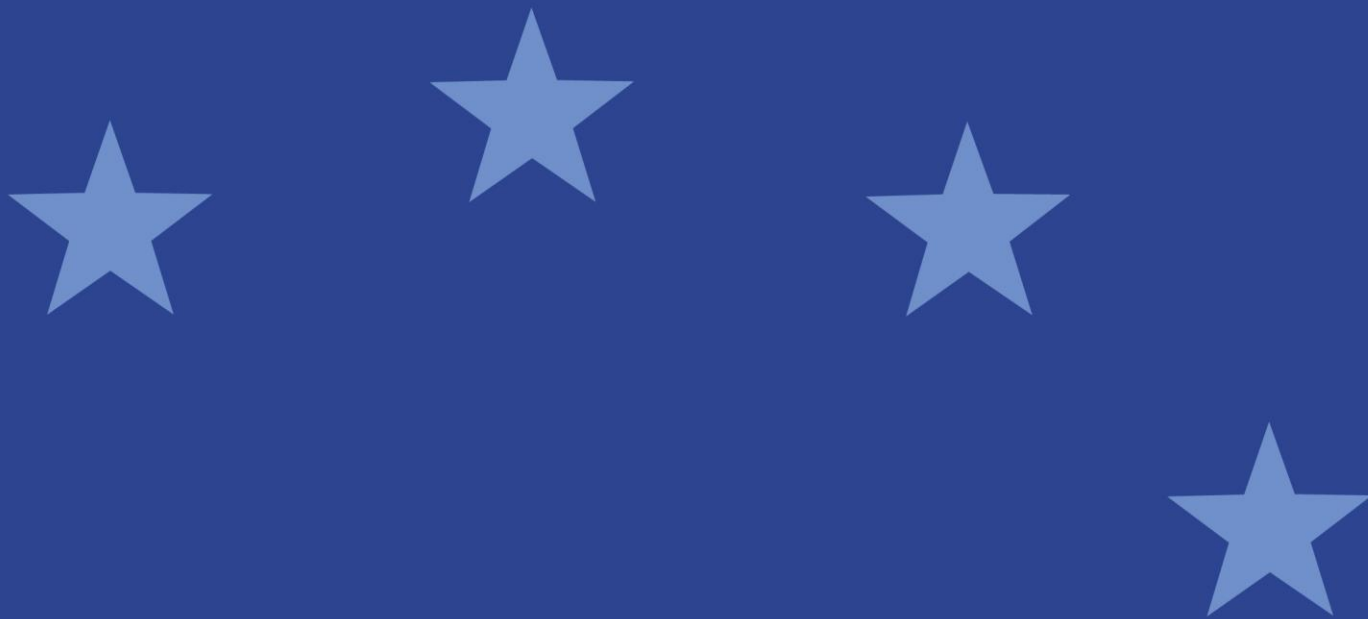




European Securities and
Markets Authority

Consultation Paper

Clearing Obligation under EMIR (no. 1)



Responding to this paper

The European Securities and Markets Authority (ESMA) invites responses to the questions listed in this Consultation Paper on the Clearing Obligation under EMIR (no. 1).

All contributions should be submitted online at www.esma.europa.eu under the heading ‘Your input - Consultations’.

Please follow the instructions given in the document [Reply form](#) for the Consultation Paper on the Clearing Obligation under EMIR (no. 1) also published on the ESMA website.

Comments are most helpful if they:

- respond to the question stated;
- indicate the specific question to which the comment relates;
- contain a clear rationale; and
- describe any alternatives ESMA should consider.

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

Publication of responses

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

Data protection

Information on data protection can be found at www.esma.europa.eu under the heading ‘Legal Notice’.

Who should read this paper

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

¹ amended version published on 17 July 2014. This amended version modifies paragraph 320. The correct sentence is: “*The CCP notification indicates that there are only clearing volumes for Single Name CFDs, and none for Index CFDs so far.*” The previous version stated the opposite.

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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
EMIR	European Market Infrastructures Regulation – Regulation (EU) 648/2012 of the European Parliament and Council on OTC derivatives, central counterparties and trade repositories – also referred to as “the Regulation”
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
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

Executive Summary

Reasons for publication

This consultation paper seeks stakeholders' views on the regulatory technical standards that ESMA is required to draft under Article 5(2) "Clearing Obligation Procedure" of the Regulation (EU) No 648/2012 of the European Parliament and Council on OTC derivatives, central counterparties and trade repositories (EMIR). This paper follows the publication in July 2013 of a discussion paper on the clearing obligation under EMIR and includes stakeholders' feedback thereof.

The input from stakeholders will help ESMA in finalising the relevant technical standards to be drafted and submitted to the European Commission for endorsement in the form of Commission Regulations, i.e. a legally binding instrument directly applicable in all Member States of the European Union. One essential element in the development of draft technical standards is the analysis of the costs and benefits that those legal provisions will imply. Input in this respect and any supportive data will be highly appreciated and kept confidential where required.

Contents

This paper provides explanations on the draft regulatory technical standards establishing a clearing obligation on certain interest rate OTC derivative classes. The structure of this consultation paper is the following: Section 1 provides an overview of the clearing obligation procedure and the classes of OTC derivatives that are relevant for this consultation paper. 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 includes the determination of the interest rate classes of OTC derivatives that should be subject to mandatory clearing with an analysis of the relevant criteria. 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 give an analysis of some OTC derivatives classes that ESMA is proposing not to submit to mandatory clearing at this stage.

Next steps

As provided for by Regulation No 1095/2010 of the European Parliament and Council establishing ESMA, a public consultation is conducted on the draft technical standards before they are submitted to the European Commission for endorsement in the form of Commission Regulations. In addition ESMA shall consult the ESRB and, where relevant, the competent authorities of third-countries when developing the technical standards on the clearing obligation.

According to ESMA decision ESMA/2011/BS/4a on the procedure for developing and adopting draft technical standards and guidelines, the consultation paper includes the actual legal text of the provisions constituting the draft technical standards, an explanation of the measures adopted and a cost-benefit

analysis. Other consultation papers proposing to subject other classes to the clearing obligation are expected to be published in the future.

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. EMIR foresees two possible processes for the identification of the relevant classes of OTC derivatives:
 - The “bottom-up” approach described in EMIR Article 5(2), according to which the determination of the classes to be subject to the CO will be done based on the classes which are already cleared by authorised or recognised CCPs.
 - The “top-down” approach described in EMIR Article 5(3), according to which ESMA will on its own initiative identify classes which should be subject to the clearing obligation but for which no CCP has yet received authorisation.
3. This consultation paper results from the bottom-up approach only and incorporates feedback and comments received from stakeholders responding to the discussion paper on the clearing obligation published on 12 July 2013².
4. The clearing obligation procedure shall only 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 register³.
5. In accordance with the clearing obligation procedure and the Commission mandate shown in Annex I, 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).
6. This consultation paper results from the analysis of the interest rate OTC derivative classes cleared by Eurex (Germany), KDPW_CCP (Poland), LCH.Clearnet Ltd (UK) and Nasdaq OMX (Sweden), and is proposing to subject some of those classes to the clearing obligation. Interest rate OTC

² <http://www.esma.europa.eu/content/Clearing-Obligation-under-EMIR>

³ 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>

derivatives are also cleared by CME Clearing Europe (UK) but this CCP is not yet authorised at the time of publication of this consultation paper.

7. In addition this paper is proposing in Section 6 and 7 an analysis of the equity and interest rate futures and options classes that LCH.Clearnet Ltd (UK) and Nasdaq OMX (Sweden) are authorised to clear, for which ESMA has determined that a clearing obligation is not necessary at this stage.
8. This paper makes frequent references to two different sets of Regulatory Technical Standards ("RTS"). For the avoidance of doubt, it should be understood that:
 - the "RTS on OTC derivatives" is the Commission Delegated Regulation (EU) No 149/2013 which entered into force on 15 March 2013 and specifies, inter alia, the criteria for the determination of the classes of OTC derivative contracts subject to the clearing obligation in Article 7;
 - the "draft RTS on the clearing obligation" is the one on which ESMA is consulting with the present paper. Annex I provides the Commission mandate for this draft RTS, and Annex II provides the corresponding draft RTS.

1. The clearing obligation procedure

9. The clearing obligation procedure of Article 5 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, however to date ESMA has not recognised any third-country CCP, therefore this process is not covered by the current consultation.
10. The procedure of Article 5(1) for European CCPs 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 highly sub-optimal, as stakeholders would need to answer to numerous consultations potentially running in parallel.
11. 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.
12. 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 clear⁴. 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.
13. Following the grouping approach described in paragraph 11, the consultation paper is proposing a clearing obligation on interest rate OTC derivatives only, and includes an analysis of all the classes of interest rate OTC derivatives that ESMA has been notified to date, irrespective of the date of such notifications⁵. As evidenced in Table 1, the OTC interest rate classes cleared by Eurex Clearing AG, KDPW_CCP, LCH.Clearnet Ltd and Nasdaq OMX Clearing AB are covered by the current consultation. Other consultation papers are expected to follow on different asset classes⁶.
14. Among the notified classes, the ones that appear in green in the table are proposed to be subject to the clearing obligation and the ones in red are proposed not to be subject to the clearing obligation, as analysed in detail in Section 6 and 7.

⁴ 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>

⁵ CME Clearing Europe was not yet authorised under EMIR at the time of publication of this paper, but the information about the products this CCP clears is available on their website, so without pre-judging the conclusion of this process, the corresponding information could be considered where relevant.

⁶ See Table 1 for more explanation.

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 Clearing AB	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	ICE Clear Europe	UK				1			1
8	CME Clearing Europe	UK			1		1		
9	LME Clear	UK					1		
10	BME Clearing	Spain					1		
11	OMI Clear	Portugal					1		
12	Holland Clearing House	Netherlands						1	
	Number of CCP per asset class				5	2	6	3	2

(*) Those classes should be analysed in subsequent consultation papers. The reason why only the equity and interest rate classes are covered by this consultation paper is linked to the date of authorisation of the first CCP (Nasdaq OMX Clearing AB) and the fact that ESMA seeks to group the consultation papers per asset-class, to the extent possible, as explained in paragraph 11. Nasdaq OMX Clearing AB has been authorised for the equity and interest rate classes only, setting the deadline of delivery of the draft RTS to the European Commission 6 months after for those classes only. Additional time is available to perform the analysis of the other asset classes.

Legend:

Class proposed to be subject to the clearing obligation in this consultation	Class proposed not to be subject to the clearing obligation in this consultation	Class not covered by the present consultation	Classes not yet notified (CCPs not authorised)
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Question 1: Do you have any comment on the clearing obligation procedure described in Section 1?

2. Structure of the interest rate derivatives classes

2.1 Characteristics to be used for interest rate derivative classes

15. In the discussion paper on the clearing obligation, ESMA explained the approach that was envisaged for the purpose of defining the classes of OTC derivatives to be subject to the clearing obligation, i.e. the characteristics that would be used in the RTS to determine if a specific contract belongs to a certain class.
16. Based on market practice as well as international convergence, 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)
 - Options
17. Within each of those product types, the following additional characteristics should also be used to further define the contracts: 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 conditional⁷).
18. In Question 8 of the discussion paper, stakeholders were asked whether they consider that the main characteristics of interest rate derivatives are adequately captured by this proposed structure, or if they could identify other characteristics that would be relevant to further define the classes.
19. Most stakeholders welcomed the structure that was presented in the discussion paper, mainly because they found the proposition to be in line with taxonomies that are already used by the market, and because the approach was found to be similar to the one used in other jurisdictions.
20. A few stakeholders mentioned that the classes should be defined with further granularity to avoid confusion around whether or not some products would be subject to the clearing obligation. They suggested to ESMA to include in the definition of the classes other variables such as the floating rate tenor, the payment frequency, the reset frequency of the floating leg or the day count fraction.
21. With reference to the classes proposed for the clearing obligation in this paper, ESMA finds that there is not a need for these additional characteristics for the purpose of evaluating the contracts against the criteria set in EMIR (e.g. level of standardisation, liquidity and availability of reliable pricing data). In addition, this is consistent with what is being done in other jurisdictions for

⁷ A conditional notional amount means that the notional amount of the swap is not a known number or schedule of numbers, but may change based on the occurrence of some future event. This is different than variable amounts, where the notional amount varies according to a predetermined schedule and is therefore foreseeable. The unpredictable nature of conditional notional amounts adds complexity to the pricing and risk management associated to it and as of today, no CCP offer to clear interest rate swaps with conditional notional amounts

mandatory clearing. For this reason ESMA does not envisage at this stage to include those characteristics in the RTS.

22. In summary, the combination of these 7 characteristics is used to define all the interest rate OTC derivative classes to be subject to the clearing obligation in this first determination. In addition, as described in paragraph 2, the approach that is used to determine which classes are subject to the clearing obligation is the 'bottom-up' approach, meaning that the starting point for the analysis and the contracts included in the first determination are the ones that CCPs are authorised to clear. In other words, derivative contracts that are supported by CCPs and that have their 7 characteristics meeting the scope of classes defined in section 3.2.4 will need to be cleared.

Additional questions raised by stakeholders

23. Some respondents to the discussion paper requested clarification on the classification of certain products such as swaptions, caps, floors and inflation swaps.
24. At this time, ESMA has not identified those products in the notifications that were communicated to ESMA in accordance with Article 5 of EMIR, indicating that there is not currently a clearing offer on them. ESMA confirms that should those contracts become subject to the clearing obligation at a later stage, they will be regarded as interest rate derivatives and that including them into the scope of mandatory clearing would likely lead to the creation of additional classes of interest rate OTC derivatives (i.e. they would not be included in any of the classes presented in this consultation paper).

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

2.2 Additional Characteristics needed to cover Covered Bonds derivatives

25. Recital 16 of EMIR states that, in determining which classes of OTC derivative contracts are to be subject to the clearing obligation, "ESMA should take into account the specific nature of OTC derivative contracts which are concluded with covered bond issuers or with cover pools for covered bonds".
26. A covered bond is a debt instrument issued by a bank (the covered bond issuer) in which the bond is secured by a pool of financial instruments (the cover pool). The cover pool consists of assets which are generally mortgages or public sector debt, and usually include derivative contracts to hedge specific risks such as interest rate risks or currency risks.
27. From the issuer's perspective, cover bonds are an important source of funding especially in Europe in the sense that the recourse that bond holders have on the cover pool enable banks to obtain cheaper financing.
28. As the cash flows on the cover pool assets do not exactly match the payments due on the covered bonds, some hedging arrangements need to be put in place. Currency risks may arise when the payments to bondholders are made in a currency that is different than the currency of the assets of the cover pool. Interest rate risks may arise when the assets of the cover pool are based on floating rates while the covered bond holder receives fixed interest rates. OTC derivatives concluded for the purpose of hedging those mismatches (hereinafter covered bond derivatives) are therefore relevant

in the context of the current clearing obligation determination, which includes interest rates derivative classes.

29. Questions 29 to 32 of the discussion paper were related to the specific case of OTC derivative contracts concluded with covered bond issuers or with cover pools for covered bonds and the analysis of the responses is provided below.
30. Fundamentally, covered bonds derivatives are described by stakeholders as not, or not easily, CCP-clearable for a variety of reasons including:
 - (a) the current difficulty for CCPs to differentiate between the derivatives of the cover pool and those of the issuer. This means that covered bonds derivatives may be terminated if an issuer defaults, which contradicts the applicable legislations in some jurisdictions. The mechanism of unilateral collateral posting implying that the counterparty to the covered bonds derivatives posts collateral whereas the cover pool does not.
 - (b) the bespoke nature of the covered bonds derivatives including:
 - (i) non-standard reference interest rate;
 - (ii) balance guaranteed swap: some covered bonds issuers use derivatives with dynamic features (e.g. adjustment in the notional amount after each payment);
 - (c) eligible collateral: the cover pool may not hold CCP-accepted collateral. Collateral would in this case need to be posted by the issuer, which would prove problematic in case the issuer becomes insolvent.
 - (d) rating agencies criteria: rating methodologies provide for particular features to be added to standard documentation (e.g. disapplication of insolvency events, ratings-linked collateral posting obligations);
 - (e) different national legislations, with e.g. different solutions regarding termination rights in a cover pool insolvency/default, which could be challenging for a CCP.
31. In essence, many stakeholders indicate that covered bonds pose little systemic risk, that the derivatives of the cover pool are used solely for hedging purposes, that they are already subject to very strict requirements from legislators and rating agencies. They unanimously urged ESMA to design the clearing obligation in such a way that covered bonds derivatives would not be captured by the clearing obligation because in their view, doing otherwise would require a revision of some national legislations, be detrimental to this class of instrument and lead to higher risk for covered bond investors.
32. Building on the above, ESMA has further analysed the specific nature of covered bond derivatives in the context of the clearing obligation, and has come up with a proposal which leverages on the analysis performed in the context of the current consultation on draft RTS on risk-mitigation

techniques for OTC derivative contracts not cleared by a CCP (bilateral margins)⁸, as explained in the following paragraphs.

Specific nature of the covered bond derivatives

(i) Level of standardisation of the contractual terms

33. As suggested by some stakeholders, a number of covered bond derivatives are de facto excluded from the scope of the proposed mandatory classes because of some bespoke characteristics, which imply that they are not cleared by any CCP (e.g. non-standard reference rate, dynamic feature of the notional amounts).
34. However, ESMA understands that some covered bond derivatives may be standard enough to be captured by the interest rate classes that are proposed in this paper, in the absence of a specific treatment for covered bonds derivatives.
35. The cover pool is bankruptcy-remote, in order to ensure that if the issuer defaults, the bondholders are covered by the cover pool, and the derivative contracts included in the cover pool are not terminated. This is achieved by adapting or supplementing common master agreement to ensure that the insolvency of the issuer does not qualify the counterparty to terminate the derivative contract.
36. Under EMIR, CCPs are under the obligation to engage into default procedures in case they are confronted with the default of a clearing member, the result of which would be that the positions are either ported to another non-defaulting clearing member, or terminated.
37. Should those derivative contracts be cleared with a CCP, they could be subject to termination in case of default of the issuer. To prevent this from happening, CCPs would need to guarantee that they are able to differentiate between the derivatives of the cover pool and those of the issuer, so that if the issuer defaults, the covered bonds derivatives are not terminated together with the other derivative contracts of the issuer.
38. Although a number of respondents indicated that, to the best of their knowledge, CCPs were indeed unable to provide for this distinction, not all CCPs responding to the consultation appear to share this view. Besides, in light of the EMIR requirements for CCP on segregation, and the complexity of the account structure that CCPs are able to provide for e.g. client clearing or indirect client clearing, it is unlikely that CCPs would not be able to distinguish covered bond derivatives from the other derivatives of the issuer.
39. However, ESMA acknowledges that the application of credit rating agencies criteria provides for particular features to be added to standard documentation. Therefore the degree of standardisation of the contractual terms of covered bond derivatives appears to be lower than that of contracts which are economically equivalent, but concluded outside a covered bond programme. In

⁸ Consultation paper (until 14/7/2014), draft RTS on risk-mitigation techniques for OTC derivative contracts not cleared by a CCP under Article 11(15) of Regulation (EU) 648/2012 available at: <http://www.esa.europa.eu/documents/10180/655149/JC+CP+2014+03+%28CP+on+risk+mitigation+for+OTC+derivatives%29.pdf>

application of the criteria listed under Article 5(4)(a) of EMIR, this supports the view of considering that the two types of contracts should not be included in the same class of OTC derivatives.

(ii) Legal Framework

40. There is no harmonised legal framework in Europe in respect of covered bonds but in most jurisdictions, there is a specific legislation which sets up the regime applicable to covered bonds.
41. The covered bond legislations usually define the type of assets that can be included in the cover pool, i.e. mainly real-estate loans, and also define a minimum level of additional assets which purpose is to ensure that the liabilities of the cover pool are met. The cover pool may hold cash or other types of CCP-eligible collateral but under the European framework, the amount of cash is limited to 15% and its primary purpose is liquidity management.
42. Stakeholders argue that if covered bond derivatives are required to be cleared, collateral will need to be posted to CCPs which may create a conflict between the CCP rules related to accepted collateral, and the national legislations on the assets that cover pools are authorised to hold. However the responses did not provide any detail on the nature of such conflicts nor on the specific national legislations.
43. ESMA acknowledges that there may be an issue of collateral availability, but this is not specific to covered bond derivatives, and as suggested in the cost-benefit analysis of the consultation paper on draft RTS on risk-mitigation techniques for OTC derivative contracts not cleared by a CCP (bilateral margins), it may be solved e.g. by the interposition of a collateral provider, although this option would bear additional costs that are difficult to measure at this stage.
44. However, absent such third-party collateral provider, it is unclear what would be the consequences on the capacity to provide collateral in case of a default of the issuer, and who would substitute to the defaulting issuer to meet the CCP's collateral requirements.

