reference to Regulation (EU) No 575/2013 (the Capital Requirement Regulation, "CRR") with a reference to UCITS, or by having references to both UCITS and CRR.

48. Those stakeholders indicate that some covered bonds in Europe are based on strong legal framework, offering high quality and credit protection for investors, which generally fulfil the same conditions as covered bonds meeting the conditions of Article 129 of CRR, but which are backed by assets not listed therein.

49. In this respect, ESMA is of the view that a reference to UCITS alone may create an exemption to all nationally regulated covered bonds including those with relatively less liquid or less standardised underlying assets e.g. aircraft loans programmes. Article 129 of CRR enables to limit the scope to relatively more liquid and more standard underlying assets. It also provides some certainty around credit risk criteria, valuation minimum criteria, disclosure criteria to investors, which come in addition to national covered bond regimes.

50. Therefore, to better support the main rationale of this condition, i.e. that the privileged recourse of the derivative counterparty to the underlying assets is *equivalent* to the protection of margins, the reference to CRR is preferable and ESMA has not modified the original draft RTS in this respect.

(f) the covered bond programme to which they are associated is subject to a legal collateralisation requirement of at least 102%.

51. Several respondents are of the view that the 2% over-collateralisation requirement should not necessarily be of regulatory nature, as implied by the drafting "legal collateralisation". They indicate that the 2% over-collateralisation is not a legal requirement in all EU countries, hence covered bonds issued in countries where there is no such legal requirement would be put at a competitive disadvantage. They proposed to consider a contractual over-collateralisation of 2% as an alternative to a legal mandatory over-collateralisation.

52. ESMA has not modified the draft RTS in this respect because over-collateralisation is an essential way to mitigate the absence of margins and it was recognised by EBA as a best-practise in the recommendations formulated to the European Commission on EU covered bond frameworks and capital treatment[6].

2. 3. Public Register

Question 4 of the consultation paper

53. There was a large consensus in the responses supporting the views expressed by ESMA regarding the articulation between the RTS and the public register and in particular:

- that the addition of a new Class+ should exclusively be possible via the full RTS procedure
- that the RTS procedure would not be appropriate in case there is an urgent need to remove a specific Class+ from the scope of the clearing obligation.

54. Stakeholders cited a number of reasons why ESMA may need to act as a matter of urgency to remove a specific class from the clearing obligation e.g.: a drop in the liquidity of the contracts leading the CCPs to impose extremely high margin requirements, a situation where a CCP is no longer authorised/recognised or ceases to clear a Class+ and the other CCPs are unable to absorb the resultant trade activity or stressed market conditions leading to clearing member defaults.

55. For that reason respondents were supportive of the idea set out in the consultation paper i.e. to make sure that the clearing obligation process is modified to address this issue during the review process of EMIR to be performed in 2015. In the context of that review, stakeholders supported the idea of granting additional powers to national authorities and ESMA in a manner that is similar to the one adopted in the context of the Short-Selling Regulation. Others suggested that the approach of "non-enforcement" via the no-action letter adopted in the United States could also be an efficient solution in this context. In addition, some suggested that if a procedure is established to remove or suspend the clearing obligation leading those contracts to be subject to the risk mitigation techniques of Article 11, counterparties should be granted sufficient time to comply with the rules applicable to non-cleared contracts.

56. However stakeholders remained concerned that the timing of the EMIR review would come too late, probably after the entry into force of the clearing obligation, and that meanwhile ESMA should find an interim solution to address it -- some stakeholders going as far as suggesting that no clearing

[6] EBA report on EU covered bond frameworks and capital treatment available at: https://www.eba.europa.eu/documents/10180/534414/EBA+Report+on+EU+Covered+Bond+Frameworks+and+Capital+Treatment.pdf

obligation should be imposed before a suitable solution has been found to swiftly remove the clearing obligation.

57. One proposal put forward by stakeholders is to modify the RTS with an accelerated process, and in particular without public consultation. Although this solution may be possible in theory, it is unlikely to solve the issue as the time needed to modify the RTS even without public consultation would fall short of the delay (few days) in which the clearing obligation would need to be suspended.

58. Others suggested using the Public Register to communicate to the public that a clearing obligation is suspended. There would be no legal basis for ESMA to proceed in such a way under the current EMIR framework but this solution could be looked at in more detail under the review process of EMIR.

59. Finally, some respondents proposed that the RTS on the clearing obligation specify a number of conditions under which the clearing obligation would be removed or suspended e.g. the existence of at least two CCPs available to clear the contracts in the Class+, a minimum number of clearing members, some liquidity threshold. ESMA had already considered this option but discarded it mainly on legal grounds. Indeed EMIR requires ESMA to define the *contracts* subject to the clearing obligation as opposed to the *conditions* under which the contracts are subject to the clearing obligation as those conditions are already defined under the Level 1 text. There would be a number of legal and operational issues around the assessment of the new criteria to be defined in the RTS, e.g. the frequency of this assessment, and the transparency of the rules to the public.

60. ESMA has expressed several times that the lack of an agile mechanism to suspend the clearing obligation may bring additional risks to markets. As a result ESMA will seek to insist, including in the review process of EMIR, to ensure that a more efficient and flexible process is built for the establishment and removal of the clearing obligation. However, the draft RTS on the clearing obligation was not modified in this respect following the consultation since this would be beyond the empowerment for ESMA under EMIR.

61. Some suggestions were made around the practical aspects of the Public Register. ESMA will seek to make the Public Register available in csv format as suggested by some responses to facilitate downloading. Some respondents would like to be informed when the Public Register is updated. In fact this feature is already available by subscribing to the ESMA website and creating alerts. An email is then sent every time a new document is published by ESMA.

3. Classes of OTC derivatives to be subject to the clearing obligation

Question 5 of the consultation paper

62. Following the analysis of the criteria as defined in EMIR, ESMA proposed in the consultation paper to subject certain interest rate derivative classes to the clearing obligation. The classes ranged across four product types and are listed below in Table 2 to Table 5:

Table 2: Basis swaps class

Type	Reference Index	Settlement Currency	Maturity	Settlement Currency Type	Optiona-lity	Notional Type
Basis	EURIBOR	EUR	28D-50Y	Single currency	No	Constant or Variable
Basis	LIBOR	GBP	28D-50Y	Single currency	No	Constant or Variable
Basis	LIBOR	JPY	28D-30Y	Single currency	No	Constant or Variable
Basis	LIBOR	USD	28D-50Y	Single currency	No	Constant or Variable

Table 3: Fixed-to-float interest rate swaps class

Type	Reference Index	Settlement Currency	Maturity	Settlement Currency Type	Optiona-lity	Notional Type
Fixed-to-Float	EURIBOR	EUR	28D-50Y	Single currency	No	Constant or Variable
Fixed-to-Float	LIBOR	GBP	28D-50Y	Single currency	No	Constant or Variable
Fixed-to-Float	LIBOR	JPY	28D-30Y	Single currency	No	Constant or Variable
Fixed-to-Float	LIBOR	USD	28D-50Y	Single currency	No	Constant or Variable

Table 4: Forward rate agreement class

Type	Reference Index	Settlement Currency	Maturity	Settlement Currency Type	Optiona-lity	Notional Type
FRA	EURIBOR	EUR	3D-3Y	Single currency	No	Constant or Variable
FRA	LIBOR	GBP	3D-3Y	Single currency	No	Constant or Variable
FRA	LIBOR	USD	3D-3Y	Single currency	No	Constant or Variable

Table 5: Overnight index swaps class

Type	Reference Index	Settlement Currency	Maturity	Settlement Currency Type	Optiona-lity	Notional Type
OIS	EONIA	EUR	7D-3Y	Single currency	No	Constant or Variable
OIS	FedFunds	USD	7D-3Y	Single currency	No	Constant or Variable
OIS	SONIA	GBP	7D-3Y	Single currency	No	Constant or Variable

63. A large majority of respondents to the consultation either did not comment on the proposed classes or provided broad support for the classes detailed above, with the latter group being the largest. 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 interest rate derivative classes cleared by the authorised CCPs, and
- the set of classes was consistent for the largest part with the clearing mandates in other jurisdictions allowing international convergence.

64. Nonetheless, some respondents commented on the classes in favor of a change in the scope. These hinge on three changes that are further developed in the following paragraphs:

- including in the clearing obligation all the classes authorised to be cleared,
- aligning more closely the set of classes to the scope in other jurisdictions, in particular the scope of mandatory clearing in the United States, and
- adding classes of interest rate swaps denominated in some of the other EU currencies.

Widening the scope of the clearing obligation

65. A couple of respondents favoured the inclusion of all the classes that CCPs are authorised to clear. With regards to the interest rate derivative classes, that would mean all the combinations of product types, currencies, indices and tenors that the CCPs accept for clearing. In particular, in the EU, across the five CCPs authorised to clear some interest rate derivative classes, 18 currencies are supported.

66. To begin with, as indicated in Recital 15 of EMIR, "not all CCP-cleared OTC derivative contracts can be considered suitable for mandatory clearing". There cannot be an automatic inclusion of the authorised classes directly into the clearing obligation. Instead, EMIR defines the "process of identification of classes of derivatives that should be subject to the clearing obligation", based on a series of criteria to base the analysis on.

67. Following the procedure of section 1. 1, after reviewing this first set of authorised classes against the EMIR criteria, as presented in the consultation paper, ESMA has determined a subset of classes to be subject to the clearing obligation. On the contrary, several classes, including all the classes denominated in certain currencies, are currently determined to be not fit for the clearing obligation.

Strengthen further international convergence

68. As mentioned, many respondents were in support of the current set of classes in part due to their consistency with the OTC interest rate derivative contracts that are mandated to be cleared in other jurisdictions. Yet, several respondents flagged that it was not an exact match, with the majority of them highlighting the difference in the maximum maturity for the OIS class, 2 years in the United States and 3 years in the presented draft RTS. Few respondents mentioned the JPY denominated FRAs not being in the draft RTS while being in scope in the United States.

69. ESMA has consulted with the regulators in the main jurisdictions and has not received objections from their side. ESMA is not in a position to comment the process in other jurisdictions to decide on the scope of contracts and maintain it over time, but there is an effort amongst regulators to facilitate convergence where possible, which can possibly take place over several iterations as each one takes into account its own market specificities and regulatory process. Therefore, as further cooperation continues to take place, the scope may evolve and possibly align further in different jurisdictions.

70. At this stage, with regards to this draft RTS, based on the analysis of the criteria, ESMA is of the opinion that there is sufficient activity beyond the two year tenor for the OIS classes presented in the consultation paper for them to be included up to the 3 year tenor. On the contrary, the level of activity in the JPY denominated FRAs does not warrant for this class to be included in the European mandate.

Adding classes of interest rate swaps denominated in some of the other EU currencies

71. Last but not least, several respondents raised the question of the scope being limited to the G-4 currencies and not including additional classes denominated in other EU currencies. In particular, the respondents highlighted the case of derivatives denominated in the Nordic region currencies (DKK, NOK, SEK) as well as in PLN. Similarly, the ESRB pointed to additional factors and data to be taken into account when considering classes for the clearing obligation, with some of these factors also supporting including some of these classes. Beyond the liquidity considerations, the responses stress the major importance of these currencies within their respective domestic markets and the resulting systemic risk at local level.

72. In order to illustrate this case, some data presented in the consultation paper is broken down geographically in the below tables. Table 6 (corresponding to Table 4 in the consultation paper no.1) gives a view of the evolution of the flow within the OTC interest rate derivative market across several currencies, based on daily turnover figures in certain months and years.

Table 6: Daily turnover in Interest rate OTC derivatives per currency, in the month of April over the past 15 years, for currencies with a percentage share above 0.5%

Daily averages, in billions of US dollars and percentage share										
	2001		2004		2007		2010		2013	
Currency	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
EUR	232	47	461	45	656	39	834	41	1,146	49
USD	152	31	347	34	532	32	654	32	657	28
GBP	37	8	90	9	172	10	213	10	187	8
JPY	27	6	46	5	137	8	124	6	70	3
AUD	8	2	12	1	19	1	37	2	76	3
SEK	5	1	13	1	33	2	20	1	36	2
CAD	6	1	8	1	15	1	48	2	30	1
BRL	0	0	1	0	2	0	3	0	16	1
ZAR	0	0	2	0	3	0	5	0	16	1
CNY	...	...	...	...	0	0	2	0	15	1
CHF	6	1	10	1	19	1	20	1	14	1
KRW	0	0	0	0	5	0	16	1	12	1

Source: BIS Semi-annual survey

73. The relative percentages for the turnover of each currency are not the same as the relative percentages for the corresponding gross notional amounts, the latter being an indicator of the stock. Certain currencies exhibit a bigger share in terms of flow compared to their share in terms of stock and vice versa, for instance AUD and JPY respectively. Likewise, the numbers and percentages have slightly varied over the years, in particular with JPY which has had a much larger importance over time than in April 2013 alone, representing 6% on average in the table while representing 3% in April 2013. This indicator of the flow is indeed one metric amongst several others that can help determine the importance of the respective currencies and possible trends. However, overall and over time, these figures are consistent with the other metrics presented in the consultation paper and demonstrating that the G-4 currencies have been the predominant ones.

74. Turning to data related to the last column of that table, let's look at the geographic distribution of the turnover for the month of April 2013 as an indicator of the flow at a more local level. For JPY, when extrapolating the comment made in paragraph 73 locally, it can be assumed that the share of the turnover over time in terms of flow is higher than the one for the month of April 2013 alone. Table 7 gives the breakdown for the G4 currencies and Table 8 for the other currencies authorised to be cleared. In absolute terms and considering the previous comments, the G-4 currencies would still represent the predominant currencies in the European Union.

Table 7: Daily turnover in Interest rate OTC derivatives per currency, in the month of April 2013, for the G-4 currencies (amounts in million USD and relative percentages)

	G4			
OTC IRD Turnover	EUR	GBP	JPY	USD
International				
Australia	351	104	8	8,732
Canada	3,305	968	53	12,725
Japan	478	7	60,549	4,880
Norway	330	4	0	634
Switzerland	24,267	1,015	87	3,184
United States	27,090	3,162	4,323	546,268
European Union				
Total	1,277,744	201,284	15,758	180,866
Percentage	96%	97%	19%	23%
Total (all countries)	1,336,075	206,643	84,335	776,268

Source: BIS Semi-annual survey

Table 8: Daily turnover in Interest rate OTC derivatives per currency, in the month of April 2013, for the non G-4 currencies offered for clearing (amounts in million USD and relative percentages)

	non-G4 currencies authorised to be cleared by one or more EU CCPs													
OTC IRD Turnover	AUD	CAD	CHF	CZK	DKK	HKD	HUF	MXN	NOK	NZD	PLN	SEK	SGD	ZAR
International														
Australia	54,744	15	-	-	-	2	-	-	-	2,089	-	-	119	-
Canada	493	16,337	2	-	-	-	-	46	-	12	-	-	-	-
Japan	737	1	3	-	-	0	-	1	-	14	-	-	-	2
Norway	-	2	-	-	-	-	-	-	4,536	-	11	133	-	-
Switzerland	234	-	3,132	-	59	-	-	-	246	-	0	394	-	-
United States	3,535	17,834	276	121	120	263	122	9,074	118	212	140	360	318	282
European Union														
Total	26,425	1,050	13,602	804	4,389	429	2,976	726	6,804	1,638	9,093	43,362	390	9,390
Percentage	26%	3%	80%	87%	96%	16%	96%	6%	58%	22%	98%	98%	8%	46%
Total (all countries)	102,405	35,261	17,025	929	4,568	2,752	3,098	12,337	11,706	7,377	9,244	44,257	4,650	20,228

Source: BIS Semi-annual survey

75. At the same time, besides the absolute numbers and their comparison to the G-4 currencies, Table 8 confirms a high concentration of the flow of European currencies denominated interest rate swaps within the European Union. For instance, it indicates that 98% of the daily turnover in April 2013 for interest rate OTC derivatives denominated in PLN or SEK was in the European Union. We break down further this data within the European Union in Table 9 to look at their predominance in their respective domestic markets.

Table 9: Daily turnover in Interest rate OTC derivatives per currency, in the month of April 2013, for the non G-4 currencies offered for clearing (amounts in million USD and relative percentages)

			non-G4 EU & EEA currencies authorised to be cleared by one or more EU CCPs						
OTC IRD Turnover	Total for the country	Percentage of domestic currency in total for the country	CHF	CZK	DKK	HUF	NOK	PLN	SEK
Domestic (EU)									
Czech Republic	157	90%	-	142	1	-	-	-	-
Denmark	59,354	5%	6	-	3,189	3	377	80	4,391
Hungary	83	100%	-	-	-	83	-	-	-
Poland	3,038	96%	-	13	-	-	-	2,916	-
Sweden	16,998	78%	-	-	61	-	778	-	13,228
Domestic (EEA)									
Norway	5,651	80%	-	-	-	-	4,536	11	133
Switzerland	32,618	10%	3,132	-	59	-	246	-	394
Percentage in domestic country			18%	15%	70%	3%	39%	32%	30%
European Union									
Total			13,602	804	4,389	2,976	6,804	9,093	43,362
Percentage in EU			80%	87%	96%	96%	58%	98%	98%
Total (all countries)			17,025	929	4,568	3,098	11,706	9,244	44,257

76. Table 9 indicates that apart from DKK and CHF, the flow of interest rate derivatives denominated in CZK, HUF, NOK, PLN and SEK is in majority done outside their domestic market, while these currencies still represent the most dominant part of the flow within their respective countries. This is an indication of the relative importance of these classes for their domestic markets and the counterparties operating in these markets as well as their connection to the rest of the EU-wide region. For DKK, it is slightly different as the figures indicate a much larger flow in Denmark of EUR denominated swaps in comparison to the DKK denominated ones, but the majority of the flow of DKK denominated interest rate derivatives is in Denmark.