(iii) Classification of counterparties entering covered bond derivatives

45. Depending on the structure of the covered bonds and on the national legislation, the counterparty that is entering into OTC derivative contracts for the purpose of hedging the interest rate or currency mismatches of the cover pool will either be the issuer itself, a Special Purpose Vehicle (SPV) in the case of bonds issued through an SPV, or an SPV which itself is a bank.
46. There may be cases where the SPV qualifies as a non-financial counterparty within the meaning of Article 2(9) of EMIR and, given that the contracts concluded for the cover pool would likely qualify as "hedging", those SPV would be regarded as non-financial counterparties below the clearing threshold and therefore not subject to the clearing obligation.
47. This means that differences in national legal frameworks for covered bonds may lead to unequal treatments within the EU, in the sense that, while performing the same activity in OTC derivative markets, some counterparties would be subject to the clearing obligation while others would be exempted.

Possible options to tackle the issue of covered bond derivatives

Option A: Creating a specific category of counterparty

48. One option that ESMA had identified in the discussion paper to tackle the issue of covered bond derivatives was to define the cover pool (or any counterparty trading on behalf of the cover pool) as a distinct category of counterparty as foreseen by Article 5(2)(b) of EMIR, and to attribute an appropriate phase in to this category. This would have resulted in a temporary exemption pending the development of other solutions. This option was proposed under question 32 of the discussion paper and found very little support, with 12 respondents against and 1 respondent in favour of it.
49. Besides, defining a category of counterparty in this context would be challenging. Indeed, Recital 16 of EMIR recommends ESMA to take into account the specific nature of OTC derivative contracts which are concluded with covered bond issuers, on one side, and with cover pools for covered bonds, on the other side. If it is reasonable to assume that a cover pool does not conclude OTC derivative contracts for other purposes than hedging risks (essentially interest rate risks or currency mismatches), the same conclusion does not hold for the covered bond issuer, which, as a counterparty, can conclude OTC derivative contracts for any purpose not linked to its covered bonds activity. This means that the covered bond issuer would belong to a certain category (with phase-in X) for its derivative activity linked to covered bond, and to another category (with phase-in Y) for its derivative activity not linked to covered bond.
50. Therefore ESMA has concluded that the option of creating a specific category of counterparty should not be adopted in the draft RTS.

Option B: Consider that covered bond derivatives belong to separate classes not subject to clearing obligation

51. In view of the above analysis of the specific nature of OTC derivative contracts which are concluded with covered bond issuers or with cover pools for covered bonds, ESMA concludes that it is reasonable to assume that two contracts which are identical with the exception that one is concluded for the purpose of hedging the interest rate or currency mismatches of a cover pool, and the other is not, do not share common and essential characteristics, leading them to belong to the same class of OTC derivatives.
52. Indeed those two contracts are not subject to the same legal framework, nor to the same legal documentation. In particular the former may be subject to unilateral collateral posting which could not be maintained in a CCP environment.

Conclusions

53. The draft RTS on the clearing obligation establishes that the classes subject to the clearing obligation do not encompass contracts associated to covered bonds programmes, meeting certain conditions. These conditions are proposed to be similar to the ones set out in the consultation paper on risk management techniques for non-centrally cleared OTC derivatives⁹, to ensure consistency

⁹ Consultation paper (until 14/7/2014), draft RTS on risk-mitigation techniques for OTC derivative contracts not cleared by a CCP under Article 11(15) of Regulation (EU) 648/2012 available at: <http://www.esa.europa.eu/documents/10180/655149/JC+CP+2014+03+%28CP+on+risk+mitigation+for+OTC+derivatives%29.pdf>

between the two sets of RTS. The only differences are justified by the different nature of the obligation (central clearing vs. bilateral margins).

54. Therefore the classes of OTC derivative subject to the clearing obligation do not include contracts associated to covered bonds programmes when such contracts satisfy all of the following conditions:
- (a) they are not terminated in case of default of the covered bond issuer;
 - (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;
 - (c) they are registered in the cover pool of the covered bond programme in accordance with national covered bond legislation;
 - (d) they are used only to hedge the interest rate or currency mismatches of the cover pool;
 - (e) the covered bond programme to which they are associated meets the requirements of Article 129 of Regulation (EU) No 575/2013; and
 - (f) the covered bond programme to which they are associated is subject to a legal collateralisation requirement of at least 102%.

Question 3: Do you consider that the proposed approach on covered bonds derivatives ensures that the special characteristics of those contracts are adequately taken into account in the context of the clearing obligation? Please explain why and possible alternatives.

Stakeholders (CCPs and covered bond derivatives users, in particular) are invited to provide detailed feedback on paragraph 38 above. In particular: what is the nature of the impediments (e.g. legal, technical) that CCPs are facing in this respect, if any? Has there been further discussions between CCPs and covered bond derivatives users and any progress resulting thereof?

2.3 Public Register

55. In the discussion paper, ESMA proposed to define the Class+ with some key characteristics in the RTS, and some additional characteristics in the public register. The original intention of this approach was to add flexibility to the clearing obligation procedure, and to find a pragmatic process to add or to remove the clearing obligation on specific contracts belonging to pre-existing mandatory classes.
56. The vast majority of the respondents welcomed the principle of defining the key characteristics of the OTC derivative classes in the RTS, while leaving more technical features to be defined as additional characteristics in the public register maintained on ESMA's website. This approach is viewed as pragmatic and efficient to ensure that stakeholders are able to identify in a clear and timely manner what is in and what is out of the scope of the clearing obligation. Another reason to support this approach is that criteria not currently relevant for central clearing might be necessary to be included in the register in the future as central clearing goes further to include new types of contracts.
57. However, stakeholders also raised a number of concerns on the practical implications, the governance of the public register, the importance of public consultation and the necessary time

between the modification of the public register and the date of application of a new clearing obligation.

58. In fact, the reason most cited by respondents to adopt this approach is the possibility that it would grant to remove a Class+ (or a subset of it) from the clearing obligation in a timely manner. Indeed market participants consider that ESMA may need to remove or suspend the clearing obligation on specific classes for a number of reasons including:
- when the composition of market participations dramatically shifts (e.g. fewer clearing members), thereby rapidly impacting the risk profile of the market;
 - when there is only one CCP left to clear the contract
 - when liquidity dries on a contract e.g. during a financial crisis¹⁰, because of the migration from rate indices such as LIBOR to potential alternatives, because of the introduction of a new and more attractive substitute to a certain contract;
 - when the quality of available market prices deteriorates;
 - when the collateral accepted by the CCP is reduced.
59. Under such circumstances, it is generally agreed by market participants that ESMA would need to act as a matter of urgency (within a few days) to remove the clearing obligation from a specific Class+. The procedural delays resulting from the modification of an RTS would not be compatible with this objective.
60. This being said, stakeholders also point out that the removal of a class from the clearing obligation should only take place in limited and exceptional circumstances. It is therefore crucial to keep the process for removing a class as transparent as possible.
61. Some respondents encouraged ESMA to clarify the way in which the public register will be updated and governed and in particular:
- (a) the timing: when new contracts are added through the public register, there should still be a phase-in and market participants should be able to contact ESMA with questions before the clearing obligation becomes binding;
 - (b) if an addition through the public register results in counterparties having to establish links with a new CCP (i.e. if the new contracts captured by the clearing obligation are not cleared by a CCP which already cleared the existing Class+) the phase-in should be longer to take into account the necessity to establish new clearing links;
 - (c) the governance of the public register should be further discussed at the time when the draft RTS on the clearing obligation are circulated for consultation;
 - (d) any clearing obligation for which the scope is at least partially disclosed via the public register, should not come into force until ESMA has in place robust operational processes and infrastructure to ensure the public register is accurately updated on a real time basis;

¹⁰ Markit « During the financial crisis, the liquidity of even the on-the run series of some structured finance CDS evaporated and never returned. »

62. However, some stakeholders prefer to exclude the possibility to further partially define the Class+ in the public register, as they consider that it creates a lack of certainty for market participants, who would need to consult the register on a daily basis to check whether new contracts have been added. They also consider that this process is not compliant with the obligation of ESMA to verify that the new contracts match the relevant criteria, and the consultation period.
63. Taken all these considerations into account, ESMA has further analysed the practical aspects of the clearing obligation procedure and the interaction with the public register, and has concluded that there is little room for manoeuvre in the Level 1 text to achieve the result of modifying the scope of the clearing obligation without going through the issuance of new or modified RTS.
64. Although the public register may encompass more granular information than the RTS themselves, ESMA has not identified, to date, a solution with an appropriate level of legal certainty with regards to the phase-in periods. In accordance with the suggestion made under point (a) and (b) above, ESMA believes that it would be inappropriate that new contracts are subject to the clearing obligation without an appropriate phase-in period, and in accordance with Article 5(2)(b) of EMIR, the dates of application of the clearing obligation, including the phase-in per categories of counterparties, need to be defined in the RTS.
65. The consequences of this are different in the case of the addition and in the case of the removal of a class (or some contracts within the class) from the clearing obligation. In the case of an addition, the RTS procedure does not have an immediate negative impact, and it guarantees that any widening of the scope of the clearing obligation is subject to a public consultation as foreseen by Article 5(2).
66. However, it may be more problematic that, in case a clearing obligation needs to be removed or suspended because e.g. the level of liquidity on a specific set of contracts has dried out, ESMA does not have another possibility than going through the procedure of modification of the RTS, which is the same as the procedure of issuance of a new RTS. Indeed, EMIR foresees in Article 5(6) that a class ceases to be subject to the clearing obligation only if it no longer has a CCP to clear it, which may happen if all the CCPs, on their own initiative, stop clearing a specific class or if their competent authorities withdraw the authorisation to clear this class to all the CCPs clearing it.
67. Therefore, during the 2015 review of EMIR foreseen by Article 85(1), ESMA will flag that the clearing obligation process may need to be reviewed to take into account the fact that the classes that had been deemed subject to the clearing obligation in the past may no longer satisfy the necessary conditions in the future, and that the time of the procedure to amend the RTS is unsuited to the level of urgency that such a modification may require.

Question 4: Do you have any comment on the public register described in Section 2.3?

3. Determination of the classes of OTC derivatives to be subject to the clearing obligation

3.1 Legal basis

68. In accordance with Article 5(4) of EMIR, with the overarching aim of reducing systemic risk, the draft RTS for the part referred to in Article 5(2)(a) of EMIR (i.e. the specification of the classes of OTC derivatives that should be subject to the clearing obligation) shall take into consideration the following criteria:
- (a) the degree of standardisation of the contractual terms and operational processes of the relevant class of OTC derivatives;
 - (b) the volume and liquidity of the relevant class of OTC derivatives;
 - (c) the availability of fair, reliable and generally accepted pricing information in the relevant class of OTC derivatives.
69. Those criteria are further specified in Article 7 of the RTS on OTC derivatives. EMIR also provides for a primary source of information for ESMA to perform its assessment of the classes of OTC derivatives against the criteria, in the form of the “CCP notifications”, the details of which are defined in Article 6 of the RTS on OTC derivatives.
70. The paragraphs below provide for an analysis of the notified classes of interest rate OTC derivatives against those criteria. Please note that the notified classes can be found in ESMA’s public register¹¹, whereas the classes proposed for the clearing obligation are defined on the basis of the relevant criteria and summarised in section 3.2.4

3.2 Analysis of the criteria for the OTC interest rate derivatives

71. Looking at the interest rate derivative class as a whole, its predominant share in the overall OTC market, both in notional terms as well as in market value as per Table 2 and Table 3 reinforces the need for those classes to be considered in priority as part of the clearing obligation procedure from a systemic risk point of view. According to the Bank of International Settlements, as of December 2013, OTC interest rate derivative contracts represented 82% of the outstanding notional and 75% of the market value of all OTC derivative contracts¹².

¹¹ 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>

¹² Bank for Settlement Instructions statistics as of end of June 2013: <http://www.bis.org/statistics/derdetailed.htm>

Table 2: Notional amounts outstanding in OTC derivatives, per asset class

<i>as of December 2013</i>	Notional Amounts Outstanding (trillion of USD)	% of total
Foreign exchange contracts	70.6	9.9%
Interest rate contracts	584.4	82.3%
Equity-linked contracts	6.6	0.9%
Commodity contracts	2.2	0.3%
Credit default swaps	21.0	3.0%
Unallocated	25.5	3.6%
TOTAL	710.2	100%

Source: BIS semi-annual OTC derivatives statistics

Table 3: Gross market values in OTC derivatives, per asset class

<i>as of December 2013</i>	Gross Market Values (trillion of USD)	% of total
Foreign exchange contracts	2.3	12.2%
Interest rate contracts	14.0	75.2%
Equity-linked contracts	0.7	3.8%
Commodity contracts	0.3	1.4%
Credit default swaps	0.7	3.5%
Unallocated	0.7	3.8%
TOTAL	18.7	100%

Source: BIS semi-annual OTC derivatives statistics

73. Additionally, this asset class is also the one, along with the credit derivative one, being looked at in priority in other jurisdictions, strengthening international regulatory convergence. Both the US CFTC and the Japanese FSA have now implemented their initial and respective clearing determinations on classes of these two asset classes. Other jurisdictions have further requirements in the pipeline that will need to be looked at in light of the local predominant classes, which are listed in the latest FSB report¹³.
74. Finally, the view that interest rate derivatives together with credit derivatives are to be considered in priority for central clearing is also shared by a large majority of the stakeholders who responded to the discussion paper on the clearing obligation.
75. These considerations converge and confirm that the interest rate derivative asset class needs to be looked at in priority, but within this asset class, each segment has its own relative contribution to the overall systemic risk of the asset class. For interest rate OTC derivatives, the combinations of characteristics that make up the specific classes listed in this note and that have been notified to ESMA range across multiple currencies and indices, maturities and product types, which do correspond to different market segments.

¹³ FSB report number 7 is available at the following link: http://www.financialstabilityboard.org/publications/r_140408.pdf

76. The impact for the market of a move to mandatory clearing depends on the relative size of the classes. Each class thus requires to be looked at individually and EMIR captures this complexity and the need for granularity by defining a set of criteria to evaluate which derivative classes are appropriate for the clearing obligation.
77. The three specific criteria defined in Article 5.4 of EMIR and that ESMA shall take into consideration are the level of standardisation and the liquidity of these classes as well as the availability of reliable pricing data.

3.2.1 Criteria 1: degree of standardisation of OTC interest rate derivatives

78. To assess the degree of standardisation of the OTC interest rate derivatives, ESMA used the following sets of data:
- The CCP-notifications that were made to ESMA in April 2013 under Article 89(5) (Transitional Provisions) and more specifically, the notifications related to the CCPs clearing or intending to clear interest rate OTC derivatives i.e. CME Clearing Europe, Eurex Clearing AG, KDPW_CCP, LCH.Clearnet Ltd and Nasdaq OMX Clearing AB
 - The CCP-notifications that were made to ESMA in the period from March to June 2014¹⁴ under Article 5(1) and that launched this consultation paper i.e. the notifications of Nasdaq OMX Clearing AB, KDPW_CCP, Eurex Clearing AG and LCH.Clearnet Ltd
 - Relevant public information and reports that were published by ISDA and by the FSB using data of the ODSG
 - Public data by Trade Repositories¹⁵
79. In the various sources of data that ESMA looked into for the purpose of assessing the degree of standardisation of OTC interest rate derivatives, ESMA did not find evidence that there was a need for a granular assessment at the level of the class, but rather that the group of notified interest rate derivative classes could be assessed altogether. The approach adopted by ESMA in this consultation paper is therefore to assume that there are no material differences in the degree of standardisation of the various contracts belonging to the classes of OTC interest rate derivatives that are proposed to be submitted to the clearing obligation in this paper. Therefore the analysis presented below holds for all the interest rate OTC derivatives classes considered in this consultation.

Criteria 1(a): Standardisation of the contractual terms

80. Article 7(1)(a) of the RTS on OTC derivatives requires ESMA to take into consideration whether the contractual terms of the relevant class of OTC derivative contracts incorporate common legal documentation, including master netting agreements, definitions, standard terms and confirmations which set out contract specifications commonly used by counterparties.

¹⁴ The review by the college of the application of the 5th EU CCP clearing some of the interest rate OTC derivative classes discussed in this consultation paper, CME Clearing Europe, is not complete at the time of publication of this paper, but the information about the products this CCP clears is available on their website, so without pre-judging the conclusion of this process, the corresponding information could be considered where relevant.

¹⁵ The reporting start date was 12 February 2014 and the time needed to access and process the relevant data across 6 different TRs means the results are being considered but will only be included in a future document.

81. The terms of interest rate contracts are generally less standardised than the ones of CDS for example, because each interest rate derivative contract is made of numerous trade characteristics, the main ones being currency, underlying index and maturity, but including more technical ones such as day count fraction, business day convention, floating rate reset frequency, payment frequency, notional type or embedded optionality.
82. However, there has been some initiative by market participants to enhance the level of standardisation of the contractual terms. This was notably achieved by the adoption of common definitions that are broadly used by market participants and allow them to agree swiftly on the most important terms of the contract.
83. The 2000 and 2006 Definitions published by ISDA provide generally accepted standards on the definitions used to define contractual terms for interest rate swaps. The contractual terms of the OTC derivatives have also been standardised by the use of master confirmation agreements such as Deutscher Rahmenvertrag and the ISDA Master Agreement. The latter references the ISDA 2006 Definitions which further define the contracts and describe the degrees of freedom which can be chosen on a trade-by-trade level and which need to be confirmed via an official confirmation.
84. The use of this standard documentation allows counterparties to simplify the documentation process entered into under the relevant master agreement by confirming each transaction through the transaction supplement or “short form”.
85. Those reference documents are cited by several CCPs in the corresponding notifications and appear to be generally accepted by market participants. CCPs also indicate that they make use of these standards by referencing the relevant agreements and definitions in their rules.
86. Contractual terms have also been standardised through the use of FpML messaging creating a common data capture and communication protocol for the cleared derivatives that are traded OTC.
87. This high level of standardisation of the terms and documentation for these classes has allowed their processing and their confirmation to be largely electronic. This will be covered in the next paragraph.

Criteria 1(b): Standardisation of the operational processes

88. Article 7(1)(b) of the RTS on OTC derivatives requires ESMA to take into consideration whether the operational processes of that relevant class of OTC derivative contracts are subject to automated post-trade processing and lifecycle events that are managed in a common manner according to a timetable which is widely agreed among counterparties.
89. Data on electronic processing are an important indicator to analyse the level of standardisation of the operational processes because the fact that a contract can be electronically confirmed indicates that it is sufficiently standardised for admission on a confirmation platform, and that counterparties are able to reconcile the information relative to the trade.

90. In this respect, the fifth FSB report on OTC Derivatives Market Reform¹⁶ shows a number of statistics that are useful to measure the level of standardisation of each asset class, and to measure the progress on the level of standardisation with a comparison between 2010 and 2012. In particular, the report shows the progress in electronic processing per OTC derivative types by comparing numbers from 2010 to 2012.
91. For interest rate derivatives, the level of electronically processed transactions grew from 77% in 2010 to 90% in 2012, while the level of electronically eligible transactions grew from 91% to 96%. In absolute terms these numbers support the view of a high level of standardisation of the processes for the interest rate asset class. In relative terms as well, the FSB reports shows that together with credit derivatives and energy derivatives, the interest rate asset class is the most advanced in terms of electronic processing.
92. With respect to electronic confirmation, more recent data could also be found in the 2013 ISDA Operations Benchmarking Survey¹⁷ (based on 2012 data). The scope of the survey is considered to be sufficiently broad for the data to be relevant, since 77 companies responded to the survey including 21 classified as large firms, 17 classified as medium and 39 classified as small, with a classification based on group size results.
93. As evidenced in the survey, the highest volumes of trades that are electronically confirmed are seen in the Credit and Interest rate asset classes, with rates of electronic confirmation of 98% and 86% respectively. Those numbers are in line with the ones of the FSB report mentioned in paragraph 91 above and therefore lead to the same conclusion that a significant portion of interest rate OTC derivative contracts are subject to automated post-trade processing.
94. CCPs indicate that they are connected to affirmation and confirmation platforms that are commonly used by market participants and CCPs are making references to the same platforms which is a relevant indicator that post-trade processes of interest rate OTC derivatives are dealt with in a common manner and are widely agreed among market participants.
95. Based on the above analysis, ESMA considers that the contractual terms and operational processes of the notified OTC interest rate derivative contracts presented in this consultation demonstrate an important level of standardisation.

3.2.2 Criteria 2: liquidity of OTC interest rate derivatives

Criteria 2(a): Proportionate margins – EMIR 5(4)(b) and RTS 7(2)(a)

96. To start with, provision 7(2)(a) of the RTS on OTC derivatives states that, in relation to the volume and liquidity of the relevant classes of OTC derivative contracts, ESMA shall take into consideration whether the margins or financial requirements of the CCP would be proportionate to the risk that the clearing obligation intends to mitigate. The margins and financial requirements at the EU CCPs clearing interest rate OTC derivatives, including these classes, were reviewed as part of the CCP applications and authorisation process.

¹⁶ “OTC derivatives Market Reforms, Fifth Progress Report on Implementation”, FSB, 15 April 2013, available at http://www.financialstabilityboard.org/publications/r_130415.pdf

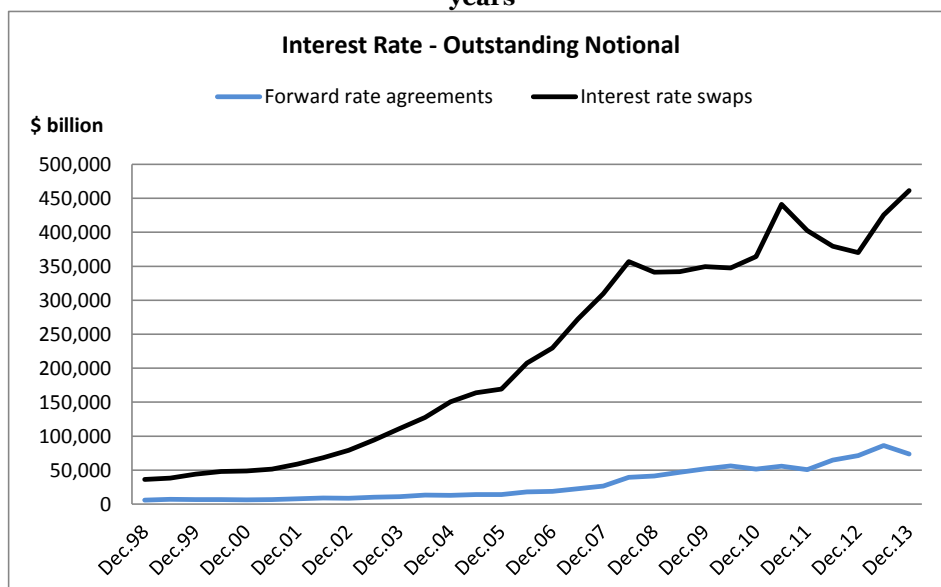
¹⁷ <http://www2.isda.org/functional-areas/research/surveys/operations-benchmarking-surveys/>

97. Following this, ESMA ensured that the determination process would follow the overarching goal of reducing systemic risk, and that for instance a less liquid product currently cleared but with a disproportionate margin would not be part of a class. ESMA has determined that the inclusion of the interest rate OTC derivative classes presented in this consultation paper for the clearing obligation did not result in disproportionate margin and financial requirements.

Criteria 2(b): Stability of the market size and depth – EMIR 5(4)(b) and RTS 7(2)(b)

98. Provision 7(2)(b) of the RTS on OTC derivatives states that, in relation to the volume and liquidity of the relevant classes of OTC derivative contracts, ESMA shall take into consideration the stability of the market size and depth in respect of the product over time.
99. The interest rate OTC derivative market including the classes proposed for the clearing obligation has increased over time in terms of outstanding notional. Figures from the BIS semi-annual survey up to December 2013¹⁸ indicate an upward trend with some fluctuations as per Figure 1.

Figure 1: Outstanding Notional in Interest rate swaps and Forward rate agreements over the past 15 years

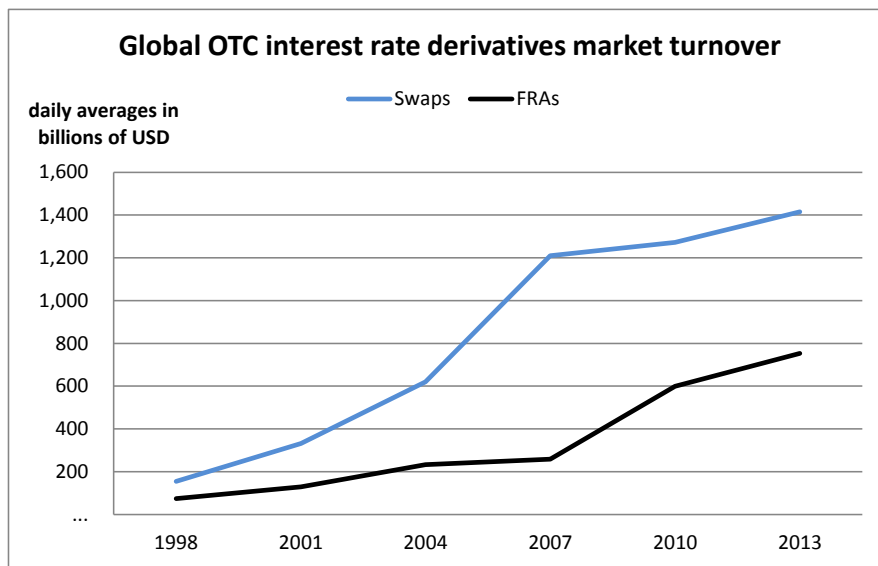


Source: BIS Semi-annual survey

100. The level of activity in these classes has remained important over the past years and should continue to be important. It is to be noted though that as these markets transform, in particular through increased standardisation, trade compressions and central clearing, the corresponding outstanding notional may reduce, similarly to what the credit OTC derivative market has experienced. Yet these could still be considered active markets. Indeed, in addition to the analysis of the outstanding notional which gives an indication of the stock, other metrics can be used to give an indication on the flow. The BIS quarterly review report of December 2013 uses the daily turnover for instance, which also comforts these results indicating growth over time in the market size and depth for these classes, as per Figure 2 below.

¹⁸ Data from the BIS semi-annual surveys is available at the following link: <http://www.bis.org/statistics/derdetailed.htm>

Figure 2: Daily turnover in Interest rate swaps and Forward rate agreements, in the months of April, over the past 15 years



Source: BIS Semi-annual survey

102. With regards to the proportion of cleared trades within this asset class, with data from June 2013, the BIS quarterly review¹⁹ of December 2013 stated that 35% of all swaps and 57% of all FRAs were centrally cleared. The report explained the analysis was based on answers to their survey and that the results were roughly in line with data provided by LCH.Clearnet, the largest central counterparty in the OTC interest rate derivative asset class. Even though the analysis shows important differences in the share of centrally cleared trades across currencies, the main currencies showed important levels of cleared trades.
103. Taking into account the ramp up of mandatory clearing in several jurisdictions, trade compressions and voluntary clearing, it is expected these ratios have increased since. A paper from ISDA²⁰ states that by the end of 2013, 65% of outstanding notional of interest rate OTC derivatives have been cleared. Finally, when factoring that some currencies, products, maturities, etc. are not offered for clearing by the CCPs, the share of centrally cleared trades within the eligible population would be even bigger.
104. As a result, looking forward, including some of these classes in the clearing obligation will help bring in more trades and more counterparties into central clearing, in line with the G20 objectives of Pittsburgh²¹. But at the same time, as a large share of these classes are already cleared, this asset class as a whole has already evolved greatly towards the clearing regime in size and depth, the clearing prices of these classes are already widely available.
105. The next criteria to be assessed will reinforce this argument: the profile and the composition of the clearing memberships across the authorised CCPs further indicate the existing availability in size and depth of the cleared markets for these classes.

¹⁹ BIS Quarterly Review from December 2013 can be found at the following link: http://www.bis.org/publ/qtrpdf/r_qt1312h.pdf

²⁰ ISDA paper 'Size and Uses of the Non-Cleared Derivatives Market' can be found at the following link: <http://www2.isda.org/functional-areas/research/studies/>

²¹ Reference to the G20 objectives agreed in Pittsburgh in 2009 is included in Recital 5 of EMIR

Criteria 2(c): Market dispersion – EMIR 5(4)(b) and RTS 7(2)(c)

106. Provision 7(2)(c) of the RTS on OTC derivatives states that, in relation to the volume and liquidity of the relevant classes of OTC derivatives, ESMA shall take into consideration the likelihood that market dispersion would remain sufficient in the event of the default of a clearing member.
107. All combined, as detailed in paragraph 155, there are 110 clearing members that are part of one or more of the four CCPs authorised to clear some of these interest rate OTC derivative classes. At group level (i.e. when clearing members of the same group are counted only once), there are 78 members. Even though this is a large number that would likely ensure sufficient market dispersion in the event of the default of a clearing member, given the size of this market, this can be looked at a more granular level. Indeed, as explained above, a majority of the trades in these classes are already cleared and there is a varied level of open interest and activity across these CCPs.
108. At the time of authorisation of these four CCPs, one CCP, LCH.Clearnet Ltd, was responsible for the clearing of the vast majority of these cleared trades, about 95%. At the same time, LCH.Clearnet²² has the largest number of clearing members (more than 60 at group level) including the fifteen largest dealers and many of the smaller ones. As a result, as the open interest is the largest at this CCP for most of these clearing members, the impact of a defaulting member could thus be the largest at this CCP. On the other hand, the market share in these asset classes is split between the various clearing members and not concentrated in one single entity. Therefore there is not a unique clearing member with open interest which is disproportionately greater than any of the other members, which would make the management of the default more manageable. The level of the guaranty fund requirements and the default management process take this into account and are part of the EMIR requirements. Their review was part of the re-authorisation process of CCPs under EMIR. But broadly speaking, having the largest dealers as well as many others, it can be reasonably assumed that through an auction process the portfolio of the defaulting member could be absorbed by the other members and allow sufficient dispersion.
109. It should be considered that as new CCPs are authorised and go live with their clearing offerings, the market share and the overall activity in absolute terms among these CCPs may change. In addition, their respective market share will also evolve based on the take-up of their respective client clearing and indirect clearing offerings as more counterparties move to clearing. Looking at the CCPs other than LCH.Clearnet Ltd, they have been able to expand their membership in parallel to their commercial offerings. Some of them are attracting a large base of dealers as clearing members, in particular some of the bigger ones that are particularly active in client clearing as is detailed in paragraph 154. And some other CCPs have started by developing a more regional membership in line with the start of their offering. In all cases, as stated, the EMIR requirements related to the default of a clearing member have been vetted for each of these CCPs as part of their re-authorisations.
110. Given the large number of clearing members for these classes, their variety in size and location, the number of CCPs authorised and their respective open interest, ESMA is of the view that market dispersion would likely remain sufficient for these classes in the event of the default of a clearing member.

²² LCH clearing members that are part of SwapClear: http://www.lchclearnet.com/membership/ltd/current_membership.asp

Criteria 2(d): Number and value of the transactions – EMIR 5(4)(b) and RTS 7(2)(d)

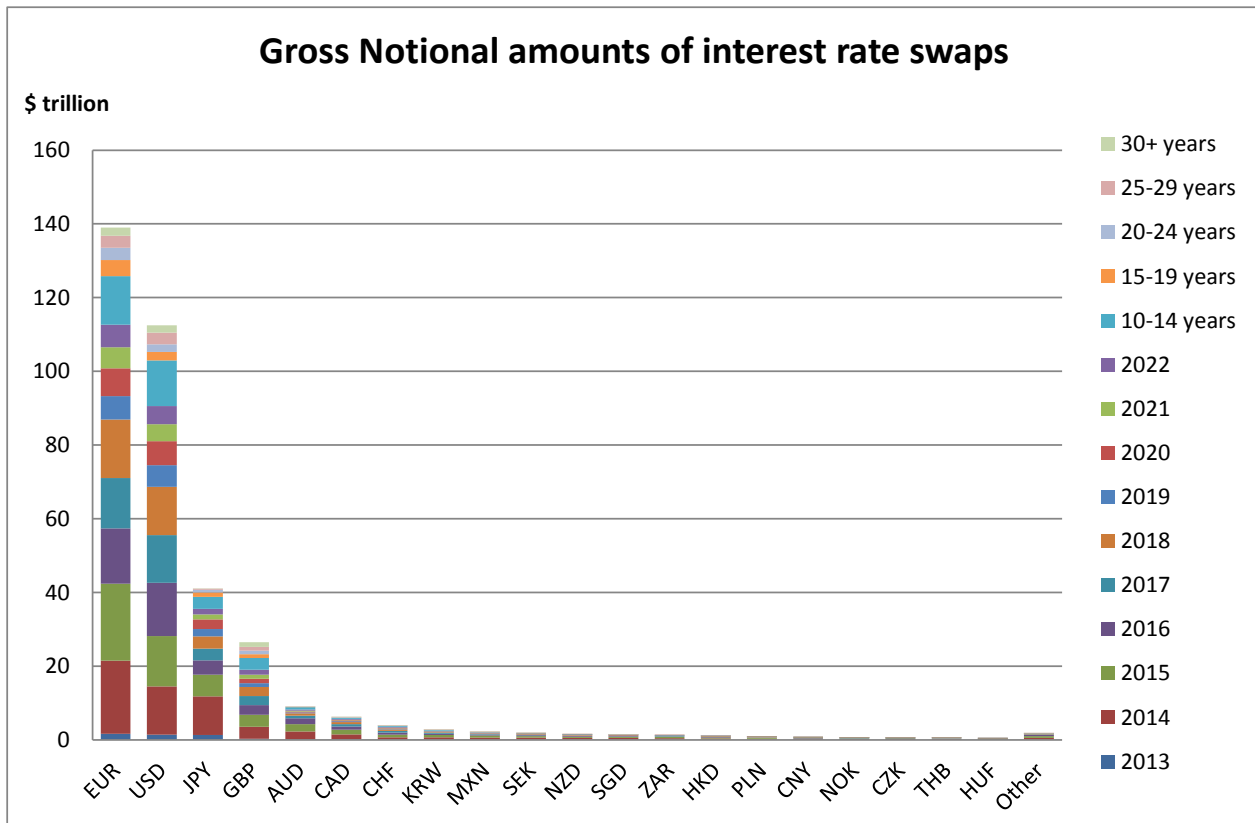
111. Provision 7(2)(d) of the RTS on OTC derivatives states that, in relation to the volume and liquidity of the relevant classes of OTC derivative contracts, ESMA shall take into consideration the number and the value of the transactions. When looking at recent studies as well as data reported at various trade repositories, these classes show a relatively important level of activity²³.
112. For the analysis of this criteria we have used data from DTCC Global Trade Repository²⁴ when considering liquidity globally as the markets for these classes are international as well as data from the European Trade Repositories when looking at the volume of trades for counterparties under the scope of EMIR.
113. DTCC Global Trade Repository does not contain a comprehensive set of data but the largest dealers are part of this initiative. These dealers are a counterparty to most trades, whether they face another reporting dealer or a non-reporting counterparty. Even if not comprehensive, the outstanding notional figures provided by this source are close to the numbers reported by the Bank for International Settlements semi-annual survey, and can thus be used to identify trends and draw comparisons at the global level.
114. Going back to the scope of the analysis, the CCP notifications included seventeen cleared currencies²⁵ for these classes. The number and value of transactions denominated in these 17 currencies vary significantly from one currency to another. ESMA has looked at both the stock (outstanding notional and trade count) as well as the flow (daily turnover).
115. From a stock point of view, looking at the interest rate derivative market as a whole, a breakdown of the total outstanding notional per currency shows the dominance of a few currencies. As shown in Figure 3, the G4 currencies amount for 90% and the G7 currencies for 95% of the total outstanding notional of interest rate OTC derivatives.

²³ Level of activity in the Triennial Central Bank Survey from December 2013: http://www.bis.org/publ/qtrpdf/r_qt1312h.pdf

²⁴ DTCC GTR public reports from voluntary reporting can be accessed at the following link: <http://www.dtcc.com/en/market-data/gtr-interest-rate-swap-data/table-1.aspx>

²⁵ The classes for CME Clearing Europe have not been notified to ESMA as the review of their application by the college is not complete at the time of publication of this paper, yet as the classes this CCP clears can be found on their website, we could confirm they are included in other notifications and thus evaluated in this paper, except for a few long maturities that ESMA has determined not to be a good candidate for the clearing obligation's first determination: <http://www.cmegroup.com/europe/clearing-europe/products/otc-financial-derivatives.html>

Figure 3: Notional amounts outstanding in interest rate OTC derivatives, per currency



Source: DTCC, 6 December 2013

116. Looking at these classes from a daily turnover point of view, to consider the flow, similar to paragraph 100, the order of magnitude is similar, in terms of which currencies account for the largest share of the interest rate OTC market as indicated in Table 4. As a preliminary view, based on both the stock and the flow indicators, we consider the following four currencies in priority: EUR, GBP, JPY, USD.

Table 4: 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										
Currency	2001		2004		2007		2010		2013	
	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

117. Going a level down, beyond the breakdown just by currency, the same analysis was performed by product type and by currency as per Table 5 to Table 8, showing the trade count and the gross notional for each of the four classes.