77. This set of metrics is one of several factors that can inform the decision whether to include some of these currencies in the clearing obligation. With regards to the European currencies denominated OTC interest rate derivative classes discussed in Table 9, the vast majority of the flow being in

Europe, it can be argued that international consistency is less a driving factor as these currencies are most relevant for the European region.

78. This turnover breakdown complements additional evidence or metrics communicated by respondents. The ESRB's response also goes in that direction[7], that although the current metrics may indicate lower levels of liquidity and do not allow to conclude with certainty on whether to include them, running the analysis on a larger set of data may validate that additional classes denominated in other currencies could be included in the clearing obligation. ESMA is using this data and is collecting additional data via trade repositories as progress is made on data quality and usability. This is used as the basis to analyse further these classes against the criteria of EMIR for the clearing obligation.

79. The analysis presented in the consultation paper, as well as the analysis by the ESRB and some feedback to the public consultation suggest that it is appropriate to continue to assess the scope beyond the G-4 currency denominated classes fit for the clearing obligation. Clearly, mitigating systemic risk in the EMIR framework requires also regional considerations. However, before ESMA determines unambiguously which other currencies need to be added to the clearing obligation, some more analysis is required. As a result, they are not added to this draft RTS. As explained in section 1.2, ESMA can add at any moment classes that were not previously declared to be subject to the clearing obligation.

80. ESMA is already conducting the analysis, with the information provided and its own data collection, on some of the classes denominated in other currencies, including the Nordic region currencies as well as PLN, as to whether they should be subject to the clearing obligation. For these classes denominated in other currencies, it is likely that, following this analysis, ESMA launches a new consultation shortly. This can be envisaged in the coming few months, probably right after the Commission approval of this first set of RTS.

4. Dates of application and categories of counterparties

4. 1. CCPs and clearing members

Question 6 of the consultation paper

81. In the answers to question 6 regarding the number of CCPs and clearing members available to clear a certain Class+, numerous stakeholders reiterated a feedback already collected after the publication of the discussion paper in the summer 2013, i.e. that no clearing obligation should be imposed unless there are at least 2 CCPs available to clear them. The most cited reason for this is to avoid a situation of monopoly and the concentration of risk in a single market infrastructure. As discussed above some suggested including this condition in the RTS so that the clearing obligation can be automatically removed in case the number of CCPs available to clear a specific class falls below 2.

82. It should be noted that the issue is not relevant for the IRS classes proposed to be subject to the clearing obligation in this final report, as there are currently 4 European CCPs authorised to clear some or all the classes[8] and at least two CCPs clearing each one of them. Besides, as explained in the

[7] The ESRB's response is available at the following address: https://www.esrb.europa.eu/pub/pdf/other/140820_ESRB-response.pdf?afabaffb51f97801554f1af57aa9548b

[8] The public register for the clearing obligation includes the classes that CCPs are authorised to clear. It is available under the post-trading section of: http://esma.europa.eu/page/Registries-and-Databases

section related to the Public Register, ESMA shall define the *contracts* subject to the clearing obligation but currently has no legal basis to specify in the RTS additional *conditions* under which those contracts are subject to the clearing obligation. Although no action is required in the current draft RTS to address the issue, ESMA notes that it is a point of importance for stakeholders and that it should be taken into consideration for subsequent clearing obligation procedures.

Indirect Client Clearing

83. A few stakeholders urged ESMA to bear in mind that indirect clearing may be essential in order to facilitate the use of central 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.

84. 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. ESMA is considering the reasons for this lack of offer, including the commercial incentive and the existence of some legal impediment to provide indirect clearing services in accordance with the requirements of the RTS on OTC Derivatives.

4. 2. Categories of Counterparties

4.2.1. Category 1

85. In the consultation paper, ESMA proposed to include in Category 1 counterparties that, on the date of entry into force of the RTS on the clearing obligation, are clearing members for any of the Class+ of the draft RTS, of any CCP authorised to clear at least one of the Class+. This proposal was generally supported by stakeholders subject to a few clarifications and suggestions as detailed below.

Classification for clearing members: cumulative or per asset-class

86. Some responses supported a classification of clearing members that is done per asset-class. This corresponds to Option 4 in the Cost-Benefit analysis and means that the same counterparty could be in Category 1 for e.g. Interest Rate and in Category 2 for CDS. 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.

87. 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.

88. In this respect it would be useful to consider the responses received to the second consultation paper on the clearing obligation (ended on 18 September 2014) to have a broader picture of the stakeholders views on this issue. Indeed the first RTS on the clearing obligation is not directly impacted by the choice for one option ("cumulative" approach, as presented in the consultation paper, or "per asset class" as proposed in the responses to this consultation paper) whereas the second RTS will be impacted.

89. It should be noted that the approach where the clearing membership is assessed "per asset class" contradicts another comment put forward by numerous stakeholders and that is examined in more detail below, i.e. that the Category 2 is too broad, heterogeneous and that it contains too many counterparties. Indeed, if clearing members are classified per asset class, it would lead to having a smaller group of counterparties in Category 1 and more in Category 2, and to having more sophisticated counterparties falling under Category 2.

90. In this respect it is likely that the level of sophistication of a counterparty is best assessed overall rather than at the level of the asset-class, and therefore 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.

91. Therefore at this stage ESMA has used a wording in the draft RTS which allows either the non-cumulative or the cumulative approaches. The approach will depend on the choices made with the next sets of classes+, following the related consultations. In practice the cumulative approach is achieved by referring to clearing members, for at least one of the classes of OTC derivatives subject to the clearing obligation, of at least one of the CCPs authorised or recognised to clear at least one of those classes.

Definition of clearing members: general and individual clearing members

92. Some respondents suggested to introduce a distinction between "individual" and "general" clearing members, where individual are the ones trading for their own accounts while the general clearing members are providing client clearing services, on the ground that the former are less active and sophisticated, which may explain that they have not taken the step of providing client clearing.

93. In this respect ESMA first notes that, although some clearing members are not clearing for clients, all clearing members have the capacity to clear transactions for themselves, and it is therefore sufficient to keep them in the same category rather than to introduce a distinction for this category. Secondly, ESMA also notes that "Clearing Member" is already a defined term in Article 2(14) of EMIR and that the draft RTS makes a cross-reference to that definition. As this definition of a clearing member does not establish a difference between clearing members providing or not providing client clearing, ESMA finds that the current draft RTS provides sufficient legal certainty in the sense that all clearing members of a CCP are covered, and has not modified the draft RTS compared to the version of the consultation paper.

Clearing members of third-country CCPs

94. A number of responses highlighted that the proposed drafting of the RTS remained ambiguous regarding the inclusion or exclusion of clearing members of recognised third-country CCPs in Category 1. ESMA finds that, in line with the level 1 text, which equally encourages the use of authorised European CCPs and recognised third-country CCPs (e.g. Article 4(3) establishing that the Class+ shall be cleared with either an authorised EU CCP or a recognised third-country CCP), clearing members should be granted equal treatment irrespective of the fact that they are clearing members of an authorised EU CCP or a recognised third-country CCP.

95. This interpretation was supported in some responses and notably by a third-country association representing the banking sector.

96. Based on the above, ESMA has modified the draft RTS to clarify that Category 1 counterparties are clearing members of CCPs either authorised or recognised for the purpose of the clearing obligation as listed in the Public Register in accordance with Article 6(2)(b) of EMIR. The Public Register includes the dates on which the CCPs have been authorised/recognised therefore establishing with full legal certainty the relevant CCPs.

Register of Clearing Members

97. A number of respondents suggested that ESMA should maintain a public register of clearing members to facilitate the identification of the counterparties included in Category 1 at a global level, using the LEI, with the objective of avoiding that each counterparty checks the information on clearing members provided by each CCP. They mention that although this information is usually available for European CCPs, this is not necessarily the case for Third-Country CCPs. If it was not possible to create such a register, some encouraged ESMA to ensure that every CCP covered by the clearing obligation makes this information readily accessible.

98. In addition, the register would be helpful because the identification of a Category 1 counterparty requires some information on the date on which the counterparty became a clearing member and the asset-class related to the clearing membership, and this information is not publicly available.

99. ESMA agrees that the establishment of such a unique register of Clearing Members would enhance market transparency and facilitate the identification of the counterparties of Category 1, which may in turn also be valuable for the other categories of counterparties as it would identify the undertakings through which they could get an access to clearing. However ESMA needs to further reflect on the practicalities of such a register including considerations around the confidentiality and the legal responsibility of its maintenance.

100. Such a register would only have the intent to facilitate the classification of counterparties but would not affect their ability to assess the appropriate classification and thus the resulting obligations.

4.2.2. Category 2

101. The initial proposal of ESMA was that Category 2 encompasses financial counterparties not included in Category 1 (non-clearing members and clearing members not meeting the condition of Category 1), as well as Alternative Investment Funds (AIFs) that are non-financial counterparties above the clearing threshold. More detail on AIFs is provided in the next section on non-financial counterparties.

102. Several stakeholders expressed some doubts on the fact that this definition of Category 2 would ensure a smooth implementation of the clearing obligation for the following reasons:

- Heterogeneous group: some noted that this category includes counterparties with very diverse degree of sophistication and experience with OTC derivatives, for which it would be appropriate to accommodate different phase-in periods (hence further sub-divide the category in smaller groups);
- Bottleneck situation: the number of counterparties in Category 2 is estimated to be several thousands. This compares to roughly 100 counterparties in Category 1. The number of counterparties that will look to establish clearing arrangements at the same time is viewed as too large to ensure a smooth application of the clearing obligation.

103. Although often citing the fact that Category 2 is too broad, only one stakeholder provided ESMA with an alternative solution to further subdivide it into two groups. The proposal was to apply a quantitative threshold linked to the level of activity of the counterparty in OTC derivatives, more specifically a threshold of EUR 8bn of gross notional outstanding amounts, in line with the lowest threshold defined in the BCBS-IOSCO document "Margin requirements for non-centrally cleared derivatives"[9]. This threshold agreed at international level is also used in the draft RTS on risk-mitigation techniques for OTC-derivative contracts not cleared by a CCP under Article 11(15) of EMIR[10].

104. The idea of establishing a quantitative criteria to define the categories of counterparties was introduced in the discussion paper on the clearing obligation published in the summer 2013, and was subsequently ruled out on the basis that it would be too complex and therefore that the compliance costs would not be justified in light of the benefits (see Option 4 of the Impact Assessment in the Consultation Paper).

105. The responses to the consultation paper and additional data related to the number of counterparties active in the interest rate market has led ESMA to reconsider the options available. In particular ESMA has sought to develop options where a "big-bang" situation and the resulting bottleneck risks are addressed more effectively at a reasonable compliance cost.

106. In this respect ESMA sees merit in the adoption of a quantitative threshold that is about to be implemented in EMIR for a similar purpose, i.e. the definition of different phase-in periods applicable to counterparties with regards to non-cleared OTC derivatives. The main advantages have been determined to be the following:

- The differentiation between the two sub-groups is made in relation to the OTC derivatives activity of the counterparty, removing an arbitrary dimension of the equation: the counterparties with little OTC derivatives activity and which, for this reason, are in the most difficult situation to establishing client clearing or indirect client clearing arrangements, are the ones to which the longest phase-in apply.
- It creates an incentive to clear voluntarily ahead of the clearing obligation: given that cleared OTC derivatives are not included in the positions to be compared to the threshold, counterparties may prefer to start clear some contracts on a voluntary basis to remain under the threshold, which in turn may effectively reduce the risk of bottleneck as each counterparty may do it at its own rhythm.
- Reduced compliance costs achieved through regulatory convergence: the costs to counterparties is expected to be minimal given that the classification is identical to the one counterparties will have to adopt in application of the rules on risk-mitigation techniques for OTC-derivative contracts not cleared by a CCP.

Detail of the new proposal for Category 2

107. ESMA has therefore amended the draft RTS to divide in two the original Category 2:

- Old Category 2-a (New Category 2): Financial counterparties and AIFs that are non-financial counterparties above the clearing threshold, which are not included in Category 1, and which

[9] Available at: http://www.bis.org/publ/bcbs261.pdf
[10] Consultation Paper available at: https://www.eba.europa.eu/documents/10180/655149/JC+CP+2014+03+%28CP+on+risk+mitigation+for+OTC+derivatives%29.pdf

belong to a group whose aggregate month-end average notional amount of non-centrally cleared derivatives for *[November 2014, December 2014 and January 2015]** is above EUR 8 billion.

- Old Category 2-b (New Category 3): Financial counterparties and AIFs that are non-financial counterparties above the clearing threshold , which are not included in Category 1 or 2

(*) those months are chosen under the assumption that the RTS on the clearing obligation for IRS will enter into force during the month of February 2015. If this assumption is incorrect, the months will be adjusted so that they include the three months preceding the entry into force of the RTS, excluding the month of entry into force.

108. To be aligned with the draft RTS on risk-mitigation techniques for OTC-derivative contracts not cleared by a CCP, the draft RTS on the clearing obligation were also amended to specify that, for the purposes of calculating the group aggregate month-end average notional amount, all of the group's non-centrally cleared derivatives, including foreign exchange forwards, swaps and currency swaps, shall be included.

4.2.3. Category 3

109. The original proposal for Category 3 was to include all non-financial counterparties above the clearing threshold not included in Category 1 or 2. This proposal was generally accepted although some responses indicated that counterparties of Category 3 might actually be more sophisticated and more active players in the OTC derivative markets that certain small financial counterparties included in Category 2. Therefore it may be easier for the former that the latter to find an access to clearing.

110. The other suggestions made on this category related to clearing members and AIFs and are summarised below.

NFC+ that are clearing members

111. Some responses indicated a preference to modify the current classification so that NFC+ that are also clearing members belong to Category 3 instead of Category 1, on the basis that for some commodity derivative markets (e.g. power market) it is necessary for the market participants to become clearing members.

112. Given that the responses seem to confirm ESMA's analysis that the presence of NFC+ in Category 1 appears to be limited to the commodity asset-class, ESMA does not consider that any modification of the current draft RTS is necessary at this stage, and that the specific case of NFC+ that are commodity clearing members should be further analysed in the context of a consultation paper on the clearing obligation for the commodity asset-class.

NFC+ that are AIFs

113. Regarding AIFs, the proposal by ESMA to include all AIFs in the same category of counterparty irrespective of the fact that they are financial or non-financial counterparties was generally supported by stakeholders mainly because it ensures equal treatment between a set of similar counterparties. The few responses that were not in favour of this approach mentioned the creation of unfair treatment in respect of frontloading between AIFs that are financial counterparties (and therefore subject to frontloading) and AIFs that are NFC (and therefore not subject to frontloading).

114. However this difference in the application of frontloading is embedded in the Level 1 text of EMIR and would not be solved by changing AIFs that are NFC+ from the proposed classification (old Category 2) to old Category 3. Indeed, the fact that frontloading is inapplicable to NFC+ applies in the same way for all NFC+, irrespective of the category of counterparty to which they belong. The section below on frontloading further elaborates on this issue.

4.2.4. Third-Country entities

115. There was no clear consensus regarding the proposal for the classification of third-country entities. Most respondents agreed with ESMA that it would ensure a fair competition between EU and non-EU counterparties to impose that third-country entities belong to the category of counterparty to which they would belong *if they were established in the Union*. Those stakeholders explain that the establishment of a specific phase-in for transactions with a third-country entity would put EU counterparties at a competitive disadvantage after the respective phase-in have ended, because counterparties could be tempted to trade with non-EU counterparties to benefit from a longer phase-in period.

116. Others however considered that a longer phase-in should apply to transactions concluded with or between third-country entities, and in particular when those transactions are intragroup. In their opinion, the European Commission not having yet adopted an implementing act determining that some third-countries are equivalent to EU countries in respect of EMIR complicates the application of the clearing obligation. Besides, they noted that when transacting with a third-country entity, as the obligation to clear lies with the counterparty established in the EU, third-country entities have less incentives to establish clearing arrangements and EU entities may have difficulties to persuade their third country counterparties to clear transactions.

117. Although ESMA is sympathetic to the reasons put forward by the second group of stakeholders, it is of the view that preserving fair competition in the market is of the utmost importance. Besides, third-country entities transacting with EU counterparties being aware that the latter would only be in a position to continue doing so if they accept to clear the transactions should constitute a strong incentive for third-country entities to make the necessary clearing arrangements. For this reason ESMA has not modified the draft RTS in this respect.

<u>Intragroup transactions involving a third-country counterparty</u>

118. Intragroup transactions concluded between an EU and a third-country entity can benefit from an exemption from the clearing obligation under some conditions (Article 3 and Article 4(2) of EMIR). One condition is that the non-European entity is established in a third-country in respect of which the European Commission has adopted an implementing act in accordance with Article 13(2) of EMIR (an "equivalent third-country") as clarified in OTC Question 6(b) of the Q&A on the implementation of EMIR[11].

119. Some stakeholders mentioned that the timing for third-countries to become equivalent being unpredictable, there should be a specific phase-in period for intragroup transactions concluded with third-country entities, potentially linked to the date on which the third-country becomes equivalent.

[11] The Q&A is available at http://esma.europa.eu/page/post-trading

120. The clearing obligation and the adoption by the European Commission of implementing acts on equivalence are two separate procedures and EMIR does not introduce dependencies between them therefore the draft RTS have not been modified in this respect.

Drafting suggestions regarding third-country counterparties

121. Respondents agree with the interpretation provided in Paragraph 202 of the consultation paper i.e.: in application of Article 4(1)(a)(iv) of EMIR, when a contract subject to the clearing obligation is concluded between one EU and one non-EU counterparty, the obligation to clear lies with the counterparty established in the Union, that would be in a position to conclude transactions with a counterparty established in a non-equivalent third-country only if this counterparty agrees to clear the contract. The absence of the agreement by the third country counterparty is not a waiver on the clearing obligation.

122. However some felt like this approach should be reflected in the draft RTS in another manner and made some drafting suggestions in this respect. Specifically, the idea would be to replace the current reference to "counterparties" in Article 2 with the wording "financial counterparties and non-financial counterparties meeting the conditions referred to in Article 10(1)(b) of EMIR" – which would only encompass EU entities – and to add two sub-paragraphs dealing specifically with the contracts to be subject to the clearing obligation in application of Article 4(1)(a)(iv) of EMIR (i.e. between one EU and one non-EU counterparties) and Article 4(1)(a)(v) of EMIR (i.e. between two non-EU counterparties).

123. ESMA is of the view that, although this proposed modification is unlikely to change the outcome of the RTS, the original drafting is more aligned with the EMIR Level 1 text which states in Article 4(1) that "Counterparties shall clear all OTC derivative contracts pertaining to a class of OTC derivatives that has been declared subject to the clearing obligation." Therefore, when addressing the clearing obligation globally EMIR makes a reference to "counterparties" and this approach was replicated in the RTS – hence the original draft RTS was not amended in this respect.

4. 3. Dates on which the clearing obligation takes effect

Question 8 of the Consultation Paper

4.3.1. 6 months phase-in for Category 1

124. With a few exceptions, the proposal for a 6 month phase-in for counterparties in Category 1 was supported. Two respondents not supporting the proposal justified it by the fact that they preferred that the same phase-in applied to all counterparties (ideally 12 months), or at least that the difference between the length of the phase-in was reduced to ensure fair competition.

125. A few responses also indicated that 6 months can be seen as slightly generous for counterparties that already clear on a voluntary basis.

126. ESMA is of the view that the 6 month phase-in is justified by the fact that although the counterparties are clearing members, they may not all be in a position to clear with one another from day one because e.g. they are clearing members of different CCPs, as also noted in some responses. Besides, as explained in one of the Recital of the draft RTS, counterparties of Category 1 are not necessarily clearing members in all the Class+. Therefore the original draft RTS was not modified in this respect.

4.3.2. 18 month phase-in for Category 2

127. The proposal regarding the 18-month phase-in for counterparties of Category 2 was relatively controversial.

128. On one side numerous responses from the sell-side indicated that an 18 month phase-in was appropriate and did not constitute by any mean an overestimation of the time needed to put in place the necessary clearing arrangements.

129. On the other side, the 18-month phase-in was considered by many to be undermined by the application of frontloading during those 18 months: according to those respondents (most of them being clearing members) the risk is high that clearing members would only accept to resume business with a Category 2 counterparty during the phase-in if that counterparty accepts to clear the transaction ahead of the deadline. On top of the sources of uncertainty related to frontloading already acknowledged by ESMA (pricing, CCP available to clear at the time the trades have to be cleared) one reason often cited is the uncertainty around the capacity of the Category 2 counterparty to have established the necessary clearing arrangement by the time the contract will have to be cleared. This effect is exacerbated by the length of the phase-in for Category 2 (18 months) which is seen by those counterparties as far too remote.

130. In addition, the ESRB pointed out that the later the clearing obligation comes into effect, the longer the counterparty risk might not be managed adequately, and therefore recommended to shorten the phase-in for Category 2 from 18 to 12 months. Indeed the ESRB considered that the experiences with other long-dated implementation deadlines (e.g. the Single Euro Payments Area, where the migration end date had to be eventually delayed by further six months) have shown than most market participants defer work on implementation until the deadline is nearly reached.

131. The old Category 2 being divided into two Categories (new Category 2 and new Category 3) as explained in 4.2.2, ESMA had to propose new phase-in periods for those two categories. The 18 months phase-in period envisaged for old Category 2 mainly aimed at accommodating the least sophisticated counterparties of this category which was relatively heterogeneous in the first proposal. However, now that the counterparties are more adequately classified as a function of their level of activity in derivatives, it is possible to adopt a more granular approach for the phase-in period.

132. In the draft RTS, the proposals related to the phase-in periods were hence modified as follows:

- 18-month for new Category 3 (no change)
- 12 months for new Category 2. The principle of proportionality leads to a reduction of the phase-in period for those counterparties to which the access to clearing should be easier than for the counterparties in new Category 3. A period of 12 months was used as suggested by the ESRB.

4.3.3. 3 years phase-in for Category 3

133. There has been very little participation of non-financial counterparties to the consultation but those who have commented supported the proposal of a 3 year phase-in for Category 3.

134. However, as already mentioned, the ESRB pointed out that the later the clearing obligation comes into effect, the longer the counterparty risk might not be managed adequately, and therefore recommended to shorten the phase-in for Category 3 from 3 years to 18 months.

135. ESMA has kept the proposed 3 year phase-in for Category 3 in this first RTS in accordance with the Commission's declaration mentioned in the consultation paper.

5. Remaining maturity of the contracts subject to frontloading

Question 9 of the Consultation Paper

136. 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 possible the application of the frontloading requirement.

5. 1. Period A, Period B

137. Stakeholders welcomed the proposal by ESMA to divide the frontloading window in two periods, Period A (between the notification of the classes to ESMA and the publication in the Official Journal of the regulatory technical standards on the clearing obligation) and Period B (between the publication in the Official Journal of the RTS and the date on which the clearing obligation takes effect i.e. the date of application) to gain the flexibility of applying different minimum remaining maturities during the two periods.

138. Although supporting the introduction of those two periods, the ESRB indicated it did not see an excessive market risk if the frontloading was required on a strict basis, as it could be expected that the overall effect due to a mispricing on the trade date would be negligible.

139. Still on the distinction between the two periods many indicated a preference to modify the end of Period A (and beginning of Period B) from the current proposal "date of publication of the RTS in the Official Journal" to the date of entry into force of the RTS. The reason for this is that the latter is predictable -- the entry into force of the RTS falls on a number of days, usually 20, after the date of publication in the Official Journal -- whereas the date of publication in the Official Journal is only known after it has happened. Therefore choosing the date of entry into force of the RTS as a starting date for Period B reinforces legal certainty and ensures sufficient predictability for market participants.

140. ESMA understands the rationale for this proposal and that using the date of entry into force of the RTS reinforces legal certainty compared to the date of publication in the Official Journal. Yet, although the use of the date of entry into force of the RTS reinforces legal certainty, there starts to be legal certainty at the time of publication in the Official Journal already. As a result, the argument of legal uncertainty in Period A stops when the publication in the Official Journal takes place. To comply with the frontloading obligation as introduced in EMIR, there is not a strong enough legal justification to have Period A run until the entry into force as legal certainty is achieved already on the date of publication in the Official Journal.

5. 2. Frontloading for Category 2

141. The main concern echoed by numerous stakeholders lied in the applicability of frontloading for counterparties of Category 2. Participants noted the absence of accepted techniques for determining the pricing of a derivative contract which will have to be cleared in the future, or for agreeing in advance the terms of future clearing. They indicated that significant legal and operational measures were associated to frontloading including during Period B.

142. Although the approach developed in the consultation paper ensures that there is legal certainty when trades are executed during period B, as the counterparties know which classes need to be cleared, when the clearing obligation applies and which CCPs are authorised or recognised, some price uncertainty still remains. Indeed, prices of OTC derivative contracts traded during this period will have to incorporate forward-clearing which will only take place several months after execution, requiring pricing model changes and amendments to the contracts documentation. Additionally, the longer is the phase-in, the longer is the period of time counterparties are subject to frontloading and the higher is the complexity for pricing. As a result, the implementation of frontloading may be particularly complex and costly for the least sophisticated counterparties of old-Category 2 (new Category 3).

143. A possible consequence of the implementation of frontloading may be that counterparties in Category 1 may impose that their Category 2 counterparties accept to clear the relevant OTC contracts ahead of the deadline. Alternatively, Category 2 counterparties may prefer to start clearing on a voluntary basis before the end of the phase-in to avoid frontloading.

144. In both cases frontloading may turn out to be a strong incentive for counterparties to start central clearing as soon as possible to minimise the number of contracts subject to frontloading. Although this appears to be a virtuous cycle, one should also acknowledge that the impact of frontloading is highest for the smallest and least sophisticated counterparties: because of their low volume of activity it is likely that they would face more difficulty to establish clearing arrangements with a clearing member or through indirect client clearing. The expected longer time that they would need to start clearing will mechanically lengthen the period of time during which frontloading applies to them, which will only reinforce the presumed Category 1 counterparty reticence to conclude transactions with them.

145. ESMA considers that this potential negative impact of frontloading is more acute for the least sophisticated counterparties of old Category 2 (new Category 3). Therefore in the draft RTS, the proposal on the minimum remaining maturity was modified to ensure that the number of contracts subject to frontloading for the counterparties of new Category 3 is kept to a minimum.

5. 3. Inapplicability of frontloading for non-financial counterparties

146. Counterparties unanimously welcomed the clarification provided under paragraph 237 of the consultation paper indicating that frontloading is not applicable to contracts for which at least one of the counterparty is a non-financial counterparty.

147. However ESMA has received several comments indicating that Article 4(3)[12] of the draft RTS was unclear or apparently contradicting the statement embedded in paragraph 237 of the explanatory part. To take this into account, ESMA has removed the original paragraph (3) of Article 4 and has clarified in the recital that NFC+ should not be subject to frontloading.

5. 4. Minimum remaining maturity during Period B

148. ESMA has received some comments regarding the calibration of the minimum remaining maturity during Period B, which was proposed to be 6 months in the consultation paper. All those comments

[12] 4(3) This Article shall not apply to contracts to which at least one counterparty is a non-financial counterparty.

proposed to increase the minimum remaining maturity in order to reduce the impact of frontloading, at levels comprised between 1 and 2 years.

149. However, those suggestions were generally made in the context of the application of frontloading for Category 2. Setting the minimum remaining maturity at a higher level of 1 or 2 years was usually proposed as an alternative to the removal of the frontloading requirement for Category 2, which was the most supported approach.

150. Therefore, given that ESMA has modified the draft RTS to ensure that the number of contracts subject to frontloading for the new Category 3 is kept minimal, and that no comments was received regarding the application of frontloading for Category 1, ESMA is proposing to keep the minimum remaining maturity at 6 month during Period B, for contracts concluded between counterparties included in Category 1 and new Category 2.

Frontloading in subsequent RTS on the clearing obligation

151. Some stakeholders have requested that the first RTS on the clearing obligation includes clarifications regarding the application of frontloading in subsequent RTS on the clearing obligation, to ensure that the approach would remain identical from one RTS to the next.

152. Although ESMA has not identified at this stage a reason why the approach on frontloading would need to be modified from one RTS to the next, it cannot prejudge the analysis of a future RTS.

6. OTC equity derivative classes

Question 10 of the consultation paper

153. Section 6 of the consultation paper concluded that, following the notification of 18 March 2014 whereby Finansinspektionen has notified ESMA that Nasdaq OMX Clearing AB is authorised to clear some equity OTC derivative classes, and the notification of 12 June 2014 whereby the Bank of England has notified ESMA that LCH.Clearnet Ltd is authorised to clear some equity OTC derivative classes, ESMA did not intend to submit draft RTS to the European Commission proposing the establishment of the clearing obligation on those classes within 6 months of those notifications.

154. A large majority of the respondents supported this conclusion, acknowledging that the establishment of a clearing obligation on equity OTC derivatives would require more time and consultation with market participants on e.g. the definition of the appropriate characteristics. They also noted that this asset class should not be treated in priority in light of its systemic relevance, but also for reasons of international convergence as well as because the clearing of equity OTC derivatives is not well established. They indicated that the equity derivatives market is predominantly exchange-based, therefore the contacts which continue to be traded OTC are generally sophisticated and/or bespoke products.

155. However, a few market participants expressed the opposite view that some of the equity contracts presented in the paper should be subject to the clearing obligation, and have proposed to modify the draft RTS accordingly. In particular, they mentioned that lookalike and flexible contracts cleared by Nasdaq OMX Clearing AB were sufficiently standard and liquid to be considered for the clearing obligation.

156. They also signalled that the assessment of the liquidity of the equity OTC derivative market would merit to be further investigated using the data reported to trade repositories, as non-cleared OTC volumes cannot easily be extrapolated from data on cleared OTC nor from contracts executed on exchange.

157. Finally, they considered that the approach of prioritising OTC classes that pose larger systemic risks at European level should not result in neglecting the stability of regional financial markets.

158. In view of the above it appears necessary to clarify the process regarding the classes of OTC derivatives that are not proposed for the clearing obligation during the six months following the notification referred to in Article 5(1) of EMIR. Article 5(2) of EMIR required ESMA to develop and submit to the European Commission for endorsement draft RTS on the clearing obligation at the latest six month after the notification.

159. If EMIR acknowledges in Recital 15 that not all CCP-cleared contracts are suitable for the clearing obligation, it does not explicitly indicate the procedure to be followed when a class is deemed not suitable. Following a principle of good administration and transparency for market participants, ESMA has published, together with the analysis of the IRS classes, an analysis of the criteria set in EMIR for the equity classes it proposed not to subject to the clearing obligation within the 6 months following the notification.

160. The publication of this analysis provides clarity to market participants in particular in relation to the application of frontloading. As mentioned in paragraph 337 of the consultation paper as well as in OTC question 17 of the Q&A on the implementation of EMIR, the outcome of this "negative determination" is that counterparties have legal certainty on the fact that the frontloading requirement will not apply to those classes which, during this 6 month timeframe, have been deemed not suited for the clearing obligation.

161. In view of the number of negative feedback that ESMA received on the issue of frontloading since the beginning of the discussions on the clearing obligation, it was considered important to provide market participants with an assessment of the classes not considered for the clearing obligation (and hence the non-application of frontloading for those classes) when such analysis was possible.

162. However, the fact that ESMA does not propose the equity classes for the clearing obligation during the six month following their notification does not in any way mean that those classes will not be subject to the clearing obligation at a later point in time (see paragraph 337 of the consultation paper, OTC Question 17 of the Q&A on the implementation of EMIR and paragraph 13 above).

163. In the case of the equity OTC derivatives that LCH.Clearnet Ltd and Nasdaq OMX Clearing AB are authorised to clear, the current impediment related to scarcity of data should be alleviated in the medium term thanks to the improved quality of Trade Repositories data. Taking into account the feedback received during the first consultation paper on the clearing obligation, ESMA does not rule out mandatory clearing for lookalike and flexible OTC equity derivatives.

7. OTC interest rate future and option classes

Question 11 of the consultation paper

164. Section 7 of the consultation paper concluded that, following the notification of 18 March 2014 whereby Finansinspektionen has notified ESMA that Nasdaq OMX Clearing AB is authorised to clear some interest rate OTC future and option classes, and the notification of 12 June 2014 whereby the Bank of England has notified ESMA that LCH.Clearnet Ltd is authorised to clear some interest rate OTC future and option classes, ESMA did not intend to submit draft RTS to the European Commission proposing the establishment of the clearing obligation on those classes within 6 months of those notifications.

165. The majority of respondents did not comment with respect to these classes and a large number of respondents commented to express their support with ESMA's proposal. No particular feedback was communicated to modify the approach for the draft RTS. In line with the comments for the other classes covered in the consultation paper no.1, the ESRB did not indicate these should be added at this stage but suggested to review these classes again once possible, when more data is available.

166. As a result, ESMA has not modified the draft RTS with regards to these classes which are thus not included in the scope of the clearing obligation.