Table 5: Interest Rate Swap: Notional amounts outstanding and trade count per currency

Currency	Gross Notional (Native)	Gross Notional (USD)	Gross Notional in %	Cumulative	Trade Count	Trade Count in %	Cumulative
EUR	80,290,297,654,444	111,367,355,887,542	35.8%	35.8%	848,566	21.7%	21.7%
USD	98,370,869,433,443	98,370,869,433,443	31.6%	67.3%	1,118,760	28.6%	50.2%
JPY	4,337,325,291,831,580	42,598,172,889,019	13.7%	81.0%	578,948	14.8%	65.0%
GBP	12,730,316,359,005	21,162,524,012,469	6.8%	87.8%	335,120	8.6%	73.6%
AUD	9,458,837,157,380	8,545,726,420,715	2.7%	90.6%	165,112	4.2%	77.8%
CAD	6,984,687,192,688	6,310,076,768,039	2.0%	92.6%	91,199	2.3%	80.1%
CHF	3,970,286,053,812	4,540,635,114,751	1.5%	94.0%	80,494	2.1%	82.2%
SEK	16,718,892,233,335	2,621,194,611,941	0.8%	94.9%	55,606	1.4%	83.6%
NZD	2,653,147,985,338	2,265,227,769,474	0.7%	95.6%	52,937	1.4%	85.0%
ZAR	19,696,226,252,021	1,823,252,089,509	0.6%	96.2%	87,999	2.2%	87.2%
KRW	1,670,364,948,719,560	1,561,791,227,119	0.5%	96.7%	54,405	1.4%	88.6%
MXN	19,461,095,716,084	1,463,846,105,092	0.5%	97.2%	99,365	2.5%	91.1%
PLN	4,257,885,271,404	1,393,424,037,778	0.4%	97.6%	55,502	1.4%	92.6%
SGD	1,270,721,448,181	1,003,436,119,838	0.3%	97.9%	32,296	0.8%	93.4%
HKD	7,431,609,868,300	957,029,342,010	0.3%	98.2%	36,368	0.9%	94.3%
BRL	2,023,785,021,545	856,084,944,787	0.3%	98.5%	24,410	0.6%	94.9%
NOK	4,789,616,917,779	802,953,412,386	0.3%	98.8%	25,159	0.6%	95.6%
HUF	157,148,269,729,643	694,453,918,838	0.2%	99.0%	36,538	0.9%	96.5%
CZK	10,397,482,522,268	527,324,962,146	0.2%	99.2%	22,162	0.6%	97.1%
MYR	1,609,206,056,446	490,686,352,487	0.2%	99.3%	19,892	0.5%	97.6%
Other		2,096,956,741,035	0.7%	100.0%	94,482	2.4%	100.0%
Total		311,453,022,160,418			3,915,320		

Source: DTCC, 14 March 2014

Table 6: Overnight Index Swap: Notional amounts outstanding and trade count per currency

Currency	Gross Notional (Native)	Gross Notional (USD)	Gross Notional in %	Cumulative	Trade Count	Trade Count in %	Cumulative
EUR	25,734,479,915,852	35,695,234,257,564	56.5%	56.5%	54,004	43.0%	43.0%
GBP	7,163,320,520,638	11,908,104,893,252	18.9%	75.4%	18,207	14.5%	57.4%
USD	11,364,307,901,829	11,364,307,901,829	18.0%	93.4%	21,260	16.9%	74.3%
AUD	2,029,397,946,742	1,833,489,610,076	2.9%	96.3%	1,959	1.6%	75.9%
CAD	1,122,719,340,878	1,014,282,391,520	1.6%	97.9%	1,265	1.0%	76.9%
INR	28,503,099,104,906	465,774,843,113	0.7%	98.7%	20,096	16.0%	92.9%
JPY	34,180,933,712,323	335,701,204,276	0.5%	99.2%	1,097	0.9%	93.8%
NZD	225,360,200,000	192,409,992,196	0.3%	99.5%	237	0.2%	93.9%
CHF	110,465,900,000	126,334,812,583	0.2%	99.7%	414	0.3%	94.3%
SEK	446,720,000,000	70,036,940,288	0.1%	99.8%	187	0.1%	94.4%
BRL	124,644,392,725	52,726,048,926	0.1%	99.9%	1,965	1.6%	96.0%
CLP	20,101,824,072,587	35,005,316,457	0.1%	99.9%	2,823	2.2%	98.2%
COP	30,838,323,440,000	15,046,018,020	0.0%	100.0%	1,616	1.3%	99.5%
DKK	50,200,000,000	9,330,332,640	0.0%	100.0%	46	0.0%	99.6%
CLF	149,446,639	6,127,373,444	0.0%	100.0%	463	0.4%	99.9%
PLN	7,035,000,000	2,302,255,107	0.0%	100.0%	38	0.0%	100.0%
TRY	1,110,000,000	496,733,214	0.0%	100.0%	30	0.0%	100.0%
RUB	6,665,800,000	182,144,318	0.0%	100.0%	13	0.0%	100.0%
Other		380,824,979	0.0%	100.0%	16	0.0%	100.0%
Total		63,127,273,893,802			125,736		

Source: DTCC, 14 March 2014

Table 7: Basis Swap: Notional amounts outstanding and trade count per currency

Currency	Gross Notional (Native)	Gross Notional (USD)	Gross Notional in %	Cumulative	Trade Count	Trade Count in %	Cumulative
USD	15,054,218,055,474	15,054,218,055,474	57.2%	57.2%	78,702	52.9%	52.9%
JPY	441,443,363,526,504	4,335,547,706,315	16.5%	73.6%	30,064	20.2%	73.1%
GBP	2,492,988,828,075	4,144,275,322,843	15.7%	89.4%	21,001	14.1%	87.2%
EUR	1,110,032,286,141	1,539,679,939,926	5.8%	95.2%	8,274	5.6%	92.7%
AUD	619,089,249,136	559,325,344,690	2.1%	97.4%	5,722	3.8%	96.6%
CHF	433,007,895,000	495,211,384,368	1.9%	99.2%	3,163	2.1%	98.7%
CAD	192,922,636,463	174,289,357,978	0.7%	99.9%	1,161	0.8%	99.5%
NOK	55,841,549,180	9,361,534,175	0.0%	99.9%	61	0.0%	99.5%
ZAR	34,539,725,426	3,197,294,027	0.0%	99.9%	165	0.1%	99.6%
BRL	6,289,612,335	2,660,580,236	0.0%	100.0%	119	0.1%	99.7%
HKD	18,657,997,870	2,402,743,381	0.0%	100.0%	56	0.0%	99.8%
CLP	1,366,644,380,000	2,379,874,530	0.0%	100.0%	164	0.1%	99.9%
KRW	2,108,700,000,000	1,971,634,500	0.0%	100.0%	57	0.0%	99.9%
MXN	13,548,928,607	1,019,138,218	0.0%	100.0%	17	0.0%	99.9%
SEK	4,823,875,474	756,289,127	0.0%	100.0%	28	0.0%	99.9%
CZK	8,366,390,786	424,314,895	0.0%	100.0%	27	0.0%	100.0%
ILS	693,553,000	199,727,314	0.0%	100.0%	13	0.0%	100.0%
Other		3,376,106,883	0.0%	100.0%	47	0.0%	100.0%
Total		26,330,296,348,880			148,841		

Source: DTCC, 14 March 2014

Table 8: Forward Rate Agreement: Notional amounts outstanding and trade count per currency

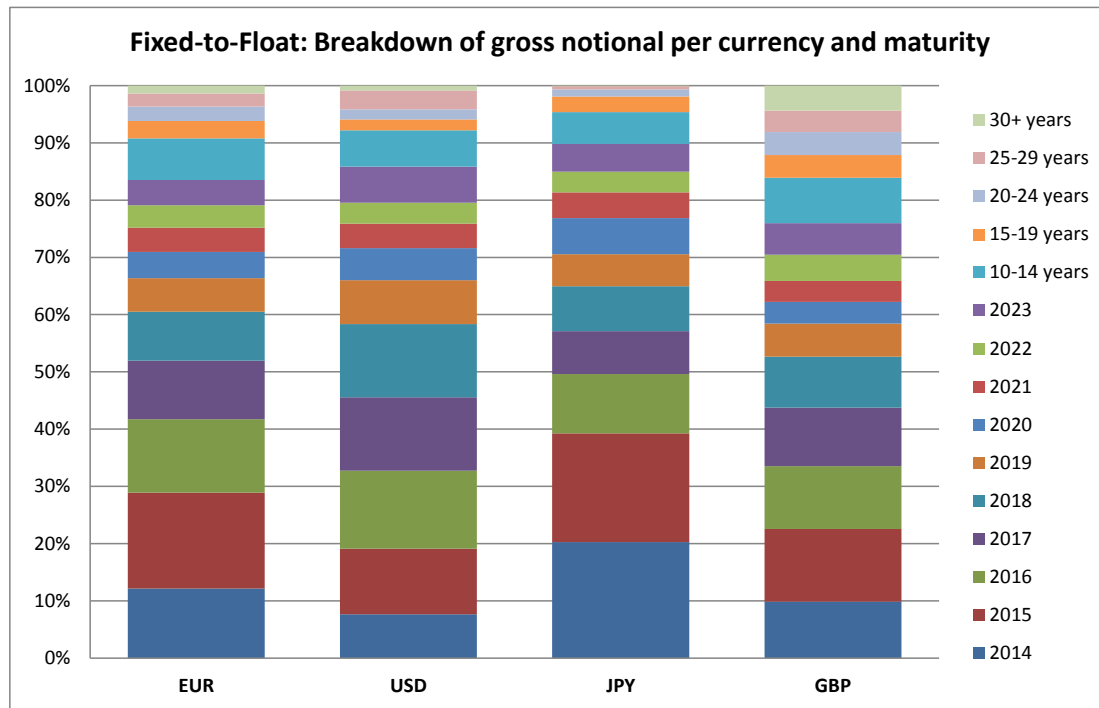
Currency	Gross Notional (Native)	Gross Notional (USD)	Gross Notional in %	Cumulative	Trade Count	Trade Count in %	Cumulative
EUR	36,056,740,100,000	50,012,815,049,364	46.2%	46.2%	128,080	42.5%	42.5%
USD	33,030,362,810,000	33,030,362,810,000	30.5%	76.7%	76,183	25.3%	67.8%
GBP	10,133,400,050,000	16,845,482,534,595	15.6%	92.3%	53,048	17.6%	85.4%
SEK	19,403,766,581,143	3,042,130,286,099	2.8%	95.1%	11,548	3.8%	89.2%
CHF	1,140,867,625,000	1,304,758,279,152	1.2%	96.3%	6,600	2.2%	91.4%
ZAR	10,529,170,770,000	974,670,597,340	0.9%	97.2%	5,948	2.0%	93.4%
NOK	4,513,553,791,000	756,672,919,873	0.7%	97.9%	5,457	1.8%	95.2%
PLN	2,182,401,800,000	714,206,920,600	0.7%	98.6%	4,902	1.6%	96.8%
HUF	130,265,322,400,000	575,655,486,219	0.5%	99.1%	3,610	1.2%	98.0%
AUD	420,734,700,000	380,118,991,589	0.4%	99.5%	2,203	0.7%	98.7%
CAD	182,224,000,000	164,624,040,740	0.2%	99.6%	269	0.1%	98.8%
DKK	817,880,500,000	152,013,886,951	0.1%	99.8%	2,018	0.7%	99.5%
ILS	338,660,000,000	97,526,290,820	0.1%	99.9%	395	0.1%	99.6%
CZK	1,684,700,500,000	85,442,281,377	0.1%	99.9%	732	0.2%	99.9%
NZD	40,403,000,000	34,495,624,848	0.0%	100.0%	175	0.1%	99.9%
JPY	2,892,300,000,000	28,406,145,990	0.0%	100.0%	33	0.0%	99.9%
RUB	246,848,000,000	6,745,170,970	0.0%	100.0%	214	0.1%	100.0%
AED	14,500,000,000	3,947,619,200	0.0%	100.0%	17	0.0%	100.0%
Other		1,233,168,837	0.0%	100.0%	5	0.0%	100.0%
Total		108,211,308,104,564			301,437		

Source: DTCC, 14 March 2014

118. Starting with the fixed-to-float interest rate swap classes, given the predominance of these swaps within the interest rate OTC asset class as a whole, Table 5 indicates results in line with the analysis of paragraph 116 above. Indeed, in this table the G4 currencies dominate largely, fixed-to-float interest rate swaps denominated in EUR, GBP, JPY and USD represent 88% of the total outstanding notional. Some of the next currencies, in the order of gross notional outstanding, can represent certain levels of activity but ESMA has determined that from a volume and systemic risk point of view, the priority for fixed-to-float interest rate swap classes for the first determination is on the G4 currencies as the 4 of them combined are responsible for the vast majority of the activity.

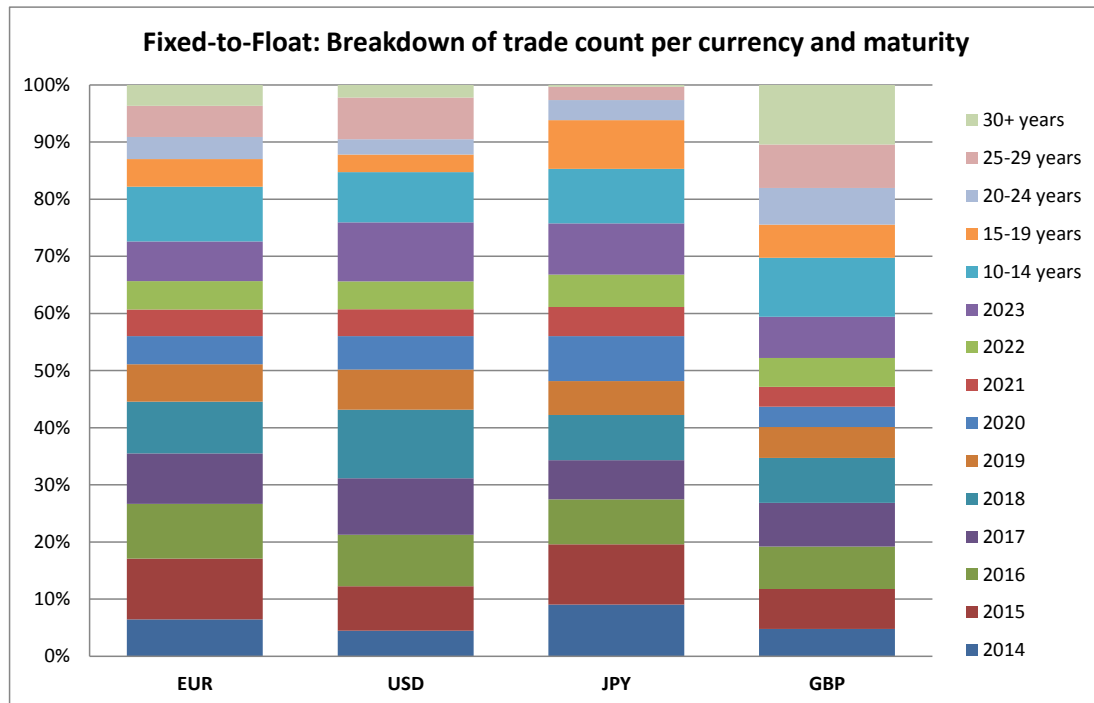
119. With regards to the overnight index swaps, Table 6 indicates that the market is highly concentrated on three currencies that are EUR, GBP and USD. Overnight index swaps denominated in these three currencies account for 93% of the total outstanding notional. The next currencies in the order of their outstanding notional can represent up to a few percentage points but in absolute terms represent fewer trades.
120. When doing the same analysis for Basis swaps, Table 7 gives a similar picture to the one for fixed-to-float interest rate swaps in terms of which currencies dominate this market, but in this case the G4 currencies dominate even more. Basis swaps denominated in EUR, GBP, JPY and USD alone account for 95% of the total outstanding notional.
121. Finally, with regards to the forward rate agreements, similar to the overnight index swaps, Table 8 indicates that this market is concentrated in three currencies that are also EUR, GBP and USD. Together, forward rate agreements cleared in these three currencies represent 92% of this market. The next currencies in their order of outstanding notional account for much less trades.
122. From a systemic risk point of view, the above tables have indicated which currencies for each of these classes have a greater importance. Following this, ESMA has drilled down another level to have granularity in the results at the maturity level. For each of the four classes in the relevant currencies, the following paragraphs provide an analysis of the number and value of transactions per maturity bucket.
123. Starting with fixed-to-floating interest rate OTC swaps, Figure 4 and Figure 5 show the percentage of the outstanding notional and the trade count per maturity for each currency considered in paragraph 118. There are two ranges of maturities:
 - For EUR, GBP and USD trades, there are significant levels of activity and outstanding risk from short maturities up to the long maturities that are bucketed in the '30 year+' category, which bucket includes the 50 year tenor.
 - For JPY trades, there are significant levels of activity up to the 30 year tenor.

Figure 4: Breakdown of the outstanding gross notional per currency for fixed-to-float interest rate swap



Source: DTCC, May 9 2014

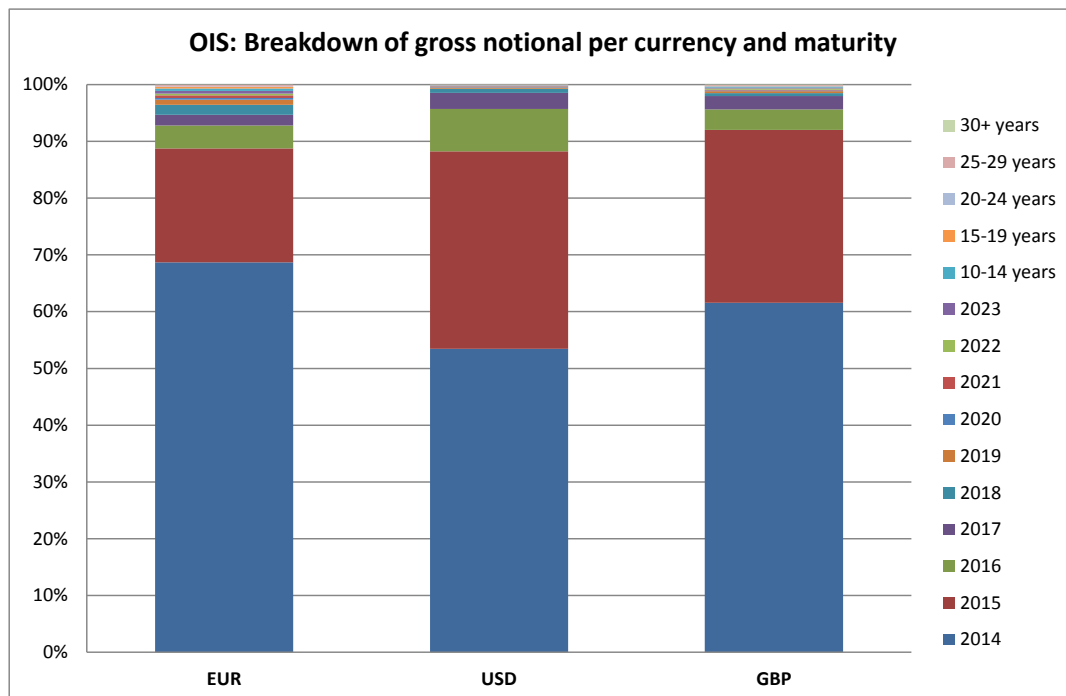
Figure 5: Breakdown of the trade count per currency for fixed-to-float interest rate swaps



Source: DTCC, May 9 2014

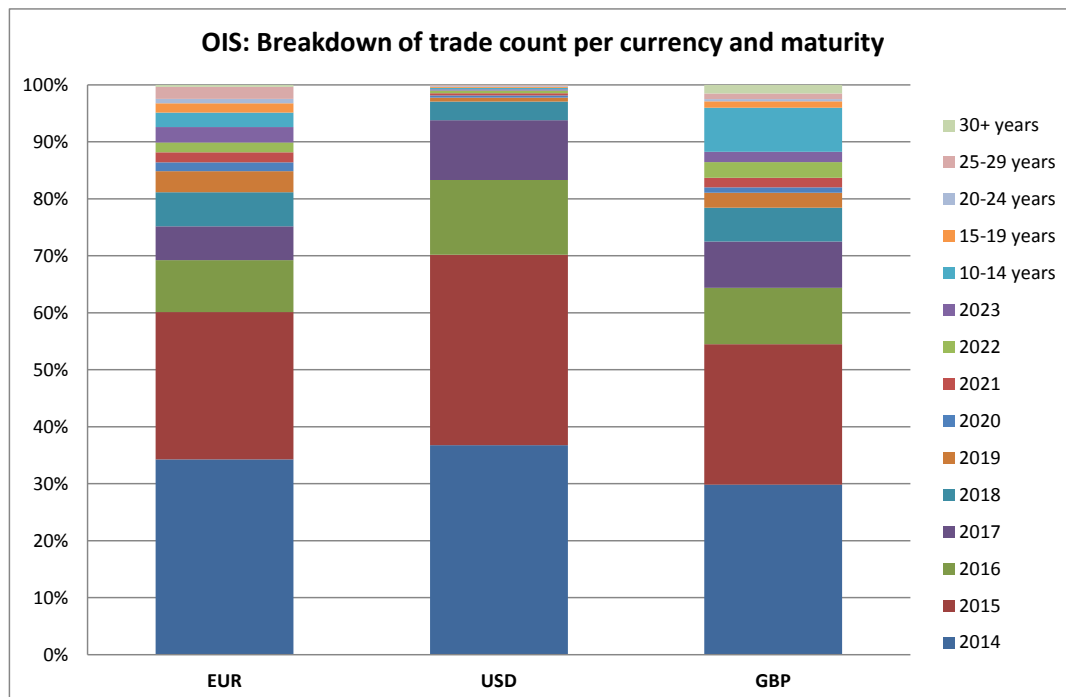
124. With regards to overnight index swaps, Figure 6 and Figure 7 show the percentage of the outstanding notional and the trade count per maturity for each currency considered in paragraph 119. The bulk of the trading activity and the outstanding risk are concentrated on the initial 3 years for overnight index swaps denominated in EUR, GBP and USD.

Figure 6: Breakdown of the outstanding gross notional per currency for overnight interest rate swaps



Source: DTCC, May 9 2014

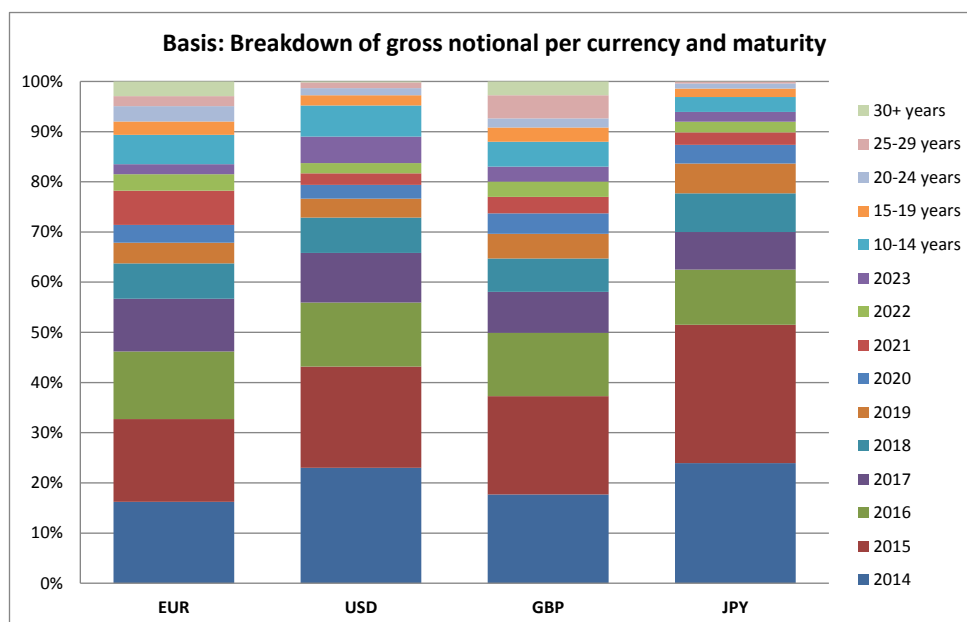
Figure 7: Breakdown of the trade count per currency for overnight interest rate swaps



Source: DTCC, May 9 2014

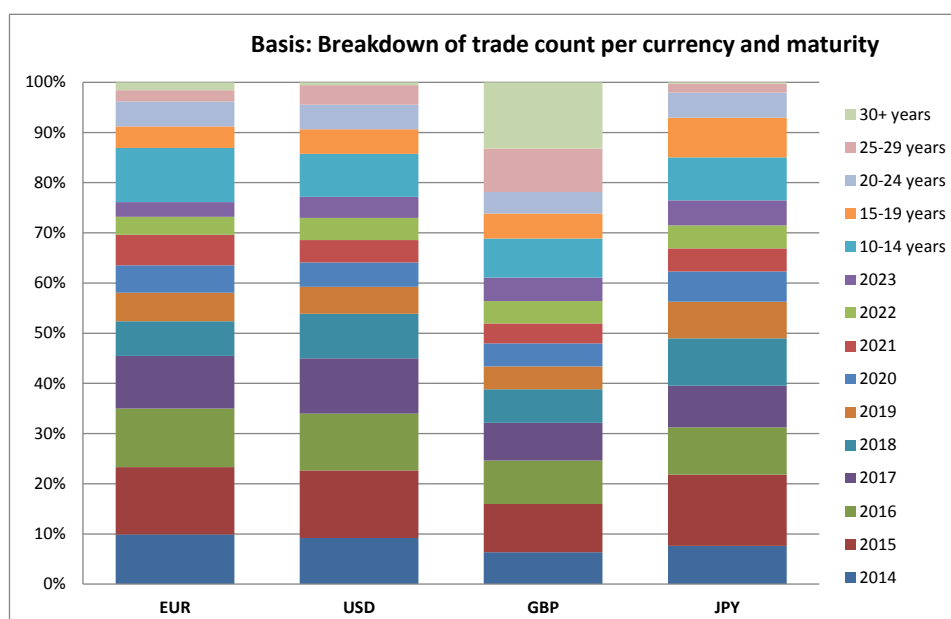
125. When doing the same analysis for basis swaps, Figure 8 and Figure 9 show the percentage of the outstanding notional and the trade count per maturity for each currency considered in paragraph 120. Similar to the fixed-to-float analysis, for Basis swaps denominated in EUR, GBP and USD, there is a significant level of activity up to the long maturities bucketed in the '30+ years' category which includes the 50 year tenor, and for the Basis swaps denominated in JPY, up to the 30 year tenor.

Figure 8: Breakdown of the outstanding gross notional per currency for basis swaps



Source: DTCC, May 9 2014

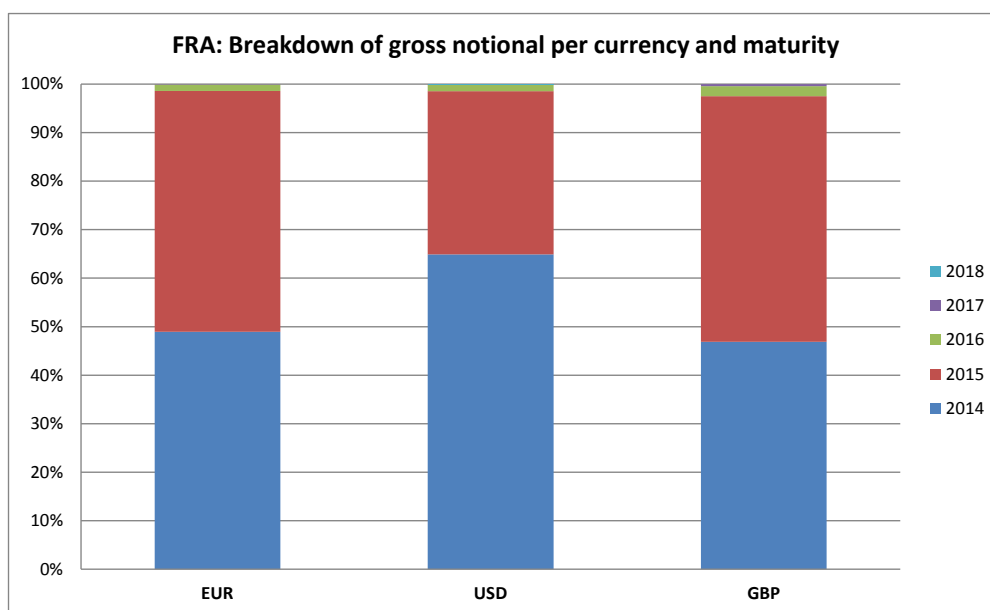
Figure 9: Breakdown of the trade count per currency for basis swaps



Source: DTCC, May 9 2014

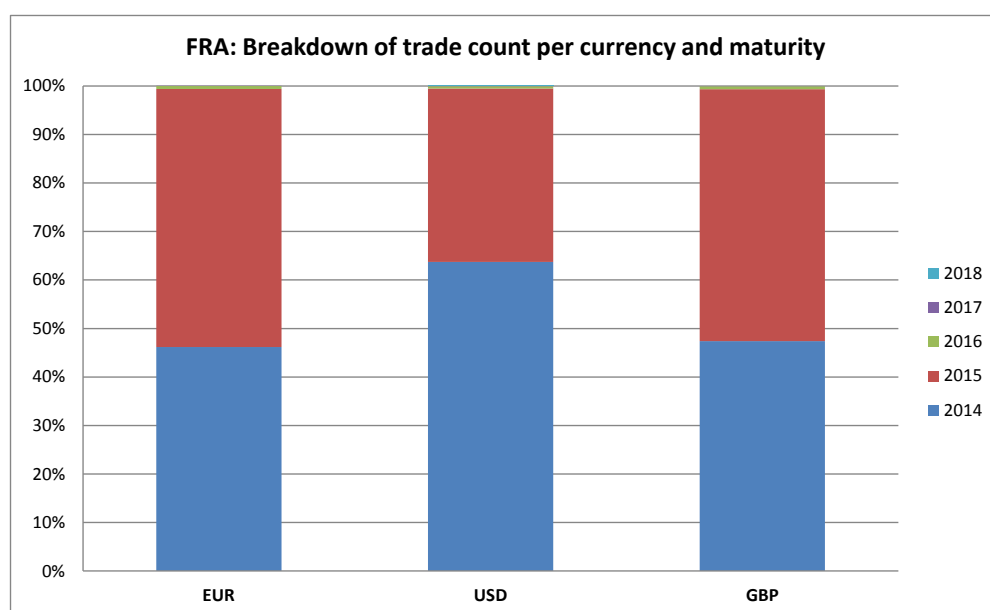
126. Finally, with regards to the forward rate agreements, Figure 10 and Figure 11 show the percentage of the outstanding notional and the trade count per maturity. The levels of activity and outstanding risk are concentrated on the initial 3 years for forward rate agreements denominated in EUR, GBP and USD.

Figure 10: Breakdown of the outstanding gross notional per currency for forward rate agreements



Source: DTCC, May 9 2014

Figure 11: Breakdown of the trade count per currency for forward rate agreements



Source: DTCC, May 9 2014

3.2.3 Criteria 3: availability of the pricing information in OTC interest rate derivatives

127. In relation to the availability of fair, reliable and generally accepted pricing information in the relevant class of OTC derivative contracts, Article 7(3) of the RTS on OTC derivatives requires ESMA to take into consideration whether the information needed to accurately price the contracts within the relevant class of OTC derivative contracts is easily accessible to market participants on a reasonable commercial basis and whether it would continue to be easily accessible if the relevant class of OTC derivative contracts became subject to the clearing obligation.
128. The fixing of the corresponding indexes is a well-established process. Rates for interest rate swaps, overnight index swaps, forward rate agreements and basis swaps in the currencies notified to ESMA are available through a large number of sources. It includes market data vendors, eTrading platforms, newspapers, interdealer brokers, dealers as well as the CCPs themselves²⁶. The availability of data varies by product, currency and tenor but are available for these classes on a reasonable commercial basis.
129. The number and diversity of sources should remain large and accessible on reasonable commercial terms when a bigger proportion of these products are cleared; there is no indication that it would not be the case for these classes. As a matter of fact, these classes are already cleared in large proportions and many of these sources indicate prices for cleared trades within these classes. In addition, moving to clearing could contribute to an increased use of the more standardised swaps within these markets. Indeed, the CCPs accept for clearing the most standardised of these contracts, and as such enable a greater access to pricing data.

3.2.4 Conclusion: interest rate OTC derivative classes to be subject to the clearing obligation

130. Following the review of the notified classes against the 3 criteria set in EMIR and their analysis in light of the overarching principle of systemic risk, ESMA is of the view that the following interest rate OTC classes should be subject to the clearing obligation:

Table 9: Basis swaps class

Type	Reference Index	Settlement Currency	Maturity	Settlement Currency Type	Optionality	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

²⁶ Sources include amongst others Bloomberg, Reuters, TradeWeb, ICAP, BGC, Tullett Prebon, GFI, etc.

Table 10: Fixed-to-float interest rate swaps class

Type	Reference Index	Settlement Currency	Maturity	Settlement Currency Type	Optionality	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 11: Forward rate agreement class

Type	Reference Index	Settlement Currency	Maturity	Settlement Currency Type	Optionality	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 12: Overnight index swaps class

Type	Reference Index	Settlement Currency	Maturity	Settlement Currency Type	Optionality	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

131. The indication of the relevant CCPs clearing these contracts and the determination of the phase in and the categories of counterparties to which the clearing obligation should apply are discussed in the next section of this consultation paper.

Question 5: In view of the criteria set in Article 5(4) of EMIR, do you consider that this set of classes addresses appropriately the systemic risk associated to interest rate OTC derivatives? Please include relevant data or information where applicable.

4. Determination of the dates on which the obligation applies and the categories of counterparties

132. Article 5(2)(b) of EMIR requires ESMA to include in the draft technical standards on the clearing obligation 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.
133. ESMA considers that there are strong arguments supporting the idea of adopting a phased-in implementation, as a number of market participants do not yet have in place any clearing arrangements. A phased-in implementation should encourage a timely and orderly application of the clearing obligation, avoiding “bottleneck” situations to the extent possible, i.e. situations in which an important number of counterparties look for an access to CCP at the same time, complicating the on-boarding process both for CCPs and for clearing members. It would also ensure that homogeneous groups of counterparties are subject to the same date of application, and that more time is granted to counterparties to which access to clearing is more difficult.
134. In defining the dates from which the clearing obligation applies and the categories of counterparties, ESMA shall take into consideration the criteria listed in Article 5(5) of EMIR:
- (a) the expected volume of the relevant class of OTC derivatives
 - (b) whether more than one CCP already clear the same class
 - (c) the ability of the CCP to handle the expected volume
 - (d) the type and number of counterparties active in the market
 - (e) the period of time a counterparty subject to the clearing obligation needs to put in place arrangements to clear
 - (f) the risk management and the legal and operational capacity of the counterparties
135. ESMA has determined that the first three criteria are essentially relevant for the determination of the dates while the last three criteria are more relevant for defining the different categories of counterparties to which the clearing obligation applies.
136. Those criteria are analysed in the following paragraphs, globally or per asset class where relevant.

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

137. In relation to criteria (c), it should be noted that the classes proposed in this paper are already cleared in substantial volumes and, in some cases, already subject to the clearing obligation in other jurisdictions. In addition, the scalability of the CCPs was validated during the re-authorisation process of CCPs under EMIR
138. In relation to criteria (a), all the classes that are proposed for the clearing obligation in this paper exhibit high volumes and liquidity as analysed in detail in the section above. However ESMA finds that the volume of the class in itself is only relevant for the purpose of determining the dates of application when it is compared to the number of CCPs and the number of clearing members of the

specific class. This conclusion is shared by a majority of stakeholders responding to the discussion paper. Therefore the following paragraphs focus on criteria (b) and add to this criteria an analysis of the clearing members.

Feedback from the consultation paper regarding the number of CCP clearing the same class

139. In the discussion paper on the clearing obligation, market participants were asked their views on the appropriate timeframe for counterparties to start clearing depending on:
- the number of CCP clearing the relevant class
 - the number of clearing member
 - the fact that the counterparty already has access to clearing
140. One key feedback from the responses is that a majority of the respondents (roughly 60%) would prefer that a clearing obligation is not imposed unless at least two CCPs are available to clear the contracts belonging to a mandatory class.
141. The main reasons found in those responses are (1) the centralisation of all market participants in a single point, which may go against the overarching objective of the reduction of systemic risk (2) a risk of “bottleneck” situation, and (3) the risk of monopoly situations.
142. The remaining respondents can be divided as follows: 20% consider that the number of CCPs clearing the same class is irrelevant in the context of the clearing obligation and that the same dates of application should be given irrespective of the number of CCPs, and another 20% find appropriate that a longer phase-in is granted when the clearing obligation is decided on a class of OTC derivatives which is cleared by only one CCP.
143. The main arguments found in those responses are that it could be the case that a second CCP never enters the market, that a clearing obligation on a class cleared by a single CCP may be a sufficient incentive to promote competition and that the number of clearing members of a specific Class+ is more relevant than the number of CCPs itself.

ESMA's proposal

144. It is important to keep in mind that, as defined under Article 5(5) of EMIR, the number of CCPs clearing the same class is a criteria that ESMA shall take into consideration for the purpose of defining the dates from which the clearing obligation would apply, as opposed to a criteria relevant to define the classes themselves.
145. Therefore, there would be no legal basis for ESMA not to launch a clearing obligation determination as foreseen by Article 5(2) solely on the ground that the classes are cleared by a single CCP at the beginning of the clearing obligation procedure. This should not be understood as meaning that the number of CCPs clearing the same class is irrelevant for the purpose of determining the classes, however the existence of a single CCP to clear the class does not lead to an automatic exclusion of that class from the scope of the clearing obligation determination.
146. As regards the current clearing obligation determination, the number of CCPs authorised to clear each Class+ is presented below.

4.1.1 Number of CCP per class

147. Table 13²⁷ shows that there is a minimum of two CCPs already authorised to clear the mandatory class. In addition there are three sub-classes, for which three CCPs are available. Those three sub-classes are fixed-to-float IRS on Euribor, FRA on Euribor and OIS on Eonia, therefore all denominated in EUR and among the most liquid markets of those classes.
148. Although KDPW_CCP is authorised to clear OTC interest rate swaps, it is authorised only for IRS denominated in PLN, a class that is not covered by the current determination. For this reason, this CCP does not appear in the table below.

Table 13: Number of CCP for the OTC interest rate classes

Class	Eurex Clearing AG	LCH.Clearnet Ltd	Nasdaq OMX Clearing AB	Total
Basis Swap	4	4		
EUR EURIBOR	1	1		2
GBP LIBOR	1	1		2
JPY LIBOR	1	1		2
USD LIBOR	1	1		2
Fixed-to-Float	5	8	2	
EUR EURIBOR	1	1	1	3
GBP LIBOR	1	1		2
JPY LIBOR	1	1		2
USD LIBOR	1	1		2
Forward Rate Agreement	3	3	1	
EUR EURIBOR	1	1	1	3
GBP LIBOR	1	1		2
USD LIBOR	1	1		2
Overnight Index Swap	3	3	1	
EUR EONIA	1	1	1	3
GBP SONIA	1	1		2
USD FedFunds	1	1		2

4.1.2 Number of clearing members per class

149. In the responses to the discussion paper, it was noted that the number of clearing members may be of greater importance than the number of CCP clearing the same class. Indeed a number of counterparties will access CCP through them to fulfil their obligations under EMIR. One should not focus on the absolute number of clearing members, but rather compare the number of clearing member to the size of the respective markets, and the types of market participants in this market.
150. In this respect, the OTC interest rate situation is different than for many of the other asset classes, in part due to the size of its market, the range of counterparties using these contracts as well as the maturity of the clearing offering. The clearing of IRS has existed since 1999, whereas for CDS it has only been in operation for about 5 years, allowing more counterparties to participate and start

²⁷ CME Clearing Europe is not included in this table as the review of their application is not complete at the time of this consultation paper, but this CCP currently clears all the classes proposed for the clearing obligation, further strengthening the argument developed in this section.

clearing and for the offering to expand with more products, following which we can see more clearing members for the interest rate derivative memberships than for the credit ones for instance.

151. In order to evaluate the deployment of CCP clearing members in Europe, ESMA has collected in May 2014 information on the clearing members of CCPs in coordination with the national competent authorities responsible for their supervision. The purpose of this data collection was to gather information on the number of clearing members for each asset class and, among those clearing members, those offering client clearing and/or indirect client clearing.
152. The clearing members being identified with their Legal Entity Identifier (LEI) it was possible to spot the clearing members of numerous CCP and avoid double counting. In the following table, the numbers marked as “without duplicate” should be understood as meaning that clearing members (with the same LEI) of multiple CCPs are counted only once in the total.
153. It was also possible to aggregate the clearing members per group and have a view not only at entity but also at group level. Indeed this is important because the choice of a clearing member by a counterparty would likely be done at group rather than entity level. Once a counterparty has selected a clearing member, the choice between one entity of the group or the other would mainly be driven by legal or practical reasons (e.g. the geographical location), but it is likely that the offer of the clearing member would be identical for various entities of the same group. From the point of view of a counterparty seeking to become the client of a clearing member, the number of “groups” clearing member is therefore more relevant than the number of entities.

Clearing members in OTC interest rate derivatives

154. For the interest rate asset class, Table 14 shows that there is an important number of clearing members at entity level, ranging from 5 to 91 per CCP, of which 5 to 29 offer client clearing. When several clearing members of the same group are counted only once, as indicated in the columns “group level”, those numbers go down, ranging this time from 5 to 62 clearing members per CCP, of which 5 to 18 offer client clearing.
155. In total, the number of clearing members for OTC interest rate is 146 at entity level (110 without duplicates), and 114 at group level (78 without duplicates).
156. For the time being, the indirect client clearing activity remains undeveloped. CCPs have indicated that they are able to offer indirect client clearing in accordance with EMIR, but they have not yet received requests from their clearing members to do so. It is anticipated that the indirect client clearing activity will gradually develop while the dates of application of the clearing obligation approach.
157. Based on the above, ESMA concludes that the number of clearing members including those offering client clearing is sufficient to support the clearing obligation of the OTC interest rate classes proposed in the current determination, and that it is not necessary to delay the application of the clearing obligation for the sole purpose of giving time to other clearing members to enter the market.