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

Question 12 of the consultation paper

167. 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. For the few issues not covered in the previous sections of this final report, the main two topics concern a format change for the table and the introduction of specific treatments for various types of trades.

168. With regards to the format change, the suggestion was to number the classes. ESMA agrees this can help identify the classes when someone needs to refer to a combination of characteristics in scope for the clearing obligation. Accordingly, ESMA has amended its tables with a unique number for each entry in the tables of the Annex.

169. Secondly, in addition to securitisation swaps as well as trades with third country entities or intragroup exemptions covered in previous sections, several respondents commented on the need to exempt a range of trades concluded in one or several of the following scenarios:

- Offsetting trades,
- Hedge accounting trades,
- Trades concluded as part of the wholesale restructuring of a corporate group,
- Trades associated to a life cycle event such as a swap generated from the exercise of a swaption or a trade being partially or fully novated.
- Trades generated as part of post trade risk reducing initiatives such as multi-portfolio compression runs or counterparty risk rebalancing.

170. EMIR defines the scope of trades that are subject to the clearing obligation. Article 5(1)(b) states that the clearing obligation applies to trades that are entered into or novated. In addition, EMIR indicates that there are certain considerations for derivatives entered into in the context of covered bonds that allow ESMA to include conditions for this particular case. But there are no other cases in EMIR for which ESMA could add conditions leading to a different treatment and there would be no legal basis

to carve out specific provisions for other types of trades. As a result, ESMA has not modified the draft RTS.

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.

Annex II - Draft Regulatory Technical Standards on the Clearing Obligation

COMMISSION DELEGATED REGULATION (EU) No …/..

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

of [ ]

(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[13], and in particular Article 5(2) thereof,

Whereas:

(1) The European Securities and Markets Authority (ESMA) has been notified of the classes of interest rate OTC derivatives that certain central counterparties (CCPs) have been authorised to clear in accordance with Regulation (EU) No 648/2012. For each of those classes ESMA has assessed the criteria that are essential for 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 ones that should be subject to the clearing obligation in accordance with the procedure defined in Regulation (EU) No 648/2012.

(2) Following this process, the set of classes covered by this Regulation has been based on a selection of the classes which the CCPs had been authorised to clear at the time of their authorisation. The selection covered only contracts that the authorised CCPs have accepted for clearing at the time of authorisation.

(3) Regulation (EU) No 648/2012 considers in Recital (16) that, in determining which classes of OTC derivative contracts should be subject to the clearing obligation, the specific nature of OTC derivative contracts which are concluded with covered bond issuers or

13 OJ L 201, 27.7.2012, p. 1.

with cover pools for covered bonds should be taken into account. In this respect, the classes of OTC derivative subject to the clearing obligation should not encompass contracts concluded by covered bond issuers or covered pools, meeting the conditions established in this Regulation.

(4) Interest rate derivative contracts can have a constant notional amount or a notional amount that varies over the life of the contract. In the latter case, a distinction exists between variable notional amounts with a predetermined schedule and conditional notional amounts of an unpredictable nature, adding complexity to the pricing and risk management associated to it and thus to the ability of the CCPs to clear them. The type of notional amount is thus an important characteristic which has been taken into account when defining the classes to be subject to the clearing obligation.

(5) Defining different categories of counterparties enables to schedule a series of successive dates when the clearing obligation should take effect for each respective category, and therefore to ensure an orderly and timely implementation.

(6) The categories of counterparties to which the clearing obligation applies should be defined in such a way that counterparties included in the same category are sufficiently similar with regards to the criteria set out in Regulation (EU) No 648/2012.

(7) The first category (Category 1) should include clearing members for the classes subject to the clearing obligation as they already have an experience with voluntary clearing and have already established the connections with at least one of the relevant CCPs, i.e. European CCPs authorised under Regulation (EU) No 648/2012 and third-country CCPs recognised under Regulation (EU) No 648/2012 to clear the classes subject to the clearing obligation. These clearing members are relatively limited in number but account for a significant portion of the traded volume and usually are the most relevant liquidity providers. In addition, they constitute the access point to clearing for the counterparties that will not become clearing members. Non-financial counterparties that are clearing members should also be included in Category 1 as their experience and preparation towards central clearing is comparable with that of financial counterparties included in Category 1.

(8) Category 1 should not capture counterparties which are clearing members only for classes not covered by the clearing obligation. In addition, to ensure legal certainty, this category should only encompass clearing members of CCPs authorised or recognised before this Regulation enters into force.

(9) The second and third categories (Category 2 and Category 3) should cover financial counterparties not included in Category 1. The criteria set in Regulation (EU) No 648/2012 to be taken into consideration when defining the categories of counterparties to

which the clearing obligation applies refer to the number and type of active counterparties, to their risk management and to their legal and operational capacity. In this respect, since the financial counterparties not included in Category 1 are numerous and demonstrate heterogeneous levels of sophistication, they should be grouped in different categories. For that purpose, the level of activity in derivatives can be used as a proxy to differentiate the degree of sophistication between counterparties. When the level of activity exceeds the quantitative threshold defined in this Regulation, the counterparties should be included in Category 2; otherwise they should be included in Category 3. The quantitative threshold being aligned with the threshold agreed at international level related to margin requirements for non-centrally cleared derivatives, this would enhance regulatory convergence and limit the compliance costs for counterparties.

(10) Certain alternative investment funds ("AIFs") are not captured by the definition of financial counterparties under Regulation (EU) No 648/2012 although they have a similar degree of sophistication than AIFs captured by this definition. Therefore AIFs classified as non-financial counterparties should be included in the same categories of counterparties than AIFs classified as financial counterparties.

(11) The fourth category (Category 4) should include non-financial counterparties not included in the other categories, because they have a limited experience with central clearing.

(12) The date on which the clearing obligation takes effect for counterparties in Category 1 should take into account the fact that they do not necessarily have a pre-existing CCP access for all the classes subject to the clearing obligation. A reasonable timeframe for them to prepare for clearing these additional classes should be from 3 to 6 months.

(13) The date on which the clearing obligation takes effect for counterparties in Category 2 and Category 3 should take into account the fact that most of them will get access to CCP by becoming client or indirect client of a clearing member, which may require between 12 and 18 months depending on the level of sophistication and preparation of the counterparties.

(14) The date on which the clearing obligation takes effect for counterparties in Category 4 should take into account their legal and operational capacity, and the fact that most of them have a limited experience with central clearing.

(15) Regulation (EU) No 648/2012 imposes an obligation to clear a posteriori some 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 (the frontloading obligation). The objectives of the frontloading obligation as per Recital (20) of Regulation (EU) No 648/2012 should be achieved by the definition of appropriate minimum remaining maturities.

(16) The objective of the frontloading obligation is to ensure a uniform and coherent application of Regulation (EU) No 648/2012 as well as a level playing field for market participants when a class of OTC derivatives is declared subject to the clearing obligation, without undermining the overarching objective of the clearing obligation to reduce systemic risk. The application of the frontloading requirement needs to be adjusted in order to allow the achievement of its objectives by determining the minimum remaining maturity of the contracts that should be subject to frontloading and to avoid the negative effects it may have on the market.

(17) The frontloading obligation is directly linked to the date of application of the clearing obligation for each category of counterparties. The longer the period of time from the date of publication of this Regulation in the Official Journal to the date of application of the clearing obligation for a given category of counterparties, the longer the frontloading obligation applies. Therefore the minimum remaining maturity could be different for the different categories of counterparties. In this respect, it is to be noted that counterparties in Category 3 are less sophisticated and would have more difficulties to comply with the frontloading obligation.

(18) The frontloading requirement should not apply to contracts concluded before counterparties could reasonably foresee that those contracts would be subject to clearing. In this respect, before this Regulation is published in the Official Journal of the European Union, counterparties cannot foresee whether the OTC derivative contracts they conclude would be subject to the clearing obligation, on the date of application of the clearing obligation, and the CCPs that will be authorised or recognised to clear the notified classes. This uncertainty has a significant impact on the capacity of market participants to accurately price the OTC derivative contracts they enter into until they know whether they pertain to the derivative classes that will be subject to clearing. This is particularly important due to the fact that a contract that is centrally cleared is subject to a different collateral regime than a contract that is not.

(19) Therefore, to preserve the orderly functioning and the stability of the market as envisaged in Regulation (EU) No 648/2012, as well as a level playing field between counterparties entering into contracts before and after this Regulation is published in the Official Journal of the European Union, the minimum remaining maturity applicable to contracts concluded before the date of publication of this Regulation in the Official Journal should be set at a level that excludes any OTC derivative contract concluded before the publication of this Regulation in the Official Journal of the European Union from the frontloading obligation, for any category of counterparties.

(20) However, contracts concluded after the publication of this Regulation in the Official Journal of the European Union should be subject to the clearing obligation unless they are

not significantly relevant for systemic risk and could jeopardise at the same time any other of the objectives of frontloading.

(21) Counterparty credit risk associated to contracts with longer maturities remains in the market for a longer period. Therefore, the minimum remaining maturities should be set at a level ensuring that only contracts with remaining maturities of no more than a few months are exempted from the frontloading obligation to avoid a disproportionate burden on counterparties to those transactions. Those short-dated contracts represent a relatively small portion of the total market and will mature shortly. As a result, the frontloading obligation would address the largest share of the trading volume and the associated systemic risk.

(22) However, counterparties in Category 3 are specific in several aspects in relation to the frontloading obligation. First, given that the counterparties in Category 3 are defined as those below a quantitative threshold linked to the level of activity of the counterparties in OTC derivatives, counterparties in Category 3 should be the ones with the smallest portfolios of non-centrally cleared derivative contracts, hence bearing a relatively small share of the portfolios of non-centrally cleared derivative contracts, hence bearing a relatively small share of the overall systemic risk.

(23) Secondly, the prices of the OTC derivative contracts subject to the frontloading obligation will have to incorporate forward-clearing which will only take place several months after execution, requiring pricing model changes and amendments to the contracts documentation. This could limit the ability of counterparties to hedge their market risk adequately and impact the functioning of the market and financial stability, especially for counterparties in Category 3 as they are the least sophisticated of the categories subject to the frontloading obligation (counterparties in Category 4, being non-financial counterparties, should not be subject to the frontloading obligation as they should only clear contracts concluded after the date on which they become subject to the clearing obligation, i.e. once the frontloading obligation is no longer applicable).

(24) On the basis of the above, and in order to achieve an adequate balance between the risk mitigation concerns of the clearing obligation and the level playing field on one side and the coherent and uniform application of Regulation (EU) No 648/2012 on the other side, the minimum remaining maturities applicable to counterparties in Category 3 should be set at a level that excludes those counterparties from the frontloading obligation.

(25) The remaining maturity of a contract to be compared to the minimum remaining maturity should be the one as of the date of application of the clearing obligation for this contract.

(26) This Regulation is based on the draft regulatory technical standards submitted by the European Securities and Markets Authority to the Commission.

(27) The European Securities and Markets Authority has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Security and Markets Stakeholder Group established by Article 37 of Regulation (EU) No 1095/2010.

HAS ADOPTED THIS REGULATION:

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

1. The classes of OTC derivatives listed in Annex I shall be subject to the clearing obligation.

2. The classes of OTC derivatives listed in Annex I shall not include contracts associated to covered bonds when such contracts satisfy all of the following conditions:

   (a) they are not terminated in case of resolution or insolvency of the covered bond issuer;

   (b) the derivative counterparty ranks at least pari-passu with the covered bond holders except when the derivative counterparty (i) is the defaulting or the affected party, or (ii) waives the pari-passu rank;

   (c) they are registered or recorded in the cover pool of the covered bond in accordance with national covered bond legislation;

   (d) they are used only to hedge the interest rate or currency mismatches of the cover pool in relation with the covered bond;

   (e) the covered bond to which they are associated meets the requirements of Article 129 of Regulation (EU) No 575/2013; and

   (f) the covered bond to which they are associated is subject to a regulatory collateralisation requirement of at least 102%.

Article 2 – Categories of counterparties to which the clearing obligation applies

1. For the purpose of Article 3, the counterparties subject to the clearing obligation shall be divided in the following categories:

   (a) Category 1 covers 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 subject to the clearing obligation, of at least one of the CCPs authorised or recognised before that date in accordance with Regulation (EU) No 648/2012 to clear at least one of those classes;

   (b) Category 2 covers counterparties not included in Category 1 which belong to a group whose aggregate month-end average notional amount of non-centrally

cleared derivatives for *[November 2014, December 2014 and January 2015]* is above EUR 8 billion and which are:

(i) financial counterparties; or

(ii) alternative investment funds as defined in Article 4(1)(a) of Directive 2011/61/EU that are non-financial counterparties meeting the conditions referred to in Article 10(1)(b) of Regulation (EU) No 648/2012.

(c) Category 3 covers counterparties not included in Category 1 or Category 2 which are:

(i) financial counterparties; or

(ii) alternative investment funds as defined in Article 4(1)(a) of Directive 2011/61/EU that are non-financial counterparties meeting the conditions referred to in Article 10(1)(b) of Regulation (EU) No 648/2012.

(d) Category 4 covers non-financial counterparties meeting the conditions referred to in Article 10(1)(b) of Regulation (EU) No 648/2012 and that are not included in Category 1, Category 2 or Category 3.

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

Article 3 – Dates from which the clearing obligation takes effect

1. For the classes of OTC derivatives listed in Annex I, the clearing obligation shall take effect on:

(a) [the date 6 months after the date of entry into force of this Regulation] for counterparties in Category 1;

(b) [the date 12 months after the date of entry into force of this Regulation] for counterparties in Category 2;

(c) [the date 18 months after the date of entry into force of this Regulation] for counterparties in Category 3;

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

2. Where a contract is entered into between two counterparties included in different categories of counterparties as defined in Article 2, the date from which the clearing obligation takes effect for that contract shall be the latest of the two.

Article 4 – Minimum remaining maturity

1. For financial counterparties in Category 1 or Category 2 as defined in Article 2, the minimum remaining maturity referred to in Article 4(1)(b)(ii) of Regulation (EU) No 648/2012 shall be:

   (a) 49 years and 6 months for contracts entered into or novated before the date of publication of this Regulation in the Official Journal that belong to the classes of Table 1 or Table 2 of Annex I;

   (b) 2 years and 6 months for contracts entered into or novated before the date of publication of this Regulation in the Official Journal that belong to the classes of Table 3 or Table 4 of Annex I;

   (c) 6 months for OTC derivative contracts entered into or novated on or after the date of publication of this Regulation in the Official Journal that belong to the classes of Table 1 to Table 4 of Annex I.

2. For financial counterparties in Category 3 as defined in Article 2, the minimum remaining maturity referred to in Article 4(1)(b)(ii) of Regulation (EU) No 648/2012 shall be:

   (a) 50 years for contracts that belong to the classes of Table 1 or Table 2 of Annex I;

   (b) 3 years for contracts that belong to the classes of Table 3 or Table 4 of Annex I.

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]

[For the Commission
On behalf of the President]

[Position]

Annex I

Interest Rate OTC derivatives classes subject to the clearing obligation

Table 1: Basis swaps classes

id	Type	Reference Index	Settlement Currency	Maturity	Settlement Currency Type	Optiona-lity	Notional Type
A.1.1	Basis	EURIBOR	EUR	28D-50Y	Single currency	No	Constant or Variable
A.1.2	Basis	LIBOR	GBP	28D-50Y	Single currency	No	Constant or Variable
A.1.3	Basis	LIBOR	JPY	28D-30Y	Single currency	No	Constant or Variable
A.1.4	Basis	LIBOR	USD	28D-50Y	Single currency	No	Constant or Variable

Table 2: Fixed-to-float interest rate swaps classes

id	Type	Reference Index	Settlement Currency	Maturity	Settlement Currency Type	Optiona-lity	Notional Type
A.2.1	Fixed-to-Float	EURIBOR	EUR	28D-50Y	Single currency	No	Constant or Variable
A.2.2	Fixed-to-Float	LIBOR	GBP	28D-50Y	Single currency	No	Constant or Variable
A.2.3	Fixed-to-Float	LIBOR	JPY	28D-30Y	Single currency	No	Constant or Variable
A.2.4	Fixed-to-Float	LIBOR	USD	28D-50Y	Single currency	No	Constant or Variable

Table 3: Forward rate agreement classes

id	Type	Reference Index	Settlement Currency	Maturity	Settlement Currency Type	Optiona-lity	Notional Type
A.3.1	FRA	EURIBOR	EUR	3D-3Y	Single currency	No	Constant or Variable
A.3.2	FRA	LIBOR	GBP	3D-3Y	Single currency	No	Constant or Variable
A.3.3	FRA	LIBOR	USD	3D-3Y	Single currency	No	Constant or Variable

Table 4: Overnight index swaps classes

id	Type	Reference Index	Settlement Currency	Maturity	Settlement Currency Type	Optiona-lity	Notional Type
A.4.1	OIS	EONIA	EUR	7D-3Y	Single currency	No	Constant or Variable
A.4.2	OIS	FedFunds	USD	7D-3Y	Single currency	No	Constant or Variable
A.4.3	OIS	SONIA	GBP	7D-3Y	Single currency	No	Constant or Variable

Annex III – Impact Assessment

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 (Section 3 below) are therefore further supported by TR data related to the categories of counterparties and the classes and scope of the clearing obligation.