Table 14: Number of clearing members in OTC interest rate

INTEREST RATE	Number of clearing members		Number of clearing members with client/indirect client clearing	
	At group level	At entity level	At group level	At entity level
as of 15/05/2014				
CME Clearing Europe	8	9	8	8
EUREX	31	33	18	18
KDPW_CCP	8	8		
LCH.CLEARNET Ltd	62	91	19	29
NASDAQ OMX	5	5	5	5
Total (with duplicates)	114	146	50	60
Total (without duplicates*)	78	110	28	42

(*) Clearing members of multiple CCPs are counted only once in the total

Source: ESMA calculations

Question 6: Do you have any comment on the analysis presented in Section 4.1?

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

158. In Question 25 of the discussion paper, stakeholders were asked their views on the way ESMA should group the counterparties with the final objective of applying different dates of application for each of them, based on options which are summarised below:
- Option A: a two-level classification relying on the categories of counterparties defined in Article 2(8) and 2(9) of EMIR i.e. financial counterparties and non-financial counterparties;
 - Option B: a three-level classification relying on the categories of counterparties defined in Article 2(8), 2(9) and 2(14) of EMIR i.e. financial counterparties, non-financial counterparties and clearing members;
 - Option C: Create new categories of counterparties based on activity e.g. volume of activity
159. One response suggested that all market participants should have the same phase-in to avoid that competitors become subject to the clearing obligation at different times. However other stakeholders did not support this view and ESMA considers that it would not ensure a smooth implementation of the clearing obligation. Still ESMA agrees with the objective of creating categories of counterparties that are sufficiently homogeneous to avoid competitors being subject to different timetables.
160. The most supported approach was Option B, which according to stakeholders strikes the appropriate balance between the simplicity of relying on existing categories and therefore lowering the compliance costs, and the flexibility of imposing different compliance timelines depending on pre-existing access to clearing, which is the most straightforward criteria in this context.
161. A number of respondents were also supportive of Option C (criteria-based approach). They stressed the fact that the volume of activity is a good indicator of the systemic relevance of the counterparties

and of the resources that they can allocate to prepare compliance with the clearing obligation. However the major drawback of this classification is that it may prove unstable in time, i.e. a counterparty may change from one category to the next during the implementation period, which would bear complex operational consequences, and lack legal certainty.

162. Moreover, this option requires a full reclassification of all counterparties against new quantitative criteria, for the sole purpose of determining the relevant dates of application. It would create an ad-hoc classification that would likely be used only once. Lastly, some respondents noted that it might be challenging to define quantitative criteria that are sufficiently clear to avoid any disputes between counterparties.
163. Based on the above, ESMA is proposing to follow Option B subject to a number of clarifications that are detailed in the following paragraphs for each group. It also has the benefit of limiting the number of categories to enable a simplified and pragmatic implementation period.

4.2.1 Category 1 - Clearing Members

164. As proposed in the discussion paper, ESMA considers that clearing members should be regarded as the group of counterparties that becomes subject to the clearing obligation before the others for obvious reasons: those counterparties are the most active market participants and they already have direct access to the CCPs which clear the OTCD contracts proposed for the clearing obligation. This approach was generally supported by the respondents to the discussion paper.
165. More specifically, stakeholders encouraged ESMA to link the clearing membership to the asset class, because counterparties are not necessarily members of a CCP for all the asset classes that are cleared by a CCP. Rather, there are different sets of clearing members per asset class, and the sets are also different between exchange-traded derivatives (ETD) and OTC derivatives.
166. When drafting the definition of Category 1, ESMA found that the following questions needed to be addressed to determine with certainty if a counterparty falls within that group:
 - which CCP is the counterparty a clearing member of?
 - on which date should the counterparty make the assessment of its clearing membership?
 - for which asset-class is the counterparty a clearing member of this CCP?
167. When answering those questions, ESMA has followed the following principles:
 - (a) the definition should capture a group of counterparties that is small enough to ease the implementation first phase but altogether contribute to a large part of the Class+ market from a systemic risk point of view;
 - (b) the definition should not create a dis-incentive for counterparties to become a clearing member
 - (c) counterparties should have legal certainty on the group to which they belong, and this outcome should be achieved as soon as possible;
 - (d) the outcome of the classification should be straightforward. In particular it should be avoided that a counterparty belongs to different groups of counterparties for different classes;

Definition of the clearing member category

168. To ensure that active counterparties are captured by Category 1, ESMA's proposal is that it encompasses only counterparties which are clearing members of at least one CCP that has been authorised (before a certain date) to clear any of the Class+ covered by the current determination. This means that clearing members for cash instruments, ETD, or OTC contracts that do not fall in the Class+ do not belong to Category 1.
169. This definition covers the two following situations:
- (a) a counterparty could be a clearing member in a Class+ (e.g. interest rate swaps), but only with a CCP that is not yet authorised to clear it. Article 4(3) of EMIR specifies that the OTC derivative contracts subject to the clearing obligation shall be cleared with a CCP that has been authorised to clear this class. Therefore a counterparty that is a clearing member only of a CCP not yet authorised would need to connect to another CCPs to fulfil the clearing obligation. Therefore those counterparties are not included in Category 1 because they have no direct connection to authorised CCPs for any of the Class+.
 - (b) a counterparty could also be a clearing member of an authorised CCP that does not clear any of the Class+ (e.g. KDPW_CCP). Those counterparties are not included in Category 1 because they have no direct CCP connection for any of the Class+.
170. Besides, ESMA is proposing that the CCPs that are relevant for the Category 1 are those which are authorised before the entry into force of the RTS on the clearing obligation. This means that only counterparties that are clearing members of CCPs authorised before this date can belong to Category 1.
171. Another option could have been to consider for Category 1 clearing members of CCPs authorised before a certain date in the past (i.e. a date before the entry into force of the RTS on the clearing obligation). This would have allowed counterparties to assess in advance the category of counterparty to which they belong. However, given that full legal certainty is only achieved for market participants after the entry into force of the RTS, it is legally sound not to introduce a retroactive effect and to consider the date of entry into force of the RTS as a reference point to be compared to the date of authorisation of the CCPs.

Date on which the counterparty should make the assessment of the clearing membership

172. With the clearing obligation gradually entering into force in Europe as well as in other jurisdictions, it is likely that more and more counterparties are or will shortly be in the process of establishing connections with one of more CCPs.
173. A sufficient number of clearing members is essential to ensure that client clearing and indirect client clearing are developed in such a manner that all counterparties subject to the clearing obligation are able to get indirect access to CCPs in due course. The more clearing members (offering client clearing), the more possibilities for clients to get access to clearing, as many stakeholders noted in their responses to the discussion paper. Therefore it would be particularly 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.

174. To achieve this result, ESMA had considered setting the date of assessment of the clearing membership in the past, hence in a manner that avoids dis-incentives to become clearing members. Setting the date of assessment of the membership in the past ensures that counterparties planning to become clearing members in the short term have no incentive to postpone their project. Indeed, those counterparties would not belong to Category 1.
175. However, setting the date of assessment of the clearing membership in the past introduces some retroactivity which should generally be avoided for the purpose of enhanced legal certainty.
176. Therefore ESMA is proposing that the assessment date of the clearing membership is the date of entry into force of the RTS on the clearing obligation.

Asset-class for which the counterparty is a clearing member of the CCP

177. There could be situations where a counterparty is a clearing member of CCP_1 for Class_A, and CCP_1 is only authorised to clear Class_A. The question in this case is whether:
 - Option 1: this counterparty belongs to Category 1 for all the Class+ of the current draft RTS; or
 - Option 2: this counterparty belongs to Category 1 for Class_A, and to another category for Class_B on the basis that it is not a clearing member of any CCP for Class_B.
178. Under Option 1, Category 1 is defined at the level of the RTS: a counterparty belongs to Category 1 when it is the clearing member of any of the CCPs covered by the present determination, for any Class+ of the RTS. Under Option 2, Category 1 is defined at the level of the Class+: a counterparty belongs to Category 1 for Class_A when it is the clearing member for Class_A of any of the CCPs covered by the present determination.
179. This can be illustrated by the following example: IRS in EUR (Class_A) are required to be cleared, and as of the time of publication of this paper they are cleared by three CCPs authorised to clear IRS. IRS in JPY (Class_B) are also required to be cleared, and as of the time of this paper are cleared by two CCPs authorised to clear IRS (Eurex and LCH.Clearnet Ltd). In that example, Nasdaq OMX Clearing AB clears EUR IRS classes but not JPY IRS classes. Therefore, a clearing member of Nasdaq OMX but not being a clearing member of a CCP clearing JPY IRS classes would:
 - Under Option 1: belong to Category 1 for all interest rate swaps
 - Under Option 2: belong to Category 1 for EUR denominated IRS, and belong to another category for JPY denominated IRS
180. Option 2 is more flexible in that it allows making a distinction between counterparties who are already clearing the class on a voluntary basis while with Option 1, Category 1 encompasses counterparties who have an experience in clearing but not necessarily in all the Class+ of the draft RTS. Hence with Option 1, the latter counterparties might need to establish links with other authorised CCP to satisfy the clearing obligation, provided that they are active in other Class+ for which they are not a clearing member. ESMA could take this into account in the definition of the dates of application, by defining a date further in the future with Option 1. In the example above, with Option 1, the counterparty belongs to Category 1 for IRS in JPY although it is not a clearing member in this class.
181. In being more flexible, Option 2 is also more complex: it implies that the same counterparty might belong to different groups of counterparties depending on the Class+. The costs of categorising the

counterparties would be higher. Given that the counterparties would need to know to which group their counterparties belong in order to meet the clearing obligation requirements, this effort might be significant.

182. Finally, given that with Option 2, the clearing members are already clearing the Class+ on a voluntary basis, it would be reasonable to impose in this case a shorter implementation period than if Option 1 was chosen.
183. Against this background, ESMA believes that the level of complexity of Option 2 would result in disproportionate costs that would not be outweighed by the benefits, given that in any case the differences in the dates of application for Option 1 and the one for Option 2 would be limited to a couple of months. The costs of a complex reclassification of counterparties that would only be used once and for the sole purpose of determining the date of application may prove disproportionate.
184. Some respondents to the discussion paper also argue that different dates of application should apply to a counterparty that has never cleared before, and to a counterparty that already clears on a voluntary basis, even in another asset class. The underlying reason is that even though such counterparty would likely not be ready to clear the relevant Class+ on day 1, it has already completed once the full process of on-boarding with a CCP, and that this experience can easily be leveraged when getting access to other CCPs, or to the same CCP but in other asset classes. This is another valid argument in favour of Option 1.
185. Therefore, ESMA's proposed approach is 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+.

4.2.2 Category 2 – Non-Clearing Members

186. Any counterparty that falls in neither Category 1 nor Category 3 belongs to Category 2. This means that Category 2 includes (1) Financial counterparties not included in Category 1 and (2) AIFs qualifying as NFC+ not included in Category 1.

4.2.3 Category 3 – Non-Financial counterparties above the clearing threshold

187. EMIR foresees that a number of requirements apply to non-financial counterparties, and that the clearing obligation applies to non-financial counterparties only when their non-hedging activity in OTC derivatives exceeds a certain threshold. The thresholds per asset class are defined in the RTS on OTC derivatives.
188. In respect of the criteria (e) and (f) to take into account when determining the dates, it is clear that non-financial counterparties above the clearing threshold (NFC+) should be grouped in a category of counterparties to which the longest implementation period would apply. Indeed, from a readiness point of view, those counterparties are usually the most remote from clearing. It is therefore expected that they would need more time to get access to clearing, mainly via client or indirect client clearing. The risk management, as well as the legal and operational capacities of most NFC are expected to be less sophisticated than those of financial counterparties, which justifies the proposal for a longer implementation period.

189. However, with the objective of establishing homogeneous categories of counterparties, ESMA has identified two cases within the NFC+ category that necessitate a more thorough analysis: alternative investment funds and clearing members.

Alternative investment funds that qualify as NFC+

190. The definition of financial counterparties for funds is composed of the two following groups:

- UCITS and, where relevant, its management company, authorised in accordance with Directive 2009/65/EC
- alternative investment fund (“AIFs”) managed by alternative investment fund managers (“AIFMs”) authorised or registered in accordance with Directive 2011/61/EU;

191. It follows that alternative investment funds that do not fulfil the condition of being “managed by AIFMs authorised or registered in accordance with Directive 2011/61/EU” are not captured by the definition of financial counterparties under EMIR. As clarified in General Question 3 and 4 of the Questions and Answers on the implementation of EMIR, this means that some AIFs are classified as non-financial counterparties. This is the case of e.g.:

- EU AIFs referred to in Article 61(3) of AIFMD (i.e. closed-ended AIFs that do not make any investments after 22 July 2013) and in Article 61(4) of AIFMD (i.e. closed-ended AIFs whose subscription period had closed prior to entry into force of AIFMD) that are managed by AIFMs that are exempt from authorisation due to the provisions of Article 61(3) and (4) of AIFMD
- EU AIFs marketed in the Union without a passport by non-EU AIFMs (both below and above the thresholds of Article 3(2) of the AIFMD) under Article 42 of the AIFMD

192. In respect of those AIFs that are classified as non-financial counterparties, ESMA is of the view that the intention of EMIR when creating a specific definition for non-financial counterparty was to capture companies engaging into OTC derivative activities mainly as a hedge for their commercial and treasury financing activity, rather than funds. This is clarified by Recital 20:

It is recognised that non-financial counterparties use OTC derivative contracts in order to cover themselves against commercial risks directly linked to their commercial or treasury financing activities. Consequently, in determining whether a non-financial counterparty should be subject to the clearing obligation, consideration should be given to the purpose for which that non-financial counterparty uses OTC derivative contracts (...)

193. In addition, the criteria for establishing which OTC derivative contracts are objectively reducing risks are further specified in Article 10 of the RTS on OTC derivatives. Among other things, this definition refers to the risks arising from the potential change in the value of assets, services, inputs, products, commodities or liabilities that the non-financial counterparty or its group owns, produces, manufactures, processes, provides, purchases, merchandises, leases, sells or incurs.
194. It is difficult to establish a link between the activity of a fund and those described in the hedging definition, therefore AIFs falling under the NFC category should qualify their OTC trading as “non-hedging”.

195. These elements support the view that NFC+ which are AIFs, and NFC+ which are not AIFs, although falling under the definition of Article 2(8) of EMIR, are two types of entities sufficiently different to be subject to different dates of application for the purpose of the clearing obligation.
196. Based on the above and in accordance with criteria (d) and (f), ESMA's proposal states that alternative investment funds which qualify as NFC+ are included in Category 1 if they are clearing members meeting the relevant conditions, or in Category 2 otherwise.

NFC+ that are clearing members

197. The reason why NFC+ should be given a longer implementation period is to enable this category of counterparties to establish the necessary connections with CCPs or clearing members, as NFC+ generally do not have experience with CCP clearing. However, this argument cannot be considered as valid for NFCs that are clearing members. Those counterparties are already clearing some contracts on a voluntary basis, meaning that their volume of activity in OTC derivative is sufficiently developed to justify the costs of establishing direct connections with CCPs. Some of those NFC clearing members have already established connections with two CCPs.
198. Therefore, ESMA's view is that in respect of criteria (e) of Article 5(5), the period of time a counterparty subject to the clearing obligation needs in order to put in place arrangements to clear OTC derivative contracts with a CCP is the same for NFC clearing members and for FC clearing members. In addition, in respect of criteria (f) of Article 5(5), there are more similarities between the risk management, the legal and operational capacities of NFC clearing members and FC clearing members, than between NFC clearing members and NFC non clearing members.
199. As a result, the criteria "Clearing Member" should prevail on the non-financial/financial status of the counterparties, and clearing members NFC+ should fall within Category 1 if they are clearing members meeting the conditions of this category (see paragraph 185 above);
200. In respect of criteria (d) of Article 5(5), based on the analysis of the clearing members of European CCPs, ESMA found that the only counterparties which are both clearing members and non-financial counterparties are clearing members for the commodity asset class. There are about 35 such companies, of which a limited number have made a notification to ESMA under Article 10(1)(b), therefore the others are likely to qualify as NFC not subject to the clearing obligation. Given that the commodity asset class is not covered by the current consultation and draft RTS, and that the clearing membership is to be assessed at the level of the Class+, it follows that for the current clearing obligation determination, no NFC+ would fall in Category 1.

201. The table below provides a map of the different categories of counterparties defined in EMIR and the three categories described above:

Table 15: Classification of counterparties

Case	FC	NFC+ that are not AIFs	NFC+ that are AIFs
Clearing Member meeting the conditions of Category 1	Category 1 RTS Article 2(1)(a)	Category 1 RTS Article 2(1)(a)	Category 1 RTS Article 2(1)(a)
Clearing Member not meeting the conditions of Category 1, or Non Clearing members	Category 2 RTS Article 2(1)(b)(i)	Category 3 RTS Article 2(1)(c)	Category 2 RTS Article 2(1)(b)(ii)

4.2.4 Third-country entities

Counterparties established in non-equivalent third-countries

202. Contracts entered into by counterparties established in non-equivalent third-countries²⁸ may be indirectly captured by the clearing obligation in application of:

- Article 4(1)(a)(iv) of EMIR: 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;
- Article 4(1)(b) of EMIR: contracts entered into by two counterparties established in non-equivalent third-countries²⁹ have to be cleared if they fulfil the conditions defined in the RTS on the application of EMIR to third country entities.

203. Therefore, third-country entities need to assess the category of counterparty to which they belong, in order to determine the date on which the clearing obligation applies to them. To ensure an equal treatment between counterparties established in the Union and counterparties established in third-countries, the latter should determine the category to which they would belong if they were established in the Union. Therefore, they should apply the same criteria as counterparties established in the EU and answer the following questions:

- if established in the Union, would they be a financial or a non-financial counterparty?
- are they a clearing member?
- if established in the Union, would they be an AIFs qualifying as NFC+?

204. Regarding the last bullet point and in accordance with General Question 3 and 4 of the Q&A on the implementation of EMIR, the following counterparties belong to Category 2 on the basis that if they were established in the Union, they would belong to Category 2 as a “NFC+ that is an AIF”:

²⁸ The case of transactions concluded with counterparties established in equivalent third-country is covered by Article 13(3) of EMIR

²⁹ This provision only applies to contracts entered into by two counterparties established in non-equivalent third-countries, in accordance with Recital (2) of the RTS on the application of EMIR to third-country entities (Regulation (EU) No 285/2014)

- non-EU AIFs referred to in Article 61(3) of AIFMD (i.e. closed-ended AIFs that do not make any investments after 22 July 2013) and in Article 61(4) of AIFMD (i.e. closed-ended AIFs whose subscription period had closed prior to entry into force of AIFMD) that are managed by AIFMs that are exempt from authorisation due to the provisions of Article 61(3) and (4).
- Non-EU AIFs marketed in the Union by non-EU AIFMs (both below and above the thresholds of Article 3(2) of the AIFMD) under Article 42 of the AIFMD

Question 7: Do you consider that the classification of counterparties presented in Section 4.2 ensures a smooth implementation of the clearing obligation? Please explain why and possible alternatives.

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

Feedback from the discussion paper

205. Once the categories of counterparties have been established, ESMA needs to make proposals on the appropriate dates on which the clearing obligation should take effect for each of them (the “dates of application”).
206. In the discussion paper on the clearing obligation, market participants were asked their views on the appropriate timeframe for counterparties to start clearing depending on the pre-existence of an access to clearing. The responses to Question 26 show that:
 - With access: the length of the phase-in could be between 3 and 12 months (with most responses indicating 12 months as appropriate)
 - Without access: the length of the phase-in could be between 6 and 18 months (with roughly the same number of responses indicating 18 and 12 months as appropriate)
207. It is therefore difficult to extract a clear consensus from the answers. If stakeholders generally agree that access to clearing should impact the length of the implementation period, the views are split when it comes to defining the length of the period itself.
208. Some market participants have stressed that, given that the phase-in per counterparty and class will already be a complex process by itself, ESMA should develop clear timelines, with at least 6 months between the different dates of application. ESMA agrees with this principle and considers that the main benefit of a phased-in implementation of the clearing obligation is to avoid the risks of bottleneck when all counterparties start looking for a clearing member at the same time. The smooth implementation of the clearing obligation should be achieved with a minimum of 6 months between the three groups, although this period of time may be adjusted for the next clearing obligation determination, when most counterparties already have an access to clearing.

Date of application for Category 1 - Clearing Member: 6 months after the entry into force of the RTS

209. The date on which the clearing obligation takes effect (hereinafter the “date of application”) for Category 1 needs to take into account the way in which Category 1 is proposed to be designed, i.e. that a counterparty belongs to Category 1 if it is the clearing member of any of the CCPs included in this determination, and for any Class+.
210. The main consequence of this definition is that Category 1 is composed of counterparties which already have an experience in clearing, but not necessarily in all the Class+ described under this consultation. This means that some counterparties in this group are able to start clearing all the classes on day 1, while others will need to establish connections with other CCPs for some Class+, or with CCPs to which they are already connected but in different asset classes, or find some clearing members for some Class+ when they do not intend to be a direct member at certain CCPs for certain Class+.
211. It is ESMA's current understanding, as confirmed by some of the responses to the discussion paper, that a reasonable timeframe for a counterparty to become a clearing member varies from 3 to 6 months.
212. Given the current estimate of the number of counterparties in Category 1 (102 at entity level, 72 at group level), and that some of them will need to make further arrangements for some of the Class+ (e.g. clearing members of CCPs that do not cover the whole scope of the Class+), ESMA is proposing to set the date of application for Category 1 at six months from the entry into force of the RTS on the clearing obligation. It should be noted that there will be a couple of months between this consultation and the entry into force of the technical standards. Although the full legal certainty will only be achieved once the technical standards are endorsed by the Commission and non-objected by the Council and the European Parliament, these additional few months can also be used by counterparties to prepare for the clearing obligation.

Date of application for Category 2: 18 months after the entry into force of the RTS

213. A total of 29 respondents to the discussion paper agree with the approach proposed in Question 27, according to which a key factor to take into account when defining the date of application is the number of clearing members offering client clearing services.
214. In this respect ESMA has gathered information on the clearing members of all the European CCPs and found that, while most clearing members offer client clearing, the offer for indirect client clearing is only at a very early stage. This is analysed in detail in section 4.1.2 above.
215. Therefore ESMA concludes that the number of clearing members offering client clearing is already sufficiently developed in all the Class+, and that there is no need to consider an implementation period that would be disproportionately longer than the one proposed for Category 1.
216. However, given that of the 3 groups, Category 2 is probably by design the most heterogeneous one in terms of types of counterparties, ESMA is proposing to set a date of application for this group that provides sufficient flexibility for all counterparties including those who are less active in the market and whose legal and operational capacities are less sophisticated.

217. Having also in mind the objective of providing sufficient time between two categories of counterparties to start clearing, ESMA is proposing to set the date of application for Category 2 at eighteen months from the entry into force of the RTS on the clearing obligation.

Date of application for Category 3: 3 years after the entry into force of the RTS on the clearing obligation

218. Since the entry into force of the RTS on EMIR on 15 September 2013, non-financial counterparties have started to notify their competent authorities and ESMA when they are above, and no longer above, the clearing threshold. Excluding the AIFs qualifying as NFC, as well as the non-financial subsidiaries of financial groups, the number of "pure" NFC+ is fairly limited and currently amounts to less than a hundred companies, mainly in the energy sector.
219. Besides, one should remember that Commissioner Michel Barnier mentioned in the EU Parliament that the "Commission is prepared to make sure that, when it adopts its decisions on mandatory clearing for specific classes of OTC derivatives, the obligation for non-financial firms to clear will be phased-in over an appropriate period of time. Such a phased-in period could be similar to the one proposed in the technical standard for bank guarantees"³⁰ (i.e. 3 years).
220. In view of the number of counterparties in this category, as well as their low experience with central clearing, ESMA is proposing to set the date of application for Category 3 three years after the entry into force of the RTS on the clearing obligation.
221. This extensive delay of implementation for NFC+ does not pre-empt further decisions on subsequent clearing obligation determinations.

Question 8: Do you consider that the proposed dates of application ensure a smooth implementation of the clearing obligation? Please explain why and possible alternatives.

³⁰ European parliament debates on 7 February 2013

<http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+CRE+20130207+ITEM-005-05+DOC+XML+Vo//EN>
See also: 7 February 2013, statement by Commissioner Michel Barnier on the technical standards to implement the new rules on derivatives:

http://ec.europa.eu/commission_2010-2014/barnier/docs/speeches/20130207_emir_en.pdf

5. Remaining maturity and frontloading

5.1 Frontloading

Feedback from the discussion paper

222. The frontloading requirement as foreseen by Article 4(1)(b)(ii) of EMIR is the obligation to clear the OTC derivative contracts (pertaining to a class of OTC derivatives that has been declared subject to the clearing obligation) that are entered into after the notification as referred to in Article 5(1) and before the date of application of the clearing obligation³¹.
223. The compliance with this requirement has been identified by stakeholders as particularly challenging from a legal and operational point of view, mainly because of the pricing uncertainty that it creates.
224. Indeed, a transaction that is centrally cleared is subject to a different collateral regime than a transaction that is not, and this has a significant impact on pricing. 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. This pricing uncertainty may have a number of effects such as a widening of the bid-offer spreads, difficulties or dis-incentive for counterparties to appropriately manage their risks, which may eventually reduce market stability.
225. A total of 19 respondents to the discussion paper explained that frontloading poses a number of legal, operational and practical issues to market participants for the following reasons:
- it may lead to pricing uncertainty for trades executed within the frontloading window, in proportion to the length of the frontloading window, the likelihood that the clearing obligation is imposed in this asset class and the maturities of the OTC derivative contracts (the longer the maturity, the higher the impact).
 - the inability to accurately price OTC derivative contracts may reduce market certainty and discourage end-users from comprehensively managing their risk. It may increase systemic risk and reducing market stability.
 - the number of transactions entered into during the frontloading period is most likely not large enough to have an impact on systemic risk in the long run.
226. A number of market participants seemed to hold the opinion that frontloading is merely an option that ESMA may or may not use. In this respect, it should be noted that frontloading is a Level 1 requirement, and that the use of the remaining maturity of the contract was only presented in the

³¹ In accordance with EMIR Article 4(1)(b), the clearing obligation applies to contracts entered into or novated either:

- (i) on or after the date from which the clearing obligation takes effect; or
- (ii) on or after notification as referred to in Article 5(1) but before the date from which the clearing obligation takes effect if the contracts have a remaining maturity determined by the Commission in accordance with Article 5(2)(c).

discussion paper as an option to be explored in order to alleviate to a certain extent the impact of the frontloading requirement.

227. Stakeholders have proposed a number of solutions to minimise the impact of frontloading, including:
- (a) setting the minimum remaining maturity of the contract above that of the OTC derivative product subject to the clearing obligation with the longest maturity.
 - (b) informing market participants of the minimum remaining maturity immediately after the frontloading start date. This would allow market participants to anticipate, as soon as the first CCP is authorised, the contracts which are likely to be subject to frontloading and would minimise the price uncertainty.
 - (c) clarifying that in the event that clearing of a class is (i) not mandated under the initial 6 month review by ESMA and (ii) subsequently mandated after another CCP has been authorised to clear the same class, the frontloading date will be the date on which the authorisation was given to the second CCP, i.e. the CCP in respect of which the clearing obligation was made.
 - (d) clarifying that when it has determined that a class is not subject to the clearing obligation after 6 months, any subsequent determination of a clearing obligation by ESMA in exercise of its own initiative should not be subject to any frontloading and should apply only upon the adoption of the relevant regulatory technical standards.
 - (e) ESMA should define the classes with a high level of granularity so that if a CCP clears only Currency A, it does not trigger the frontloading requirement for all the currencies.

ESMA's response

228. Following the discussion paper, there has been significant progress on the clarification of frontloading, and the mitigation of the risks associated to it.
229. On 20 December 2013, ESMA has published a new Q&A (OTC Question 17) which clarifies and confirms the points (c) and (d) which had been raised by market participants.
230. The proposal under (b) could not be achieved because the minimum remaining maturity is a parameter that has to be set in the RTS, in accordance with the formal process associated to it. Anticipating on the outcome of such procedure would have introduced a risk of creating false expectations and confusion.
231. The proposal under (e) can be considered as being fulfilled without any further action from ESMA. Indeed the classes are defined with a sufficient level of granularity, preventing that frontloading is triggered in a broad manner by a single CCP authorisation. For example, the authorisation on 18 March of the first CCP clearing OTC derivatives (Nasdaq OMX Clearing AB) triggered frontloading only for the classes for which this CCP is authorised, and this includes a selected set of currencies.
232. The proposal under (a) has been further analysed by ESMA together with the other European institutions involved in the process. As a result, on 8 May 2014, ESMA has sent a letter to the

European Commission³² advancing its intention to ease certain frontloading requirements under EMIR. The objective of the letter was to inform the European Commission of ESMA's intention to establish the frontloading requirement in a manner that will minimise uncertainty.

233. Before going into the technicalities of this approach, the following paragraphs clarify the situation of non-financial counterparties with regards to the frontloading requirement.

Frontloading and non-financial counterparties above the clearing threshold

234. Article 10(1) of EMIR establishes that when a non-financial counterparty takes positions in excess of the clearing threshold it shall:

- (a) immediately notify ESMA and its competent authority
- (b) become subject to the clearing obligation for future contracts in accordance with Article 4 if the rolling average position over 30 working days exceeds the threshold; and
- (c) clear all relevant future contracts within 4 months of becoming subject to the clearing obligation

235. In terms of sequencing, it follows from Article 10(1)(b) that NFC cannot “become subject to the clearing obligation” in the absence of a clearing obligation. This means that for the purpose of this article, NFC can only become subject to the clearing obligation on or after the date on which the obligation is created, which is the date on which the clearing obligation takes effect for the category of counterparty to which that counterparty belongs (the date of application).

236. In addition, the reference to “future contracts” should be understood as meaning: entered into or novated on or after the date on which the counterparty becomes subject to the clearing obligation.

237. It follows that for NFC, no contract concluded before the date of application can be subject to the clearing obligation. Given that the frontloading requirement of Article 4(1)(b)(ii) applies to contracts entered into before the date on which the clearing obligation takes effect (i.e. the date of application for the relevant category of counterparty), it follows that frontloading is not applicable to contracts for which at least one of the counterparty is a non-financial counterparty.

General approach on frontloading

238. As explained in a letter to the European Commission dated 8 May 2014³³, 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).

³² http://www.esma.europa.eu/system/files/2014-483_letter_to_european_commission_re_frontloading_requirement_under_emir.pdf

³³ ESMA/2014/483 available at

http://www.esma.europa.eu/system/files/2014-483_letter_to_european_commission_re_frontloading_requirement_under_emir.pdf

239. 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.
240. In addition, it would be operationally burdensome for counterparties to evaluate the beginning of Period A for all their transactions, because of the level of granularity used to define the classes, implying that there may be several frontloading start dates within the same class. Taking the example of the Fixed-to-float class, the frontloading start would be 18 March 2014 (notification for Nasdaq OMX), 14 April 2014 (notification for Eurex Clearing) or 12 June 2014 (notification for LCH.Clearnet Ltd) depending on the currencies and underlying indices.
241. In contrary, as of the start of Period B, which is the same for all the classes of the RTS, counterparties have legal certainty on the contracts which are subject to the clearing obligation, on the dates from which the clearing obligation takes effect and on the CCPs available to clear the relevant classes of derivatives.
242. Therefore, as anticipated in the letter to the European Commission, the approach that ESMA is proposing for frontloading ensures that no contract entered into during Period A is subject to frontloading, while the contracts entered into during Period B may be subject to frontloading under some conditions.

5.2 Minimum remaining maturity of the contracts

243. Article 5(2)(c) of EMIR requires ESMA to specify in the draft RTS the “minimum remaining maturity of the OTC derivative contracts referred to in Article 4(1)(b)(ii)”. As a naming convention those OTC derivative contracts will be referred to as “the frontloaded contracts”.
244. For the sake of clarity, it is reminded that the “remaining maturity” of the contracts referred to in Article 4(1)(b)(ii) of EMIR, to be compared to the “minimum remaining maturity”, is the maturity of that contract as of the date of application of the clearing obligation for this contract and for this counterparty.
245. In order to achieve the legal certainty during Period A as mentioned above, ESMA is proposing to divide the frontloaded contracts into two sets -- depending on the date on which they were concluded -- to which different minimum remaining maturities would apply. In view of the date of application for Category 3 (NFC), ESMA is also proposing to adapt the minimum remaining maturity for this category. This proposal is further explained below.
246. For contracts concluded in Period A, the minimum remaining maturity is set at a level which ensures that no contract is subject to frontloading. In practise, this is achieved by setting a minimum remaining maturity per class of OTC derivatives, at a level equal to the maximum maturity of the contracts of this class minus the length of the implementation period of Category 1 (i.e. 6 months). For example, the maximum maturity of the contracts falling under the Basis swap class being 50 years, and the implementation period for Category 1 being 6 months, the resulting minimum remaining maturity for this class is set at 49 years and 6 months.
247. For contracts concluded in Period B, the remaining maturity is set at a meaningful level that ensures that contracts which are close to expiration on the date of application of the clearing obligation, are not required to be cleared. It is reminded that this was the original purpose of defining a minimum remaining maturity for the contracts subject to frontloading.
248. In the responses to the discussion paper, specifically to the question 28, the proposals for the calibration of the minimum remaining maturities ranged from 1 month to 3 years without a clear consensus for one or the other side of the range. Among those few responses, the median answer was found to be 12 months.
249. Setting a relatively low remaining maturity is of particular importance to ensure equal treatment between contracts belonging to the classes with long maximum maturities (e.g. basis swaps, fixed-to-float class and OIS class) irrespective of whether they were concluded before or after the publication in the Official Journal of the RTS. Indeed, absent such minimum remaining maturity, a 50-year contract entered into 1 week before the date of application of the clearing obligation would not be brought to central clearing although it may still pose systemic risk for the next 50 years, while the same contract entered into one week after, which is not fundamentally different, would be required to be centrally cleared.
250. For the sake of simplicity ESMA is proposing to adopt a unique minimum remaining maturity for contracts concluded during Period B, and therefore to set the parameter at a level which is proportional to the smallest maturity of the mandatory classes.

251. Based on the above, ESMA considers that contracts concluded during Period B with more than 6 months before expiration on the date of application of the clearing obligation should be subject to frontloading.

Question 9: Do you consider that the proposed approach on frontloading and the minimum remaining maturity ensures that the uncertainty related to this requirement is sufficiently mitigated, while allowing a meaningful set of contracts to be captured? If not, please explain why and provide possible alternatives compatible with EMIR.

6. OTC equity derivative classes that are proposed not to be subject to the clearing obligation

6.1 Feedback from the discussion paper on the OTC equity derivative classes

6.1.1 Structure of the equity classes

Feedback from the discussion paper

252. In the responses to Question 12 of the discussion paper on the clearing obligation, it appears that market participants mostly disagreed with the structure of OTC equity derivatives that was proposed by ESMA, with only 5 respondents (15% of those who commented on the equity section) supporting the structure of the classes as presented in the paper.
253. One of the most cited problem is that the tables are misleading and do not reflect the actual clearing offer in equity, because for the time being the CCP-cleared equity derivatives are limited to lookalike contracts traded on MTF and flexible options and futures negotiated off an order book. Stakeholders stress that this is not representative of the availability of clearing solutions for equity OTC Derivatives, and that central clearing is not available for “true” OTC equity transactions, which represent the bulk of the market.
254. Some stakeholders explain that given that clearing in OTC equity derivatives is not well established, it would make sense to reserve judgement for the moment on how ESMA might categorise and apply the clearing obligation to equity derivatives.
255. A number of respondents also explain that the proposed approach departs from market practise, and that ESMA should base its classification on taxonomies already agreed by market participants.
256. ESMA believes that the high number of additional characteristics proposed by market participants is a relevant indication that the degree of standardisation of this asset class is still low. The answers to the consultation proposed the addition of the following characteristics:
- Bespoke trading terms e.g. dividend election methodology or calculation process;
 - Availability of the contracts on regulated markets and MTF;
 - Capitalisation of the issuer, size of the issuer free float;
 - Complex versus simple derivative: this could be measured by the number of customisable parameters (e.g. settlement period, roll frequency, roll date);
 - Option style;

- Market pricing (open/closing);
- Transaction type (e.g. options, CFD, swaps/forward);
- Settlement currency type (single or multiple) e.g. quanto or compo equity derivatives where the underlying currency is different than the payoff currency behave differently and have different liquidity than equity derivatives which do not entail currency risks;
- Role date and roll frequency.

Way forward

257. ESMA is not proposing at this stage to submit any equity classes to the clearing obligation, therefore it will be possible to further consult on the appropriate structure of the equity classes in subsequent clearing obligation determination. This being said, ESMA is already taking into account the feedback received on the structure of the equity classes and acknowledges reviewing the approach initially envisaged.
258. In particular, it is understood that the three main segments of the equity derivative markets are (1) exchange-traded contracts (2) CCP-cleared contracts, i.e. usually contracts traded on MTF or flexible contracts that replicate, partially or completely, exchange traded contracts, and (3) “pure” OTC contracts, usually highly bespoke, customisable and thus less offered for clearing due to a lower level of standardisation.
259. It appears that the clearing offer in OTC equity derivative is currently limited to the second segment of the above classification, and this should indeed be reflected in any clearing obligation determination. Historically, there has been a tendency of some contracts migrating from being purely OTC to becoming more standardised and hence more easily CCP-clearable. A recent example cited by an ISDA study on central clearing for equity derivatives³⁴ is dividend swaps which migrated from pure OTC contracts to exchange-traded contracts exhibiting a high level of liquidity. This should also be taken into consideration when reflecting on the clearing obligation for equity derivatives.
260. More specifically on the structure, ESMA notes the importance of splitting the classes at least on the basis of the product type (corresponding to the “base product” of the ISDA standardisation matrix e.g. equity swaps, variance swaps, dividend swaps, options, CFD). Another crucial characteristic is that derivatives on indices, single names and baskets would typically not be part of the same classes in accordance with market practise.

Classification of single name equities

261. The proper way to structure a class on single name equities remains a complex issue which was discussed under Question 10 of the discussion paper. ESMA proposed the four following options:
- (a) identify in the Class+ the set of single names subject to the clearing obligation, for example using an entity identifier;

³⁴ “Central clearing in the Equity derivative market” available at: <http://www2.isda.org/functional-areas/research/studies/>

- (b) define the single name entities using a reference to more stable variables, such as the membership to a specific index;
 - (c) introduce a cross-reference to the list of “liquid shares” as defined in MiFID, for the underlying of the OTC equity derivatives;
 - (d) adopt a criteria-based approach, whereby ESMA would use a list of criteria that the classes should fulfil to fall within the scope of mandatory clearing.
262. There was little support for Option A and no clear consensus in the responses regarding the three other options. Option D would be the most difficult to put in practise for reasons of legal feasibility: the RTS on the clearing obligation should define the Class+ with appropriate legal certainty and this would hardly be achieved by setting criteria in the RTS, which criteria would then need to be evaluated outside the framework of the RTS.
263. The reference to the list of MiFID liquid shares found some support as it brings an suitable level of certainty to market participants: it avoid interpretation issues, it is stable and easy to implement, it is unique in Europe and updated once a year (i.e. at a lower frequency than that of indices), and therefore it strengthens the European regulatory framework by minimising the number of definitions.
264. However ESMA acknowledges that this list should not be used as such as it is likely to encompass contracts that do not meet e.g. the conditions on liquidity to support a clearing obligation, as illustrated with numerical examples in the ISDA study on central clearing for equity derivatives mentioned before. Rather, this MiFID list of liquid shares may serve as way to define the primary universe of single names to be considered for the clearing obligation, on which further criteria should be added.

6.1.2 Best candidate for the clearing obligation

Feedback from the discussion paper

265. In Question 10, ESMA asked for feedback on the equity classes that are considered best suited for the clearing obligation. Most respondents consider that generally speaking, equity OTC derivatives are not suitable for the clearing obligation, or at least not in priority, mainly because the clearing of OTC equity derivatives is not well established and because the equity derivatives market is predominantly exchange-based, therefore the contacts which continue to be traded OTC are generally sophisticated and/or bespoke products.
266. However some indicate that, should a clearing obligation be considered on Equity products in the medium term, vanilla products on single names and European indices may come first, followed by variance and volatility swaps. Others indicate that there is a fair amount of OTC equity (and commodity) derivatives which are sufficiently standardised to be subject to the clearing obligation because they are mirroring exchange-traded contracts.