2. Quantitative impact assessment

7. ESMA collected data on OTC interest rate derivatives from 5 of the 6 registered trade repositories[14] ("TRs"). This dataset includes transactions that have been reported to one of those 5 TRs between 1 March and 30 June 2014. The estimated size of the 6th TR, from which it was not possible to collect data at this stage, is compatible with the assumption that the numbers derived from the dataset are representative of the OTC derivatives interest rate market in Europe.

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.

2. 1. Assumptions on the dataset

OTC derivatives

9. To limit the dataset to OTC transactions only, ESMA has filtered out the transactions where the field "Venue of execution" was different than "XXXX" (for OTC derivatives). The transactions with value "XOFF" (listed derivatives that are traded off-exchange) was filtered out because those contracts are not relevant for the current clearing obligation determination. It was considered also prudent to filter out the transactions where the field "Execution venue" was not filled. They represented less than 0.1% of the dataset.

Interest rate swaps and FRA

10. To limit the dataset to data relevant in the context of the clearing obligation for IRS, ESMA has included transactions reported on interest rate swaps and forward rate agreements only. As shown in Table 10, more than 85% of the transactions in the dataset were marked as swaps or FRA.

Table 10: Product type (field Product_ID 2)

	% of trade count
Swap	75.0%
FRA	11.3%
Option	3.8%
Future	3.4%
Contract for difference	3.4%
Other	1.7%
Empty	1.2%
Forward	0.1%
Grand Total	**100.0%**

Source: TRs data, ESMA calculations

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

Avoiding duplicate trades

11. In order to count each trade 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. In the cases of transactions where those risks did not materialise, the removal of duplicated trade id ensures that bilateral trades are not double-counted and that transactions reported only once (e.g. because the other counterparty is not subject to the reporting obligation) are adequately taken into account.

12. However, the removal of duplicated trade id introduces a bias on the metrics provided below related to the counterparties. For each transaction only one was kept in the database, with the two counterparties embedded respectively in the fields "Counterparty ID" and "ID of the other counterparty". When examining the reported counterparties in those two fields, it appeared that the ratio of counterparties with LEI were much higher in the first than in the second field. This suggests that the first field was likely to represent much more accurately the universe of counterparties involved in the OTC derivative market that this analysis covers.

13. Therefore, the calculations below were made **on the basis of the reporting counterparty only** (field "counterparty id") excluding volumes attached to the other side of the transaction (field "other counterparty id").

European / Third country entities

14. The clearing obligation is mainly relevant for European entities, but it can also apply to third-country entities as per Article 4(1)(a)(iv) and (v) of EMIR. The dataset used by ESMA includes both European and non-European entities.

15. In order to have information on the geographical location of the parties to the transactions, ESMA used the LEIs sourced from the field “Counterparty_id”. It is to be noted that the data set includes some transactions reported by counterparties established in third-countries (1.1% of the sample). In addition, the data set includes around 20% of counterparties that reported without an LEI, therefore for which it is not possible to determine the country of establishment of the counterparty.

16. In the following analysis, the trades reported by third-country entities and by counterparties without LEI are included, as it is likely that the non-European counterparties included in the dataset are reporting to trade repositories because they are entering into OTC IRS transactions with European entities or due to applicable EMIR requirements, and therefore they are indirectly captured by the clearing obligation in Europe.

17. In any case the impact of third-country entities and counterparties without a reported LEI on the results should be limited, as they account for a small portion of the volume as measured by trade count.

2. 2. Definition of the categories of counterparties

Financial / Non-Financial counterparties

18. When defining the categories of counterparties in the context of the clearing obligation one option was to rely solely on the groups already established by EMIR i.e. financial and non-financial counterparties.

19. As evidenced in Table 11, although the number of non-financial counterparties[15] is higher than the number of financial counterparties, the latter account for a vast share of the volume as measured by trade count. This supports the need for a phased implementation of the clearing obligation. Therefore the fact that non-financial counterparties are subject to a long phase-in period of 3 years should not have a significant impact on the objective of reduction of systemic risk.

Table 11: Type of counterparties

	Number of counterparties (%)
Financial counterparty	39.9%
Non-financial counterparty	46.6%
Empty	12.2%
Undetermined	1.3%
Grand Total	**100.0%**

Source: TRs data, ESMA calculations
Non-Financial counterparties: above and below the clearing threshold
Empty: counterparties did not report their status
Undetermined: counterparties reported both financial and non-financial status

Counterparties clearing on a voluntary basis

20. The number of counterparties that are currently clearing on a voluntary basis can be used as a proxy to have an idea of the degree of preparation of counterparties towards central clearing. As evidenced in Table 12, apart from clearing members in IRS, the ratio of counterparties which have already reported cleared transactions is relatively low: 22% for other clearing members (clearing members in asset classes different than the ones subject to the clearing obligation), 17% for financial counterparties that are not clearing members and 2.5% for non-financial counterparties.

21. Those numbers support the proposals regarding the categories of counterparties. In addition, given that the number of financial counterparties not included in Category 1 is estimated to be several thousands, to which can be added AIFs that currently have a non-financial status, it is appropriate to further divide this group of counterparties in two distinct groups (Category 2 and Category 3) to prevent a situation in which all those numerous counterparties would seek to establish clearing arrangement at the same time.

[15] The group of non-financial counterparties includes counterparties above (NFC+) and below (NFC-) the clearing threshold. The number of NFC+ is expected to be significantly lower.

Table 12: Counterparties with cleared trades

	%
Clearing Member IRS	
With cleared trades	91.9%
Without cleared trades	8.1%
Clearing Member other asset class	
With cleared trades	22.2%
Without cleared trades	77.8%
Other financial counterparty	
With cleared trades	17.4%
Without cleared trades	82.6%
Other non-financial counterparty	
With cleared trades	2.5%
Without cleared trades	97.5%
Undetermined	
With cleared trades	2.4%
Without cleared trades	97.6%
Grand Total	**100.0%**

Source: TRs data, ESMA calculations

Breakdown of volumes depending on the two counterparties to the transactions

Assumptions on the cleared trades

22. There are two possible ways of identifying cleared trades in the TR database: the first one is to rely on the field "Cleared" that shall be filled by the counterparties, and the second one is to identify that one of the two CCPs is a counterparty.

23. When comparing those two methods, the dataset indicates a number of inconsistencies of two types:

(a) Some trades are reported as "Cleared" although no counterparty to the transaction matches the LEI of a CCP. This can be explained either by the fact that the CCP is not identified by an LEI (in which case the transaction should indeed be considered a cleared transaction), by the fact that the transaction was erroneously reported as "Cleared" or by the fact that there is an existing corresponding cleared transaction (with a CCP as counterparty) that is reported with a different trade id. Those cases represented 6.5% of the total number of trades in the dataset and in half of those cases at least one of the two counterparties was not identified with an LEI.

(b) Some trades are reported as "Non-Cleared" although one counterparty to the transaction matches the LEI of a CCP. Those cases represented 8.4% of the total number of trades in the dataset.

24. Using alternatively one or the other method to capture the cleared trades did not modify substantially the conclusions and results presented in this paper. The cleared volumes reported in this paper rely on the field "Cleared" as reported by the counterparties, except when information is necessary on the two counterparties to the transactions (Table 13, Table 14, Figure 1). In such cases, the trades marked as "Cleared" or "Trade facing a CCP" are the ones where one of the counterparties' LEI matches the LEI of a CCP, irrespective of the value reported in the field "Cleared" by the counterparties.

Volumes depending on the counterparties to the transactions

25. To estimate the volume of transactions that will migrate to central clearing during each phase-in period, the transactions were broken down based on the two counterparties to the transaction.

26. As indicated in Table 13 below, almost half of the transactions were reported with one CCP as one of the counterparties. As regards the remaining counterparties, another 25% of the transactions were executed between two IRS clearing members. Hence it can be estimated that approximately one half of the non-cleared volume is executed between clearing members in IRS (Category 1) and therefore a good portion[16] of this large share of the currently non-cleared market should move to central clearing within six months of the entry into force of the RTS on the clearing obligation.

Table 13: Volume (trade count) per type of counterparties

	% of trade count
Trade facing a CCP	46.9%
Between two IRS clearing members	25.0%
Involving an IRS clearing member	25.3%
Other	2.8%
Grand Total	**100.0%**

Source: TRs data, ESMA calculations

27. To evaluate the volume of transactions executed by counterparties in Category 2, 3 and 4 we have examined the distribution of the volumes across counterparties meeting the following conditions:

- The transaction is not concluded between two counterparties of Category 1
- The reporting counterparty has used an LEI and is established in Europe
- The counterparties are not CCPs

28. The focus is therefore on non-cleared transactions executed by European counterparties outside Category 1.

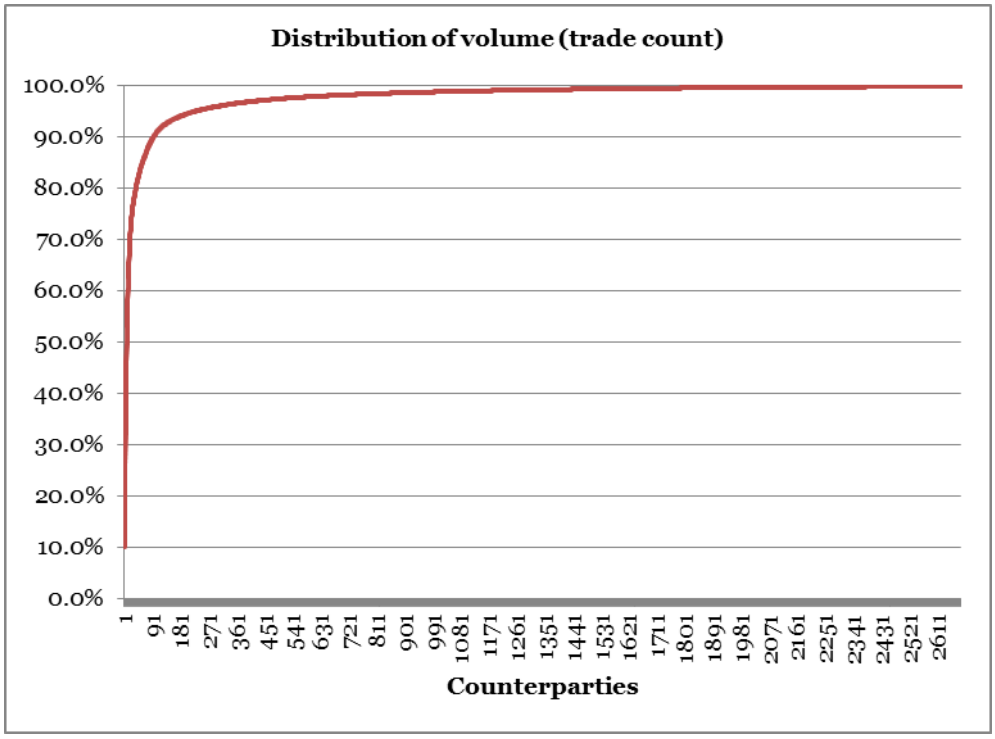
[16] The contracts that are not CCP eligible will remain bilateral and the contracts not included in the mandatory classes may as well remain bilateral unless voluntarily cleared

29. As shown in Figure 1 and Table 14 below, the distribution of volumes across counterparties is significantly skewed, with more than 90% of the traded volumes concluded by less than 5% of the total number of counterparties.

30. Several assumptions could be taken regarding the relative size of Category 2 versus Category 3, but under all hypothesis, it should be the case that even if Category 2 encompasses few counterparties (the biggest and most sophisticated ones) the volumes brought to central clearing at the end of the phase in for Category 2 will significantly outstrip the volumes left out of central clearing until the end of the phase-in periods for Category 3 and 4.

31. As an order of magnitude (see Table 14), the first 100 (resp. 500) active counterparties account for 90.7% (resp. 97.5%) of the volume of transactions excluding those traded between counterparties of Category 1. Therefore, if we take the assumption that Category 2 includes 100 counterparties, the volume of transactions that would move to central clearing during the phase-in of Category 2 should be approximately 90% of the remaining volumes to be cleared.

Figure 1: Distribution of non-cleared volume (trade count) where at least one of the counterparty is not an IRS clearing member



Source: TRs data, ESMA calculations

Table 14: Cumulative distribution of non-cleared volume across counterparties where at least one is not an IRS clearing member

Counterparties (count)	Counterparties (% of total)	Cumulative distribution of volume (trade count)
1	0.0%	10.1%
5	0.2%	38.4%
10	0.4%	56.0%
20	0.7%	72.1%
30	1.1%	38.4%
40	1.5%	81.0%
50	1.9%	83.5%
100	3.7%	90.7%
150	5.6%	93.3%
200	7.4%	94.6%
500	18.6%	97.5%

Source: TRs data, ESMA calculations

2. 3. Classes proposed to be subject to the clearing obligation

32. The consultation paper presented the analysis conducted by ESMA on the interest rate OTC derivative classes that the CCPs have been authorised to clear, against the criteria set in EMIR. In the liquidity criteria section, ESMA included a review of both the stock (outstanding) and the flow (daily turnover) of trades executed in the swap and forward rate agreement classes, broken down by currency. Using data from the European TRs as explained in the previous paragraphs, the predominance of the classes denominated in the G4 currencies is also visible in the reported transactions. Table 15 gives an overview of these findings, which is further broken down in the next paragraphs.

Table 15: Volume (trade count) broken down by product type and currency groups

	FRA	IRS	Grand Total
Cleared			
G4	91.0%	83.5%	85.0%
European excl. EUR and GBP	6.4%	5.1%	5.3%
Other	2.6%	11.4%	9.6%
Not cleared			
G4	75.7%	71.9%	72.2%
European excl. EUR and GBP	9.4%	5.4%	5.7%
Other	14.9%	22.7%	22.1%
Grand Total	**100.0%**	**100.0%**	**100.0%**

Source: TRs data, ESMA calculations

33. From a trade count perspective, using TR data, the vast majority of trades reported are trades denominated in one of the G4 currencies. Looking at cleared trades and uncleared trades separately, Table 15 indicates that between 71.9% and 83.5% of IRS and between 75.7% and 91% of FRA are denominated in one of the G4 currencies. These numbers are in line with data presented in the consultation paper, in particular Tables 5 to 8. Across these classes and across the cleared and uncleared trade populations, IRS and FRA denominated in EU currencies other than EUR and GBP account for another 5.5%. Following this first determination, further analysis will be conducted by ESMA on classes denominated in currencies other than the G4 currencies.

34. Statistics on the G4 denominated classes presented in these tables are consistent with the tables presented in the consultation paper, which is further illustrated by breaking down these numbers at the level of the currency.

35. Table 16 (volume measured by trade count) and Table 17 (volume measured by notional amounts) indicate that the predominance of each of these currencies is also similar to the findings developed in the consultation paper.

36. Whether cleared or uncleared, FRAs denominated in EUR represent between 45% and 51% of FRA (out of total trade count) and 57.5% to 60.8% of FRA (out of G4 notional amount). Given Table 16 and Table 17 are based on data sourced from EU TRs and thus counterparties reporting under the EU mandate, it can explain that EUR classes represent a slightly higher share than at the global level as presented in the consultation paper.

37. For the same reason, it is the opposite for FRAs denominated in USD, they represent a slightly smaller share. But apart from these regional specificities and beyond these 3 currencies, each of the next currencies account for a much smaller share of the FRA trades being reported. SEK is the 4th currency of reported cleared FRA trades with 2.8% and ZAR is the 4th currency of reported uncleared FRA trades with 5.8%.

38. Turning to swaps, similar conclusions can be drawn, i.e. some regional specificities explain slight differences in the share of the respective classes per currency, with for instance EUR swaps accounting for a larger share of the total reported trades, as well as the same predominance of the currencies of the classes determined to be fit for the clearing obligation. AUD is the 5th currency of reported cleared IRS trades with 3.9% and MXN is the 4th currency of reported uncleared IRS trades with 3.2%. Looking at notional amounts in Table 17, IRS denominated in EUR represent more than half of the G4 total, whether cleared or uncleared.

Table 16: Volume (trade count) broken down by product type and currencies

	Volume (Trade Count)	Cumulative
FRA		
Cleared		
EUR	51.2%	51.2%
USD	24.4%	75.6%
GBP	15.1%	90.7%
SEK	2.8%	93.5%
Not cleared		
EUR	45.0%	45.0%
GBP	19.0%	64.0%
USD	15.0%	79.0%
ZAR	5.8%	84.8%
IRS		
Cleared		
USD	34.6%	34.6%
EUR	27.9%	62.5%
GBP	11.7%	74.2%
JPY	8.3%	82.5%
AUD	3.9%	86.4%
Not cleared		
EUR	34.0%	34.0%
USD	21.3%	55.3%
GBP	11.9%	67.2%
JPY	5.8%	73.0%
MXN	3.2%	76.3%

Source: TRs data, ESMA calculations

Table 17: Volume (notional amounts) broken down by product type and currencies

G4 currencies only

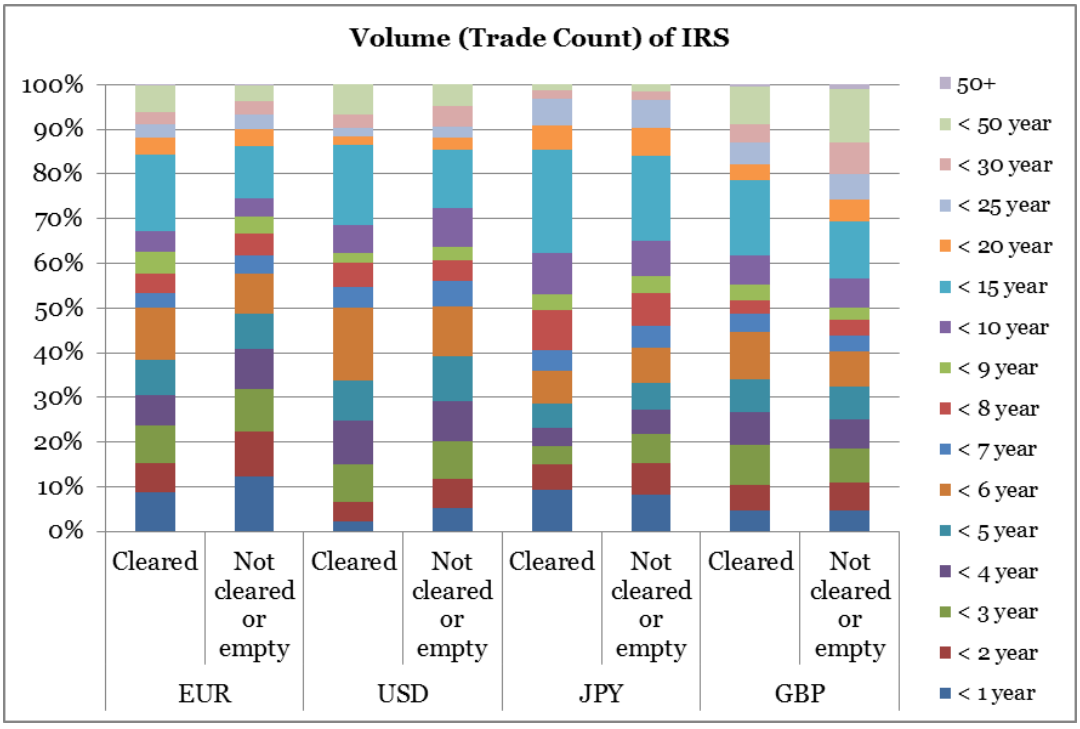
	Volume (Notional Amounts)
FRA	
Cleared	
EUR	57.5%
USD	29.2%
GBP	13.2%
Not cleared	
EUR	60.8%
USD	20.0%
GBP	19.3%
IRS	
Cleared	
EUR	58.5%
USD	24.1%
GBP	13.0%
JPY	4.4%
Not cleared	
EUR	57.0%
USD	24.0%
GBP	14.4%
JPY	4.6%

Source: TRs data, ESMA calculations

Analysis of the maturities

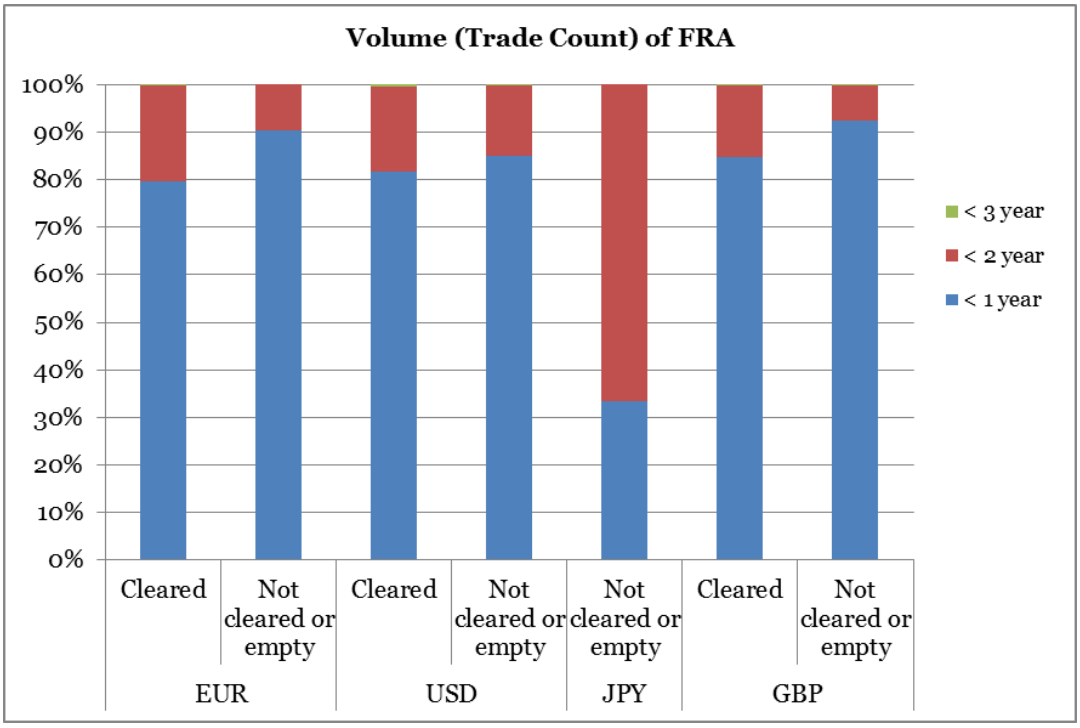
39. The analysis of the maturities of transactions reported to EU TRs under the European mandate are indicative of the term structure of the interest rate swap and forward rate agreement markets. First of all, across the CCPs that have been authorised to clear OTC derivatives and the CCPs that have been actively used, all the liquid maturity buckets have been offered for clearing. Indeed, several CCPs support clearing of swaps in EUR, GBP and USD up to 50 years, in JPY up to 30 years, and FRAs up to 3 years. As a result the two populations of cleared transactions and uncleared transactions respectively indicate similar information on the breakdown of traded maturities in these classes. Figure 2 and Figure 3 illustrate this point.

Figure 2: Volume (Trade Count) of Interest Rate Swaps – Breakdown per maturity



Source: TRs data, ESMA calculations

Figure 3: Volume (Trade Count) of FRA – Breakdown per maturity



Source: TRs data, ESMA calculations

40. Secondly, in terms of the range of maturities with active volumes, the analysis of the transactions reported to EU TRs in the time window described in the previous paragraphs is consistent with the analysis made in the consultation paper. Figures 4 to 11 from the consultation paper were based on outstanding trades at a point in time and are thus more indicative of a the stock, while Figure 2 and Figure 3 of this paper are based on transactions executed during a three month period, thus being more indicative of the flow. Both sets of statistics on traded maturities re-validate the choice of maximum maturities for the determination of the classes. For example, Figures 4 and 5 of the consultation paper and Figure 2 of this paper all indicate that EUR swaps have been actively traded with maturities up until the 50 year tenor.

3. Minimum remaining maturity and frontloading

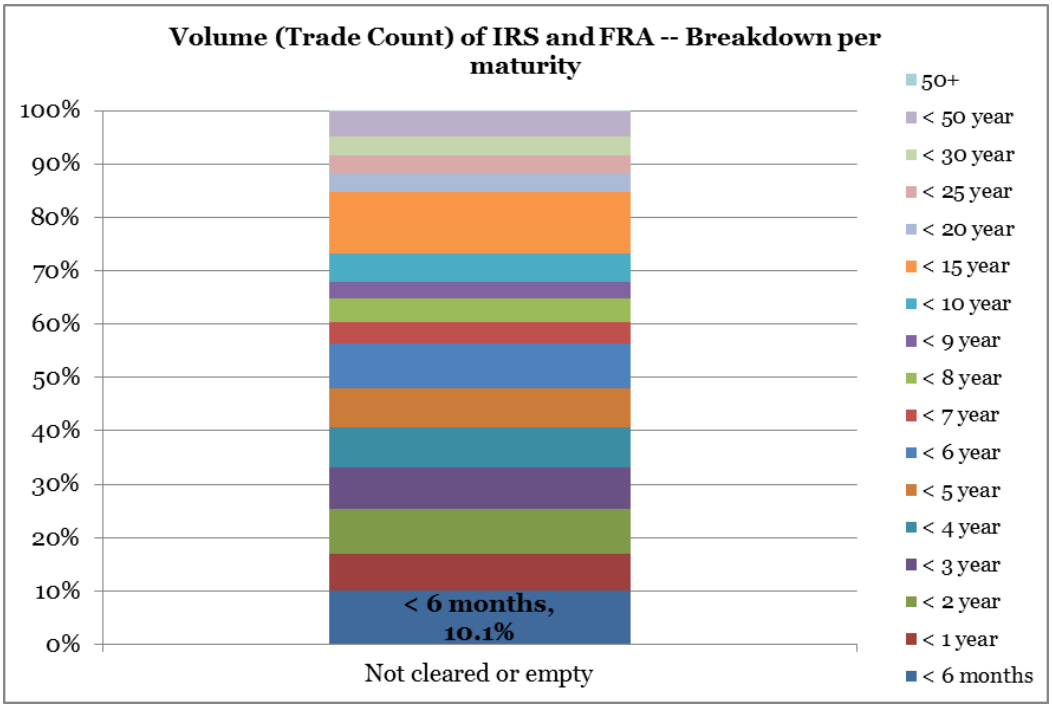
3. 1. Frontloading for Category 1 and Category 2

41. The proposal related to frontloading sets at six months the minimum remaining maturity of contracts concluded after the publication in the Official Journal of the RTS on the clearing obligation. This implies that contracts traded during that period and with a maturity of more than 6 months are subject to frontloading, hence should be cleared at the latest after the phase-in period has elapsed.

42. As indicated in Figure 4 below, trade repository data indicate that roughly 90% of the volume (measured by trade count) of non-cleared IRS and FRA, in the currencies covered by the clearing obligation, have an initial maturity above 6 months. This can be taken as a proxy for the proportion of transactions that should be subject to frontloading, under the assumption that the distribution across maturities is sufficiently stable over time.

43. This estimated breakdown (10% of trades below 6 months, 90% of trades above 6 months) was calculated across counterparties. Therefore, given that some counterparties are not subject to frontloading, the actual proportion of trades subject to frontloading is expected to be below 90%.

Figure 4: Volume (Trade Count) of non-cleared IRS and FRA – Breakdown per maturity



Source: TRs data, ESMA calculations

3. 2. Exemption from frontloading for Category 3 and 4

44. As presented in paragraph 31 above, the distribution of the trades per pair of counterparties indicates that, under the assumption that Category 2 is composed of 100 to 500 counterparties, 3% to 10% of the volumes to be cleared after the phase-in period of Category 1 would involve at least one counterparty in Categories 3 and 4. Given that those counterparties are not subject to frontloading, it means that those volumes are likely to stay outside CCPs.

45. To have an idea of the global impact of this exemption from the frontloading obligation for counterparties in Category 3 and Category 4, we can combine this result with the estimations included in Table 13, which indicates that roughly 50% of the non-cleared transactions are executed between counterparties in Category 1, hence the remaining 50% are executed between counterparties including at least one counterparty in Category 2, 3 or 4.

46. It follows that the exemption from frontloading for counterparties in Category 3 and 4 may impact 1.5% to 5% of the total non-cleared volumes.

4. Qualitative Impact Assessment

4. 1. Clearing obligation approach – Scope of classes for the analysis and the consultation

Policy Objective	**Determine the approach to define the scope of classes to analyse and consult on**
Option 1	ESMA to issue a consultation paper after each notification as referred to in Article 5(1) of EMIR, i.e. 1 consultation paper per notification.
Option 2	ESMA to issue a consultation paper grouping the analysis of all the notified classes that belong to the same asset-class, i.e. 1 consultation paper per asset-class, where asset class means (1) interest rate, (2) credit, (3) foreign-exchange, (4) equity and (5) commodity.
Option 3	ESMA to issue a single consultation paper for all the classes
Preferred Option	**Option 2**

Option 1	**ESMA to issue a consultation paper after each notification as referred to in Article 5(1) of EMIR, i.e. 1 consultation paper per notification.**
	Qualitative description
Benefits	This approach is the simplest one. Following the clearing obligation procedure defined in EMIR, ESMA has to analyse the classes of OTC derivatives included in each notification. With this option, ESMA would do the analysis and consult each time classes are notified to ESMA. The main benefits of this approach are the simplicity in defining the scope and the timing as this method allows conducting the analysis immediately. Following each notification, this would lead to the publication of a consultation paper addressing all the classes notified and that are not yet covered in previous notifications, providing clarity quickly on the classes that ESMA determines good candidates for the clearing obligation and those that are not. This would allow maximising the 6 month period provided for in EMIR for the analysis and the consultation.
Costs to regulator	This approach bears the risk of submitting multiple RTS at the end of each procedure and for multiple RTS to then enter into force, making the implementation more complex and costlier and thus more difficult to monitor.
Compliance costs	This approach bears the risk of submitting multiple RTS at the end of each procedure and for multiple RTS to then enter into force, making the implementation more complex and costlier.
Indirect costs	This option would multiply the number of consultations, making it a suboptimal and costly process for regulators and stakeholders to go through. For instance, there are 5 EU CCPs clearing interest rate classes, which could equate in 5 consultations, and for the dozen or so EU CCPs expected to notify OTC derivative classes that could also mean a dozen consultations in total. In addition, given that the authorisations are relatively close to each other, many of these consultations would run in parallel although not necessarily synchronously, limiting the clarity and effectiveness of the consultations.

Option 2	**ESMA to issue a consultation paper grouping the analysis of all the notified classes that belong to the same asset-class, i.e. 1 consultation paper per asset-class, where asset class means (1) interest rate, (2) credit, (3) foreign-exchange, (4) equity and (5) commodity.**

	Qualitative description
Benefits	With this second option, the classes from several notifications would be grouped to the extent possible, with the idea to group them per asset class. For instance, if a CCP is authorised to clear a class up to 10 years, that is deemed to be fit for the clearing obligation, but that another CCP is expected to potentially be authorised shortly after to clear the same class up to 20 years, which is also deemed to be fit for the clearing obligation, it would be more meaningful to group the two. The same argument applies with the other characteristics of the classes, in particular the product type and the currency. In addition, in support of the feedback from the discussion paper, when determining whether a given class is a good candidate for the clearing obligation, the grouping approach allows to better take into consideration whether more than one CCP will be authorised to clear it. The main benefit of this option is a more meaningful analysis and consultation, bringing clarity and efficiency for regulators and stakeholders.
Costs to regulator	With this approach, the aim would be to have one RTS per asset class which would make it easier to implement and monitor.
Compliance costs	With this approach, the aim would be to have one RTS per asset class which would make it easier to implement.
Indirect costs	If the notifications within the same asset class are sufficiently spaced out, not all notifications can necessarily be fully integrated into the analysis.

Option 3	**ESMA to issue a single consultation paper for all the classes**
	Qualitative description
Benefits	With this last and third option, the grouping is done once and for all the notifications following the authorisation of all the CCPs. This would allow having a streamlined process to analyse and consult on what would the first wave of the clearing obligation across all classes notified from all the EU CCPs authorised. The main benefits are thus efficiency for regulators and stakeholders as well as clarity at once on the full spectrum of classes.
Costs to regulator	This option is associated with the least cost compared to the other options. There would be one single RTS to be implemented and that regulators would need to monitor compliance with.
Compliance costs	This option is associated with the least cost compared to the other options. There would be one single RTS to implement.
Indirect costs	The authorisations of EU CCPs are sufficiently spaced out. Therefore, waiting for all the notifications would mean not meeting the 6 month deadlines triggered from the first notifications for the classes deemed to be good candidates for the class+, thus making this option impossible to follow, as being contrary to the text of EMIR.

4. 2. Structure of classes – Interest rate OTC derivatives

Policy Objective	**Determine the structure for the classes of interest rate OTC derivatives to be considered for the clearing obligation**
Option 1	Define classes with the main characteristics (product type, index, currency, maturity, currency type, optionality, notional type) that make up these derivatives

Option 2	Define each class in much more granular levels by specifying additional characteristics such as the floating rate tenor, the payment frequency, the reset frequency of the floating leg or the day count fraction
Preferred Option	**Option 1**

Option 1	**Define classes with the main characteristics (product type, index, currency, maturity, currency type, optionality, notional type) that make up these derivatives**
	Qualitative description
Benefits	The approach is the simplest one; it allows to identify the core characteristics related to the economic result that market participants seek to achieve with each trade. There are several benefits with this approach: a) this categorisation is in line with market practice and pre-existing taxonomies that are generally accepted by market participants, b) it is in line with the approach taken in other jurisdictions in a global interest rate OTC derivative market, c) it limits possible avoidance by some participants, it reduces the possibility to side step the scope as it does not rely on more granular and technical characteristics, d) these class structures allow through the various characteristics combinations to adequately bucket groups of derivatives trades and their associated liquidity, facilitating the monitoring of trading volume and continued suitability for the clearing obligation.
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 (Option 2).
Compliance costs	The simpler the classes are defined while still being meaningful and the more aligned internationally, the simpler they will be identified 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 (Option 2).

Option 2	Define each class in much more granular levels by specifying additional characteristics such as the floating rate tenor, the payment frequency, the reset frequency of the floating leg or the day count fraction
	Qualitative description
Benefits	The approach enables to align the definition of the classes closer to the wide range of characteristics that are included in the product specification of the contract.
Costs to regulator	The more granular the classes, the more numerous the classes will be due to a large number of possible combinations of characteristics, and the more difficult it will be to monitor and enforce compliance. Secondly, by breaking down this market in narrower classes with only some of them included in the clearing obligation, it could create opportunities for avoidance by trading outside the mandatory scope by trading out of one of the more minor characteristics in scope and limit the ability for the regulators to address systemic risk.
Compliance costs	The more granular the classes are, the more complex it will be to monitor and ensure compliance, and the more likely the classes would need to change as the market evolves with the additional difficulty to adequately maintain them internally.

4. 3. Definition of the categories of counterparties

Categories of counterparties - General

Policy Objective	**Determine the categories of counterparties to which different phase-in would apply**
Option 1	Create a single category of counterparties and apply the same phase-in to all counterparties
Option 2	Rely on the categories of counterparties already defined under EMIR Article 2(8) and 2(9) i.e. financial counterparties and non-financial counterparties
Option 3	Rely on the categories of counterparties already defined under EMIR Article 2(8) and 2(9) i.e. financial counterparties and non-financial counterparties, and create sub-categories based on qualitative criteria (clearing members and AIFs)
Option 4	Rely on the categories of counterparties already defined under EMIR Article 2(8) and 2(9) i.e. financial counterparties and non-financial counterparties, and create sub-categories based on quantitative criteria (e.g. traded volumes)
Preferred Option	**A mix of option 3 and Option 4**

Option 1	**Create a single category of counterparties and apply the same phase-in to all counterparties**
	Qualitative description
Benefits	The approach is the simplest one. Imposing the same phase-in for all counterparties would avoid situations in which the CCPs finalise their clearing offerings based on the initial preferences of clearing members, rather than the views of the full universe of entities that will ultimately be required to clear under EMIR. This could be beneficial in terms of competition.
Costs to regulator - *One-off*[17]	The less categories of counterparties and the simplest those categories are defined, the less costly it will be for regulators to enforce. In this respect the options are sorted out from the least costly (Option 1) to the most costly (Option 4)
Compliance costs - *One-off*	No classification costs for counterparties
Indirect costs	This option would result in a "big-bang" situation where all counterparties need to start complying on the same day. This may create bottleneck situations as all clients seeking for an access to clearing will do so at the same time. In addition, this option would unlikely be compatible with Article 5(5)(e) and (f) of EMIR. Indeed: • Article 5(5)(e) requires ESMA, when determining the phase-in, to take into account the period of time a counterparty subject to the clearing obligation needs in order to put in place arrangements to clear. Some counterparties need more time than others, in particular those who have never cleared before. • Article 5(5)(f) requires ESMA, when determining the phase-in, to take into account the risk management and the legal and operational capacity of the range of counterparties active in the market. Depending on their size and level of sophistication, not all counterparties have the same legal and operational capacities.

Option 2	**Rely on the categories of counterparties already defined under EMIR Article 2(8) and 2(9) i.e. financial counterparties and non-financial counterparties**

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

	Qualitative description
Benefits	The approach is simple, transparent and consistent with the definitions already provided in EMIR. Counterparties have already classified their respective counterparties according to the EMIR definitions for other purposes and would be able to leverage on that work.
Costs to regulator - *One-off*	The less categories of counterparties and the simplest those categories are defined, the less costly it will be for regulators to enforce. In this respect the options are sorted out from the least costly (Option 1) to the more costly (Option 4)
Compliance costs - *One-off*	There is no additional cost linked to the classification over and above those already introduced by EMIR.
Indirect costs	This option does not allow distinguishing between more sophisticated and less sophisticated financial counterparties, in particular those who already have an experience in central clearing. It also leads to certain funds (AIFs not captured by the definition of "financial counterparties") to be commingled with "pure" NFC although they have significantly different legal and operation capacities, as well as different risk management systems.

Option 3	**Rely on the categories of counterparties already defined under EMIR Article 2(8) and 2(9) i.e. financial counterparties and non-financial counterparties, and create sub-categories <u>based on qualitative criteria</u> (clearing members and AIFs)**
	Qualitative description
Benefits	In addition to the benefits of Option 2, with this option it is possible to adapt with additional granularity the compliance time with the operational capacity of the counterparties and to define categories of counterparties that are sufficiently homogeneous. In respect of criteria 5(5)(e), counterparties who already are clearing members are expected to be the fastest to be able to comply with the clearing obligation. Although they may not be a clearing member for all the classes subject to the clearing obligation (the "Class+"), they have already completed at least once all the steps to connect to a CCP and should be able to leverage on that experience. In respect of criteria 5(5)(f), all AIFs should be included in the same category of counterparties irrespective of their status of FC or NFC under EMIR, because their risk management, and legal and operational capacities are expected to be similar (and do not depend on the fact that they are a FC or a NFC). In addition, most of the AIFs that are currently classified as NFC+ are expected to be classified as FC in the future, when their AIFM becomes "authorised or registered" under AIFMD.
Costs to regulator - *One-off*	The less categories of counterparties and the simplest those categories are defined, the less costly it will be for regulators to enforce. In this respect the options are sorted out from the least costly (Option 1) to the costliest (Option 4). Unlike Option 2, this classification (i.e. the fact that a counterparty is a clearing member or an AIFs) is not reported to trade repositories ("TR"), which makes it more difficult for regulators to monitor.
Compliance costs - *One-off*	If the additional sub-categories are defined with straightforward and qualitative criteria, the classification costs should be limited although higher than with Option 1 or Option 2. For most counterparties there will be no additional compliance costs, as the assessment of whether they are a FC or an NFC has already been done. Compared to Option 1, there will be additional compliance costs for clearing members, as they will need to determine if they meet the conditions of Category 1.

	It is not expected that AIFs will bear additional compliance costs as they are already classified as AIFs under AIFMD.

Option 4	**Rely on the categories of counterparties already defined under EMIR Article 2(8) and 2(9) i.e. financial counterparties and non-financial counterparties, and create sub-categories <u>based on quantitative criteria</u> (e.g. traded volumes or outstanding positions)**
	Qualitative description
Benefits	The volume of activity would be a good indicator of the resources that the counterparty can dedicate to prepare compliance with the clearing obligation. The most active counterparties would need to start clearing first, which is aligned with the objective of the clearing obligation.
Costs to regulator - *One-off*	The less categories of counterparties and the simplest those categories are defined, the less costly it will be for regulators to enforce. In this respect the options are sorted out from the least costly (Option 1) to the costliest (Option 4) Unlike Option 2, this classification is not reported to TR, which makes it more difficult to monitor. The volume criteria may be subject to various interpretations.
Compliance costs -	The classification costs would be higher than with any other options. Counterparties would be required to re-classify themselves and their counterparties with the unique objective of determining a phase-in. The classification may be unstable in time, i.e. a counterparty may change categories during the phase-in periods, which is complex and burdensome. A counterparty more active in one asset class and less active in another asset class would be subject to different phase-in for each asset class, which is more burdensome and costly than Option 1 and 2. However, the suggested threshold should be used for multiple purposes, because it was adopted at international level under the bilateral margins regimes. This will compensate the greater costs implied by that introduction and monitoring of quantitative thresholds.
Indirect costs	This option requires ESMA to design a new categorisation of counterparties based on quantitative criteria which may be subject to interpretation.

Conditions on the clearing membership

Policy Objective	**Define the conditions for a counterparty to be included in the Category 1 "Clearing Member"**
Option 1	A clearing member of any authorised or recognised CCP (irrespective of the instruments cleared) falls in Category 1
Option 2	A clearing member of any CCP authorised to clear OTC derivatives falls in Category 1 (Clearing member defined at the level of the CCP)
Option 3	A clearing member for any Class+ of any CCP authorised to clear the Class+ falls in Category 1. Therefore if a counterparty falls within Category 1 for one class, it will be in that category for all the classes.
Option 4	A clearing member for a specific Class+ of a CCP authorised to clear this Class+ falls in Category 1 for this class. Therefore a counterparty may belong to Category 1 for one class, and to another category for another class.
Preferred Option	**Option 3**

Option 1	**A clearing member of any authorised or recognised CCP(irrespective of the instruments cleared) falls in Category 1**
	Qualitative description
Benefits	The approach is very simple and the easiest to implement. Although the counterparties captured by Category 1 with this option are not necessarily clearing members for the Class+, they have a certain experience with central clearing. It is therefore expected that they would need less time to connect to CCPs clearing the Class+ than counterparties who have never cleared before.
Costs to regulator - *One-off*[18]	Options 1 to 4 are sorted by increasing level of complexity and hence, increasing costs to regulators.
Compliance costs - *One-off*	Options 1 to 4 are sorted by increasing level of complexity and hence, increasing compliance costs. Option 1 bares very limited costs for counterparties as the only information necessary to determine whether they belong to Category 1 is the existence of a clearing membership with any CCP.

Option 2	**A clearing member of any CCP authorised to clear OTC derivatives falls in Category 1 (Clearing member defined at the level of the CCP)**
	Qualitative description
Benefits	This option introduces a layer of flexibility compared to Option 1 by bounding Category 1 to counterparties that are connected to the CCPs most relevant for the clearing obligation (i.e. the ones clearing OTC derivatives). However the access to clearing is only partially taken into consideration. Indeed, a counterparty which is a clearing member of only one CCP authorised to clear OTC derivatives outside the scope of the clearing obligation (e.g. KDPW_CCP in the current clearing obligation determination) would fall into the "Clearing Member" category for its entire OTC activity, although it does not have immediate and direct access to any CCP clearing the Class+.
Costs to regulator - *One-off*[19]	Options 1 to 4 are sorted by increasing level of complexity and hence, increasing costs to regulators.
Compliance costs - *One-off*	Options 1 to 4 are sorted by increasing level of complexity and hence, increasing compliance costs. Option 2 bares limited costs for counterparties as the only information necessary to determine whether they belongs to Category 1 is the

[18] On-going costs are irrelevant with respect to phase-in.
[19] On-going costs are irrelevant with respect to phase-in.

	existence of a clearing membership with the CCP authorised to clear OTC derivatives. The list of CCPs that are authorised to clear OTC derivatives is available in the Public Register on ESMA's website

Option 3	**A clearing member <u>for any Class+</u> of any CCP authorised to clear the Class+ falls in Category 1. Therefore if a counterparty falls within Category 1 for one class, it will be in that category for all the classes.**
	Qualitative description
Benefits	A counterparty belongs to Category 1 if it is a clearing member, for at least one Class+, of at least one CCP which has been authorised to clear the Class+. The access to clearing is better taken into consideration than with Option 1 and 2. Indeed, a clearing member exclusively of CCPs authorised to clear OTC derivatives outside the scope of the clearing obligation (e.g. KDPW_CCP in the current clearing obligation determination) would not fall into the "Clearing Member" category for its entire OTC activity, as it does not have access to any CCP clearing the Class+.
Costs to regulator - *One-off*[20]	Options 1 to 4 are sorted by increasing level of complexity and hence, increasing costs to regulators.
Compliance costs - *One-off*	Options 1 to 4 are sorted by increasing level of complexity and hence, increasing compliance costs. The compliance costs for Option 2 and 3 are comparable and limited as the only information necessary to determine whether counterparties belong to Category 1 is the existence of a clearing membership with the CCP authorised to clear the specific Class+. The list of CCPs that are authorised to clear OTC derivatives, and the classes of OTC derivatives that they are authorised to clear, are available in the Public Register on ESMA's website

Option 4	**A clearing member <u>for a specific Class+</u> of a CCP authorised to clear this Class+ falls in Category 1 for this class. Therefore a counterparty may belong to Category 1 for one class, and to another category for another class.**
	Qualitative description
Benefits	Clearing members in another Class+ are put on an equal footing with other counterparties for the specific Class+ in terms of timing to access the latter. Under this option, a counterparty which is a clearing member only for a specific Class+ falls in Category 1 only for this Class+. This means that for each class, only counterparties already clearing this specific class on a voluntary basis belong to Group 1.
Costs to regulator - *One-off*[21]	Options 1 to 4 are sorted by increasing level of complexity and hence, increasing costs to regulators.
Compliance costs - *One-off*	Options 1 to 4 are sorted by increasing level of complexity and hence, increasing compliance costs. Compliance costs for Option 4 are expected to be high in particular because a counterparty may belong to Category 1 for one class, and to another category for other classes. This would significantly increase the complexity of the compliance schedule.

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

Date of assessment of the clearing membership

Policy Objective	**Define the conditions on the clearing membership to be considered a Category 1 "Clearing Member": on which date should the counterparties assess the clearing membership**
Option 1	The date of assessment of the clearing membership is a date before the entry into force of the RTS on the clearing obligation (e.g. the date of publication of the consultation paper)
Option 2	The date of assessment of the clearing membership is the date of entry into force of the RTS on clearing obligation
Preferred Option	**Option 2**

Option 1	**The date of assessment of the clearing membership is a date before the entry into force of the RTS on the clearing obligation (e.g. the date of publication of the consultation paper)**
	Qualitative description
Benefits	This option avoids the existence of disincentive to become clearing members. Indeed, counterparties planning to become clearing members in the short term (i.e. before the entry into force of the RTS on the clearing obligation) have no incentive to postpone their project to avoid being captured by Category 1, as they would already know that they do not belong to Category 1. The more clearing members, the more possibilities for clients to get access to clearing. Therefore it would be damageable and opposite to the objective of the clearing obligation, if a counterparty would differ becoming a clearing member for the sole purpose of circumventing the classification in Category 1. In addition, this option allows counterparties to determine the categories of counterparties to which they and their counterparty belong earlier and hence allow a better preparation for the clearing obligation.
Costs to regulator - *One-off*[22]	There is no difference in the compliance costs or the costs to regulators with Options 1 and 2. Irrespective of the option chosen, there is no cost over and above those associated to the definition of the conditions to be a clearing member of category 1. Indeed the assessment of the clearing membership needs to be done in any case, and the choice of a certain date of assessment has no impact on the costs.
Compliance costs - *One-off*	

Option 2	**The date of assessment of the clearing membership is the date of entry into force of the RTS on the clearing obligation**
	Qualitative description
Benefits	Although potentially creating a disincentive for counterparties to become a clearing member, setting the date of assessment on the date of entry into force of the RTS on the clearing obligation does not introduce retroactive effect like it is the case with Option 1. Retroactive effect should generally be avoided for the purpose of enhanced legal certainty.
Costs to regulator - *One-off*[23]	There is no difference in the compliance costs or the costs to regulator with Options 1 and 2. Irrespective of the option chosen, there is no cost over and above those associated to the definition of the conditions to be a clearing member of

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

Compliance costs - *One-off*	category 1. Indeed the assessment of the clearing membership needs to be done in any case, and the choice of a certain date of assessment has no impact on the costs.

Qualitative category of counterparties – Clearing Members in the classes subject to the clearing obligation

Policy Objective	**Determine which counterparties (FCs/NFCs) belong to the "clearing member" category (to which the shortest phase-in period applies)**
Option 1	Apply the "clearing member" criteria over and above the other classifications i.e. a counterparty meeting the conditions of "clearing member" belongs to Category 1 irrespective of the fact that it is an FC, an AIF-NFC+ or a "pure" NFC+.
Option 2	Include only financial counterparties in the Category 1
Preferred Option	**Option 1**

Option 1	**Apply the "clearing member" criteria over and above all the other classifications i.e. a counterparty meeting the conditions of "clearing member" fall in category 1 irrespective of the fact that it is a FC, an AIF-NFC+ or a "pure" NFC+.**
	Qualitative description
Benefits	This option allows to consider in an appropriate manner the criteria of Article 5(5)(e) i.e. the period of time a counterparty needs in order to make the necessary arrangements with a CCP to clear the relevant contracts. Indeed it is sensible to consider that for all clearing members on one side, and for all non-clearing members on the other side, the period of time needed to connect to a CCP is comparable, although this is not the only criteria to be taken into account when defining the phase-in. The clearing membership is a good proxy to identify the counterparties most active in the market in relation to criteria 5(5)(d).
Costs to regulator - *One-off*[24]	The costs for regulators are slightly higher with Option 1 than with Option 2 as the number of clearing members is higher in the first case.
Compliance costs - *One-off*	The costs for financial counterparties are identical with the two options. The costs for NFC+ are null with Option 2.

Option 2	**Include only financial counterparties in the Category 1**
	Qualitative description
Benefits	Given that there are relatively few non-financial counterparties that are clearing members, and that they are understood to be clearing members only for the commodity asset-class, which is not covered by the present clearing obligation determination, this option has roughly the same benefits as Option 1 in this case (i.e. clearing obligation on contracts other than commodities). However even if there are only few counterparties (if any) affected by the choice of Option 1 versus Option 2, the former ensures equal treatment between counterparties that share similar characteristics in respect of the clearing obligation (i.e. they already have a direct access to clearing for at least some of the Class+).

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

Costs to regulator - *One-off*[25]	The costs for regulators are slightly higher with Option 1 than with Option 2 as the number of clearing members is potentially higher in the first case.
Compliance costs - *One-off*	The costs for financial counterparties are identical with the two options. The costs for NFC+ are null with Option 2.

Policy Objective	**Define categories of financial counterparties which are sufficiently homogeneous with regards to the criteria set out in Article 5(5)(d) to (f) of EMIR, i.e. the type and number of counterparties, the time needed for counterparties to establish clearing arrangements and the risk management and the legal and operational capacity of the counterparties**
Option 1	Define two categories of financial counterparties depending on the type of financial counterparties in Article 2(8) of EMIR, e.g. UCITS and AIFs in one category and the others in another category, to which different phase-in periods would apply
Option 2	Define two categories of financial counterparties depending on a quantitative threshold agreed at international level, which is based on the level activity of the counterparty in OTC derivatives.
Preferred Option	**Option 2**

Option 1	Define two categories of financial counterparties depending on the type of financial counterparties in Article 2(8) of EMIR, e.g. UCITS and AIFs in one category and the others in another category, to which different phase-in periods would apply
	Qualitative description
Benefits	This is the simplest approach. It relies entirely on definitions that are already included in EMIR and in various European legislations (UCITS, AIFMD, MiFID…)
Costs to regulator - *One-off*[26]	This option should create limited costs to regulators because the classification as "financial counterparty" is only possible with reference to the other European regulations and directive included in the definition.
Compliance costs - *One-off*	This option should create limited compliance costs because the classification as "financial counterparty" is only possible with reference to the other European regulations and directive included in the definition.

Option 2	Define two categories of financial counterparties depending on a quantitative threshold agreed at international level, which is based on the level activity of the counterparty in OTC derivatives.
	Qualitative description
Benefits	The option introduces a direct link between the level of activity of the counterparty in OTC derivatives, hence its level of sophistication, and the phase-in it will be granted to start clearing. With this option the less active counterparties would be the ones subject to the longer phase-in.

[25] On-going costs are irrelevant with respect to phase-in.
[26] On-going costs are irrelevant with respect to phase-in.

Costs to regulator - *One-off*[27]	The most significant costs for regulators may be linked to the fact the positions of all the counterparties included in the same groups should be aggregated together. For instance, the LEI (legal entity identifier) is insufficient to identify counterparties included in the same group.
Compliance costs - *One-off*	Although higher than with Option 1, the compliance costs would be reduced by the fact that the quantitative threshold is the same as the threshold used at international level in the context of margin requirement for non-cleared OTC derivatives. Indeed counterparties subject to the clearing obligation are also subject to margin requirement for their non-cleared OTC activity. Although the assessments of the non-cleared activity will have to be done at two different dates for the two requirements, the costs engaged for the purpose of complying with one requirement can be leveraged for the compliance with the second requirement. The most significant compliance costs may be linked to the fact the positions of all the counterparties included in the same groups should be aggregated together.

Category of counterparty for Alternative investment funds

Policy Objective	**Define categories of counterparties which are sufficiently homogeneous with regards to the criteria set out in Article 5(5)(f) of EMIR, i.e. the risk management and the legal and operational capacity of the range of counterparties active in the market**
Option 1	All alternative investment funds should be included in the same category of counterparty irrespective of the fact that they are a financial or a non-financial counterparty.
Option 2	Alternative investment funds should be included in different categories of counterparty depending on whether they are a financial or a non-financial counterparty.
Preferred Option	**Option 1**

Option 1	**All alternative investment funds should be included in the same category of counterparty irrespective of the fact that they are a financial or a non-financial counterparty.**
	Qualitative description
Benefits	In accordance with the definition of "Financial counterparties" in Article 2(8) of EMIR, some alternative investment funds are classified as non-financial counterparties or third country entities under EMIR, because they do not meet the condition of being "managed by AIFMs authorised or registered in accordance with Directive 2011/61/EU". This may be seen as an unintended consequence of the definition of financial counterparties as the specific treatment foreseen by EMIR and applicable to non-financial counterparties is not justified for funds which, in fact, have the profile of financial counterparties, although not meeting the definition of Article 2(8). In the context of the definition of the categories of counterparties, the fact that alternative investment funds are classified as financial counterparties, non-financial counterparties or third country entities does not create any difference in their risk management or their legal and operational capacities. Therefore this option ensures equal treatment between counterparties that are similar in respect of the criteria to be taken into consideration for the purpose of determining the

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

	phase-in per categories of counterparties. In addition, most of the alternative investment funds which are today classified as non-financial counterparties are expected to become financial counterparties in the future because of the on-going implementation of AIFMD. It is therefore pragmatic that those counterparties anticipate on their future status of financial counterparties.
Costs to regulator - *One-off*[28]	Although regulators are not expected to bear significant cost in assessing whether counterparties are alternative investment funds, this option adds complexity in the classification compared to an option where only financial counterparties are automatically classified in Category 1 or 2, and non-financial counterparties are automatically classified in Category 3. In some countries, the competent authorities responsible for financial and non-financial counterparties are different, which may introduce costs associated to the cooperation between authorities.
Compliance costs - *One-off*	Compliance costs are expected to be very limited as for other purposes (e.g. risk mitigation techniques described under Article 11 of EMIR and to which they are already subject, or the reporting obligation described under Article 9 of EMIR to which they are also subject) counterparties have already assessed if they are a financial counterparty, a non-financial counterparty or a third-country entity. Although counterparties are not expected to bear any cost in determining whether they are alternative investment funds, this option adds complexity in the classification compared to an option where financial counterparties are automatically classified in Category 1 or 2, and non-financial counterparties are automatically classified in Category 3.

Option 2	**Alternative investment funds should be included in different categories of counterparty depending on whether they are a financial or a non-financial counterparty.**
	Qualitative description
Benefits	The approach is simple as it fully relies on the EMIR classification of counterparties, which has already been implemented by counterparties for other purposes.
Costs to regulator - *One-off*[29]	No specific costs were identified with this option because it relies on a pre-existing classification.
Compliance costs - *One-off*	No specific costs were identified with this option because it relies on a pre-existing classification.

[28] On-going costs are irrelevant with respect to phase-in.
[29] On-going costs are irrelevant with respect to phase-in.

4. 4. Frontloading and minimum remaining maturities

Policy Objective	**Define the approach to frontloading in a manner that reduces the uncertainty for market participants**
Option 1	Define a single minimum remaining maturity irrespective of the dates on which the contracts are entered into or novated and set the minimum remaining maturity at a level which ensures that a minimal number of contracts is captured by the frontloading requirement.
Option 2	Define different minimum remaining maturities depending on the dates on which the contracts are entered into or novated
Preferred Option	**Option 2**

Option 1	**Define a single minimum remaining maturity irrespective of the dates on which the contracts are entered into or novated and set the minimum remaining maturity at a level which ensures that a minimal number of contracts is captured by the frontloading requirement.**
	Qualitative description
Benefits	All contracts concluded on or after the date of notification as referred to in Article 5 (date of notification to ESMA that a CCP has been authorised to clear a certain class), and before the date of application of the clearing obligation, shall be cleared if they belong to a Class+. This ensures a level playing field as the requirement and the date from which it applies are identical for all counterparties. There are several dates of notification as referred to in Article 5, i.e. one per CCP authorisation. As an illustration, for the interest rate classes, there are 5 EU CCPs offering clearing, which means there can be up to 5 different dates of notification including some of the class+ proposed for the clearing obligation. Therefore, under this example the frontloading start dates would be: - date 1 (date of authorisation of CCP 1) for the Class+ cleared by this CCP, - date 2 (date of authorisation of CCP 2) for the Class+ cleared by this CCP, and not cleared by CCP 1, - date 3 (date of authorisation of CCP 3) for the Class+ cleared by this CCP, and not cleared by CCP 1 nor CCP 2, - date 4 (date of authorisation of CCP 4) for the Class+ cleared by this CCP, and not cleared by CCP 1 nor CCP 2 or CCP 3, - date 5 (date of authorisation of CCP 5) for the Class+ cleared by this CCP, and not cleared by none of the CCPs 1 to 4. This approach is therefore very complex as each counterparty shall determine the frontloading start date for each class, and apply a different frontloading schedule depending on the Class+ to which the traded contracts belong. This complexity is alleviated if the minimum remaining maturity is set at a high level (e.g. 49 years and 6 months for Table 1: Basis swaps) as close to no contract will be subject to frontloading. However, with this option it is likely that the legislative intention of the frontloading requirement under EMIR (i.e. ensures a uniform and coherent application of EMIR and a level playing field for market participant) is not fully taken into consideration, as it results in almost no contract being subject to

	frontloading.
Costs to regulator - *One-off*[30]	Since the frontloading start date may be different for each class, this approach is more complex and therefore more costly for regulators to enforce compared to Option 2.
Compliance costs - *One-off*	Since the frontloading start date may be different for each class, this approach is more complex and therefore more costly for counterparties to apply compared to Option 2.

Option 2	**Define different minimum remaining maturities depending on the dates on which the contracts are entered into or novated**
	Qualitative description
Benefits	The frontloading period can be divided into two different timeframes: (a) Period A: between the notification of the classes to ESMA and the publication in the Official Journal of the regulatory technical standards (RTS) on the clearing obligation; (b) Period B: between the publication in the Official Journal of the RTS and the date on which the clearing obligation takes effect (the date of application). The frontloading requirement implies that during the frontloading window, counterparties enter into OTC derivative transactions without knowing if and when those transactions will have to be centrally cleared. Given that a transaction that is centrally cleared is subject to a different collateral regime than a transaction that is not, frontloading has a significant impact on pricing (e.g. possible widening of the bid-offer spreads, difficulties or dis-incentive for counterparties to appropriately manage their risks, which may eventually reduce market stability). The uncertainty and negative impact of frontloading are most significant in Period A. During this period, counterparties do not know: 1) whether the notified classes of derivatives will be subject to the clearing obligation; 2) when the clearing obligation takes effect for them; and 3) which CCPs will be available for clearing these products. This source of uncertainty and risk would be highly mitigated by setting two different minimum remaining maturities, depending on the date on which the contracts are entered into. In practise, setting a sufficiently high minimum remaining maturity for contracts entered into during Period A ensures that no contract concluded during Period A are subject to frontloading, while a meaningful number of contracts concluding during Period B is subject to frontloading. Applied to all market participants, Option 2 ensures a level playing field while being less complex than Option 1 and at the same time alleviates the pricing uncertainty that has been identified as a potential source of pricing instability.
Costs to regulator - *One-off*[31]	The relevant date to apply frontloading under this option is the date of publication of the RTS in the Official Journal, which is identical for all the classes that will be grouped in the same RTS. In this respect this Option is simpler than Option 1, with less cost for regulators.

[30] On-going costs are irrelevant with respect to frontloading, as this requirement is applicable only once.
[31] On-going costs are irrelevant with respect to frontloading, as this requirement is applicable only once.

Compliance costs - *One-off*	The relevant date to apply frontloading under this option is the date of publication of the RTS in the Official Journal, which is identical for all the classes that will be grouped in the same RTS. In this respect this Option is simpler than Option 1 and will cause less compliance costs.

Policy Objective	**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.**
Option 1	During Period B (i.e. the period of time during which the classes subject to the clearing obligation are known), define a single minimum remaining maturity that applies to all classes subject to the clearing obligation (Class+)
Option 2	During Period B (i.e. the period of time during which the classes subject to the clearing obligation are known), define different minimum remaining maturities depending on the Class+
Preferred Option	**Option 1**

Option 1	**During Period B (i.e. the period of time during which the classes subject to the clearing obligation are known), define a single minimum remaining maturity that applies to all classes subject to the clearing obligation (Class+)**
	Qualitative description
Benefits	The approach is simple. Counterparties would look at their entire portfolio of OTC derivatives to identify the contracts subject to frontloading, without the need to create multiple sub groups of transactions. This approach achieves in the simplest possible way the original purpose of the existence of the parameter "minimum remaining maturity", which is to avoid that contracts that only have very short minimum remaining maturities are not required to be cleared. Indeed it would be operationally burdensome and without any significant effect on the reduction of systemic risk to mandate the central clearing of a contract that expires in e.g. a few days.
Costs to regulator - *One-off*[32]	The two options are sorted by level of complexity and therefore increasing costs to regulators.
Compliance costs - *One-off*	This option does not require counterparties to bucket their portfolio of OTC derivatives per Class+ or types of contracts. This option does not add costs over and above the provisions of EMIR on frontloading.

Option 2	**During Period B (i.e. the period of time during which the classes subject to the clearing obligation are known), define different minimum remaining maturities depending on the Class+**
	Qualitative description
Benefits	Under this option, ESMA would define different minimum remaining maturities depending on the contracts e.g. - Option 2(a): one minimum remaining maturities per Class+; or - Option 2(b): different minimum remaining maturities depending on the original maturity of the contract, which would come up to defining "relative"

[32] On-going costs are irrelevant with respect to frontloading, as this requirement is applicable only once.

	minimum remaining maturities. These options also achieve the original purpose of the existence of the parameter "minimum remaining maturity", which is to avoid that contracts that only have a very short minimum remaining maturities are not required to be cleared, but in a different and complex way. Those options allow adding flexibility to the approach and taking into consideration the original maturity of the contract. In this respect it may increase the coherence of the frontloading requirement.
Costs to regulator - *One-off*[33]	The two options are sorted by level of complexity and therefore increasing costs to regulators.
Compliance costs - *One-off*	The increase in the compliance costs compared to those of the baseline scenario of Option 1 is expected to be moderate but still without strong evidence of additional benefits. Under Option 2(a) contract should be grouped by Class+ and the corresponding minimum remaining maturity should be applied. Under Option 2(b) counterparties should calculate the relative remaining maturity and compare it to the threshold minimum.

Policy Objective	**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.**
Option 1	Apply the same minimum remaining maturities to all financial counterparties
Option 2	Apply different minimum remaining maturities (MRM) depending on the categories of counterparties defined in the RTS on the clearing obligation: the MRM for categories 1 and 2 is lower than the MRM for category 3
Preferred Option	**Option 2**

Option 1	**Apply the same minimum remaining maturities to all financial counterparties**
	Qualitative description
Benefits	This option would ensure a *uniform* application of EMIR in the sense that the contracts concluded during a specific timeframe (the frontloading window) will eventually be cleared, irrespective of the counterparty that has entered into that transaction.
Costs to regulator - *One-off*[34]	The costs to regulators are expected to be comparable under the two options
Compliance costs - *One-off*	The longer is the phase-in period, the longer is the frontloading period. Hence the counterparties subject to the longest phase-in period, which by definition are also the least sophisticated one, will bear higher compliance costs under this option.

Option 2	**Apply different minimum remaining maturities (MRM) depending on the categories of counterparties defined in the RTS on the clearing obligation: the MRM for categories 1 and 2 is lower than the MRM for category 3**

[33] On-going costs are irrelevant with respect to frontloading, as this requirement is applicable only once.
[34] On-going costs are irrelevant with respect to frontloading, as this requirement is applicable only once.

	Qualitative description
Benefits	This option would ensure a *coherent* application of EMIR and a level playing field between counterparties in the sense that it introduces a link between the level of sophistication of counterparties and the application of frontloading. Indeed, market participants have argued that it is more costly to handle a frontloaded contract (i.e. a contract that is traded bilaterally and will be cleared at a later point in time, up to 18 months after for a counterparty subject to an 18 months phase-in period) than a contract that is cleared immediately after the execution. This creates an incentive for counterparties to start clearing on a voluntary basis ahead of the date of application of the clearing obligation, to avoid having to frontload contracts in the future. However, it is expected that such an early compliance would hardly be achieved by the least sophisticated counterparties. Indeed the less active counterparties should be included in Category 3 and benefit from an 18 months phase-in specifically because of the higher obstacles they face to access to central clearing. Under this option, the compliance costs are proportionate to the level of sophistication of the counterparties, which reinforces a level playing field for market participants.
Costs to regulator - *One-off*[35]	The costs to regulators are expected to be comparable under the two options
Compliance costs - *One-off*	The compliance costs are proportionate to the level of sophistication of the counterparties. The financial counterparties for which access to clearing is easier (Category 1 and Category 2) would be subject to frontloading during Period B, unless they opt for an early compliance which may eliminate totally or partially the frontloading obligation. The financial counterparties for which access to clearing is more complex (Category 3) would be subject to minimal frontloading during Period B.

[35] On-going costs are irrelevant with respect to frontloading, as this requirement is applicable only once.