Way forward

267. ESMA has not yet been notified of all the equity classes currently cleared by European CCPs (please refer to Table 1) and is proposing below an analysis of the equity classes it has been notified at the time of publication of this paper, i.e. the ones cleared by Nasdaq OMX Clearing AB and LCH.Clearnet Ltd.

6.2 Equity OTC derivative classes notified to ESMA

268. On 18 March 2014 Finansinspektionen has notified ESMA of a number of equity OTC derivative classes which Nasdaq OMX Clearing AB is authorised to clear.
269. On 12 June 2014, the Bank of England has notified ESMA of a number of equity OTC derivative classes which LCH.Clearnet Ltd is authorised to clear.
270. The details of those classes are available in the public register for the clearing obligation³⁵.

Characteristics of the equity classes cleared by the Nasdaq OMX Clearing AB

271. Nasdaq OMX Clearing AB is clearing vanilla equity derivatives in four different currencies (EUR, DKK, NOK, SEK) for maturities comprised between 1 day and 5 years. In terms of underlying assets, Nasdaq OMX Clearing AB is clearing equity derivatives on single names, baskets as well as the following indices: the OMX Stockholm 30 (OMXS30) in SEK, the OMX Copenhagen 20 CAP (OMXC20CAP) in DKK, the Nordic VINX30 in EUR, the Norwegian OMXO20 in NOK and the OMX Stockholm Benchmark (OMXSBGI) in SEK.
272. The CCP offer in OTC equity derivatives is limited to contracts that are replicating, up to a certain extent, contracts traded on a regulated market. The CCP refers to those contracts as “tailor-made contracts” and they cover both *lookalikes* to the listed contracts and *flexible* contracts³⁶.
273. A *lookalike* contract can be defined as a OTC contract which has the same characteristics as one particular exchange-traded contract, so that once cleared the two contracts may become fungible. In accordance with OTC Question 1(b) of the Q&A on EMIR available on ESMA’s website, lookalike contracts should be considered OTC derivatives for the purpose of EMIR, because the definition of OTC derivatives included in Article 2(7) of EMIR explicitly refers to the place of execution on the contract: ‘OTC derivative’ means a derivative contract the execution of which does not take place on a regulated market in accordance with Article 19(6) of MiFID.
274. A *flexible* contract can be defined as a contract that is mirroring an exchange-traded product while adding a possibility to customise some of the standard characteristics of a listed product to adequately fit the needs of the customers, and which is traded OTC. The flexible contracts proposed by Nasdaq OMX Clearing AB offer the possibility to customise the following characteristics: the strike price, the option type (vanilla or binary), the expiration day, month and year, the exercise style (European or American), the settlement type (cash or physical delivery) and the underlying

³⁵ 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>

³⁶ <http://www.nasdaqomx.com/europeanclearing/products/tailor-made-clearing>

security³⁷. Once cleared, those flexible contracts are not fungible with the exchange-traded or lookalike contracts.

275. Those tailor-made contracts, both flexible and lookalike, are designed by the CCP for customers wishing to keep the flexibility of the OTC market while benefiting from the security and efficiency of the processes of the regulated market. The counterparties concluding such contracts are able to benefit from services such as corporate action surveillance, recalculation handling, cross margining between OTC and contracts traded on a regulated market, as well as post-trade information in the CCP clearing system.
276. It appears that the offer of services for those contracts did not emerge from the OTC market itself, but that it was developed by the exchange for counterparties wishing to use exchange-traded derivatives (hence cleared contracts) while benefiting from additional flexibility.

Characteristics of the equity classes cleared by LCH.Clearnet Ltd

277. The OTC equity classes cleared by LCH.Clearnet Ltd are Contract for difference (“CFD”) executed on Chi-X which operates an MTF.
278. The clearing offer is composed of CFD on single stocks – there are 1795 single stock underlying stocks denominated in EUR, GBP and USD. Although the CCP has been authorised also to clear CFD on indices, it is not currently clearing any of them.

6.3 Analysis of the criteria for the clearing obligation

279. In accordance with Article 5(4) of EMIR, when assessing the relevance of the clearing obligation on the notified classes against the objective of the reduction of systemic risk, ESMA has taken into consideration the following criteria:
 - Criteria 1: level of standardisation of the contractual terms and the operational processes – EMIR 5(4)(a) and RTS on OTC derivatives 7(1)(a) and (b)
 - Criteria 2: volume and liquidity of the class – EMIR 5(4)(b) and RTS on OTC derivatives 7(2)(a) to (d)
 - Criteria 3: availability of fair, reliable and generally accepted pricing information – EMIR 5(4)(c) and RTS on OTC derivatives 7(3)
280. For the Equity OTC derivative classes cleared by Nasdaq OMX Clearing AB and LCH.Clearnet Ltd, those criteria are assessed in the following paragraphs.

³⁷ http://www.nasdaqomx.com/digitalAssets/80/80314_standardtmpolicy120523.pdf

6.3.1 Criteria 1: level of standardisation

6.3.1.1 Criteria 1(a): level of standardisation of the contractual terms – EMIR 5(4)(a) and RTS 7(1)(a)

Equity OTC derivative classes cleared by Nasdaq OMX

281. As explained in more detail in paragraphs 273 and 274, Nasdaq OMX Clearing AB is clearing two types of OTC equity derivative contracts, *lookalikes* to the listed contracts and *flexible* contracts, which both replicate to some extent derivative contracts which are traded on exchange.
282. Lookalikes contracts are by definition highly standardised since they replicate exactly some contracts traded on exchange, and the only difference between the two is the place of execution. In this respect all the contract terms are fully standardised and can be consulted in the documentation available on the CCP website.
283. Flexible contracts offer the possibility to modify some of the characteristics of the exchange-traded contracts, but this flexibility is limited to a relatively narrow set of characteristics which are: the strike price, the option type (vanilla or binary), the expiration day, month and year, the exercise style (European or American), the settlement type (cash or physical delivery) and the underlying security³⁸. The level of standardisation of those contracts is the same as exchange traded contracts in the sense that they have common characteristics, however the values that those characteristics can take are non-standards for flexible contracts (e.g. the expiration date does not need to match the one set by the exchange).

Equity OTC derivative classes cleared by LCH.Clearnet Ltd

284. LCH.Clearnet Ltd clears OTC CFDs which enable market participants to trade cash equity orders against CFD. The contracts are based on the underlying traded. CFD are relatively simple derivative contracts that allow investors to get a delta-one exposure long or short to financial instruments (equity in this case) without actually buying or selling the underlying asset.
285. As presented in the document available on LCH.Clearnet Ltd website³⁹, there is a total of ten contract terms defined in the reference document, such as the contract quantity, which defines the number of units of underlying bought or sold under the contract, the underlying instrument, and the exchange on which this underlying is listed. Therefore it appears that the terms of the CFD contracts exhibit a high level of standardisation.

³⁸ http://www.nasdaqomx.com/digitalAssets/80/80314_standardttmpolicy120523.pdf

³⁹ http://www.lchclearnet.com/Images/cccfid_contract_terms_tcm6-56495.pdf and page 235 of the CCP's general rules available at http://www.lchclearnet.com/Images/General%20Regulations_tcm6-43737.pdf

6.3.1.2 Criteria 1(b): Level of standardisation of the operational processes – EMIR 5(4)(a) and RTS 7(1)(b)

Equity OTC derivative classes cleared by Nasdaq OMX

286. The equity OTC derivatives cleared by Nasdaq OMX Clearing AB are handled in the same technical infrastructure that is used for all cleared positions at the CCP.
287. As indicated in the CCP notification, the clearing information is available to members via the Genium INET interface or via communication protocols. The following communication protocols are available:
- OMnet API: a proprietary communication protocol that offers full access to clearing functionality as well as price information on Genium INET.
 - FIX: the Genium INET FIX 4.4 protocol offers some clearing functionality, such as allocations.
288. In addition to the information received by the clearing members in the system or via the communication protocols, the CCP publishes on the member extranet IT information and IT guidelines (for example the OMNet API protocol).⁴⁰
289. However this information only stands for contracts cleared with Nasdaq OMX Clearing AB, and it is unclear that equivalent contracts traded on a pure bilateral basis would be subject to equivalent standardised operational processes.

Equity OTC derivative classes cleared by LCH.Clearnet Ltd

290. As indicated in the CCP notification, all CFD trades executed on Chi-X are received via FIX protocol electronically according to FIX 4.4 in real time. OTC CFDs are executed in a generic and standardised manner via electronic execution platforms. The CCP provides a standard fix interface to clear CFD trades which is based on the underlying instrument, i.e. CFDs on cash equities use the standard used in EquityClear.
291. According to the ISDA standardisation matrix for Equity⁴¹, roughly 60% of the volume on OTC CFD is subject to voice execution while the remaining 40% of the volume is executed electronically via a platform. However this matrix was not updated since June 2013, and it is based on data collected in Q3 and Q4 of 2012.
292. In summary, although there is no evidence on whether equivalent trades in these classes exist in an uncleared otc form and would benefit from the level of standardisation described above, the lookalike and flexible classes cleared by Nasdaq OMX as well as the CFDs cleared by the LCH Clearnet Ltd seem to leverage relatively standard sets of parameters and processes.

⁴⁰ http://nordic.nasdaqomxtrader.com/memberextranet/genium_inet/connectivity_and_protocols

⁴¹ The ISDA standardization documents are available at: <http://www2.isda.org/functional-areas/infrastructure-management/g20-objectives/g20-standardization-documents/>

6.3.2 Criteria 2: Volume and liquidity of the class – EMIR 5(4)(b)

293. In relation to the volume and liquidity of the classes of OTC derivatives, the RTS on OTC derivative further specify four criteria that ESMA shall take into consideration when assessing the suitability of a class to the clearing obligation. The four criteria are analysed below.

6.3.2.1 Criteria 2(a): Margins – EMIR 5(4)(b) and RTS 7(2)(a)

294. ESMA shall take into consideration whether the margins or financial requirements of the CCP would be proportionate to the risk that the clearing obligation intends to mitigate.
295. As explained in more detail above, the equity OTC derivatives cleared by the two CCPs are of a specific nature, because some of them mirror exchange-traded derivatives and others (the CFDs) are delta-one, vanilla equity derivatives which prices are very closely connected to those of the underlying cash equity. In this respect, the models that the CCPs are using to calculate the margins are very similar to those which are used to calculate the margins of the exchange-traded derivative contracts which are also cleared by the CCP.
296. The risk models and suitability of the resulting margins which are called from users have been thoroughly assessed and validated during the authorisation process of the CCPs, by the relevant competent authority in cooperation with the other members of the college including ESMA.
297. Therefore there is no indication that the principle of proportionality between the current margins and financial requirements of the CCPs, and the risk that the clearing obligation intends to mitigate, would not be achieved.

6.3.2.2 Criteria 2(b): Stability of the market size and depth – EMIR 5(4)(b) and RTS 7(2)(b)

298. ESMA shall take into consideration the stability of the market size and depth in respect of the product over time.
299. By doing so, ESMA should seek to gather data on the market as a whole, as opposed to data on the contracts that are currently cleared by the CCP. Although it was possible to gather data on the volume of cleared contracts, the same does not necessarily hold for equivalent uncleared contracts.
300. With the reporting obligation to Trade Repositories (“TRs”) established since 12 February 2014, ESMA is now building the necessary tools to process and aggregate data collected from TR. Data reported to TRs should be taken into consideration by ESMA at a later stage.
301. Regarding more specifically the equity OTC derivative classes cleared by Nasdaq OMX Clearing AB, it is unclear at this stage that contracts which are strictly equivalent to those cleared by Nasdaq OMX Clearing AB (i.e. contracts which fall within the notified classes as presented in the public register) exist on a pure bilateral OTC basis (hence not cleared), and if they do, what would be the consequence of a clearing obligation on the stability of the market size and depth in respect of those products over time.

6.3.2.3 Criteria 2(c): Market dispersion – EMIR 5(4)(b) and RTS 7(2)(c)

302. ESMA shall take into consideration the likelihood that market dispersion would remain sufficient in the event of the default of a clearing member.
303. ESMA has determined that Nasdaq OMX Clearing AB currently has 42 clearing members for the equity derivative market, and that LCH.Clearnet Ltd has 36 clearing members for the equity derivative market. Removing duplicates (i.e. counting only once the 16 entities that are clearing members of those two CCPs for the equity asset class), the total number of clearing members is 62. These clearing members include large and international banks which are also connected to a number of other CCPs.
304. In the absence of sufficient data to precisely evaluate the size of the whole market it is difficult to draw a conclusion on the consequence of the clearing obligation on market dispersion at this stage. However, based on the size of the equity market cleared by the two CCPs and on the potential size of the OTC market on those classes (see more detail on criteria 2(d) below), there is a satisfactory likelihood that market dispersion would remain sufficient in the event of the default of a clearing member.

6.3.2.4 Criteria 2(d): Number and value of the transactions – EMIR 5(4)(b) and RTS 7(2)(d)

305. ESMA shall take into consideration the number and the value of the transactions. For the reasons explained in paragraphs 299 and 300 in respect of the criteria 2(b), this criteria is difficult to evaluate at this stage given the absence of data at a sufficiently granular level, i.e. the level of the class for which a clearing solution exists as opposed to the contracts which are currently cleared on a voluntary basis.
306. However, ESMA is providing below an assessment of the liquidity, starting from the equity asset class in general and going down into further granularity.
307. The latest statistics from the Bank for International Settlement (BIS) are useful to get insight on the systemic relevance of the equity asset class relative to the other asset classes. As shown in Table 16 and Table 17 below, the equity asset class represents a limited share of the OTC derivative market: it accounts for 1% of the total as measured by outstanding notional amounts, and 3.4% of the total as measured by gross market value.
308. It is reminded that these considerations, among other things, supported the view set out by ESMA in the discussion paper on the clearing obligation⁴² that the equity asset class may not be given the highest priority for the clearing obligation, as opposed to the interest rate and the credit asset classes. This view was widely supported by stakeholders in their responses to the consultation.

Table 16: Notional amounts outstanding in OTC derivatives, per asset class

⁴² “The Clearing Obligation under EMIR”, Discussion Paper, ESMA-2013-925 published on 12 July 2013 and available at: <http://www.esma.europa.eu/content/Clearing-Obligation-under-EMIR>

<i>as of December 2013</i>	Notional Amounts Outstanding (trillion of USD)	% of total
Foreign exchange contracts	70.6	9.9%
Interest rate contracts	584.4	82.3%
Equity-linked contracts	6.6	0.9%
Commodity contracts	2.2	0.3%
Credit default swaps	21.0	3.0%
Unallocated	25.5	3.6%
TOTAL	710.2	100%

Source: BIS semi-annual OTC derivatives statistics

Table 17: Gross market values in OTC derivatives, per asset class

<i>as of December 2013</i>	Gross Market Values (trillion of USD)	% of total
Foreign exchange contracts	2.3	12.2%
Interest rate contracts	14.0	75.2%
Equity-linked contracts	0.7	3.8%
Commodity contracts	0.3	1.4%
Credit default swaps	0.7	3.5%
Unallocated	0.7	3.8%
TOTAL	18.7	100%

Source: BIS semi-annual OTC derivatives statistics

309. However the clearing obligation should be assessed at a more granular level, i.e. at the level of the classes that the CCP is authorised to clear.
310. The BIS data provides additional granularity in terms of geographical zone of the underlying equities. As shown in Table 18, equity OTC derivatives on European equities account for a little more than 40% of the total, while US equities account for another 30%. Although the data does not go down to the level of the currency, it is reasonable to assume that a substantial portion of those contracts are thus denominated in EUR, GBP and USD.

Table 18: Notional amounts outstanding for the equity asset class per geographic zone

<i>as of June 2013</i>	Notional Amounts Outstanding in millions of US dollars						
	Total	US Equities	Japanese Equities	European Equities	Latin American Equities	Other Asian Equities	Other Equities
Forwards and swaps	2,320,572	722,372	94,902	1,070,410	78,425	86,554	267,909
Options	4,500,834	1,359,727	615,018	1,875,869	51,275	252,192	346,753
Total	6,821,406	2,082,099	709,920	2,946,279	129,700	338,746	614,662
% of Total	100.0%	30.5%	10.4%	43.2%	1.9%	5.0%	9.0%

Equity OTC derivatives classes cleared by Nasdaq OMX Clearing AB

311. The index equity classes cleared by Nasdaq OMX Clearing AB are denominated in SEK, DKK, NOK and EUR, but the only EUR-denominated index contract is based on the Nordic VINX30, which is

not one of the most active European indices. As an illustration, the open-interest on options and futures on the VINX30 were reported to be zero by Nasdaq OMX Clearing AB as of February 2014⁴³. The CCP notification confirms that there has been limited CCP activity on EUR single stocks and no activity on VINX30 in 2013.

312. Based on the above considerations, the OTC equity derivative contracts that may fall within the classes notified by Nasdaq OMX Clearing AB is likely to represent significantly less than 0.43% (in notional amounts outstanding) or 1.5% (in gross market value) of the total OTC derivative markets. However this number needs to be considered together with all the other relevant criteria for the clearing obligation and the estimated number of the share of the OTC market in itself is insufficient to conclude that the clearing obligation is not necessary.

Equity OTC derivatives classes cleared by LCH.Clearnet Ltd

313. According to the ISDA study on central clearing for equity derivatives, the notional outstanding of OTC CFD amounts to \$44 billion at the end of 2013, which compared to the total notional outstanding published by the BIS for OTC equity derivatives amounts to less than 1%. At the end of 2012, the notional outstanding of OTC CFD was reported to be around \$32 billion in the equity standardisation matrix published by ISDA.
314. Based on the above, the CFD OTC equity derivative classes notified by LCH.Clearnet Ltd are likely to represent significantly less than 1 basis point (a percent of a percent) in notional amounts outstanding of the total OTC derivative markets. It follows that from a systemic risk point of view, there is little support to consider this class in priority.

Data on volumes cleared by Nasdaq OMX Clearing AB

315. Nasdaq OMX Clearing AB has been authorised to clear OTC equity derivatives denominated in EUR, SEK, DKK and NOK on the following types:
- Futures/Forwards⁴⁴ and Options on Equity indices
 - Futures/Forwards and Options on Equity single name
 - Futures/Forwards and Options on Equity baskets
316. Looking at the data included in the CCP notifications, it appears that the clearing activity in the different categories varies significantly from one to the next. In particular the CCP notification did not include any evidence of a clearing activity on equity baskets. For index equities, there are only clearing volumes in SEK (for Futures/Forwards) and in SEK and DKK for Options.
317. Within the notified classes, the most actively cleared contract is the flexible Future contract on the Swedish OMXS30. It represents 47% of the total OTC equity volume of Nasdaq OMX Clearing AB in terms of number of transactions, 78.6% of the total in terms of traded value (based on 2013 data).
318. On this contract, the average daily number of transactions is 4.3. For comparison purpose, the average daily number of transactions of the equivalent exchange traded contract is 63. A

⁴³ <http://www.nasdaqomx.com/transactions/markets/nordic/statistics>

⁴⁴ The reference to "Futures/Forwards" is meant to encompass both flexible and lookalikes to listed futures.

comparison of the traded values of the OTC versus ETD transactions on this contract shows that the OTC represents only 0.5% of the total.

319. The table below provides more detail on the number of transactions and traded values that have been recorded in 2013 for each of the equity OTC derivative classes cleared by Nasdaq OMX Clearing AB. For most of them, the average daily number of transactions is well below 1, hence there are a significant number of days without trades.

Table 19: Statistics on the OTC equity classes cleared by Nasdaq OMX Clearing AB

	Sum of transactions for 2013 (# of transaction)	Average daily number of transaction (# of transaction)	Sum of traded value for 2013 ('000 EUR)
Index	1,124	4.50	2,049,854,575
Future	1,070	4.28	2,022,476,543
SEK	1,070	4.28	2,022,476,543
Option	54	0.22	27,378,032
DKK	2	0.01	133,989
SEK	52	0.21	27,244,043
Stock	1,126	4.50	521,949,816
Future	630	2.52	386,839,676
DKK	62	0.25	41,626,425
EUR	383	1.53	7,121,590
NOK	22	0.09	6,962,104
SEK	163	0.65	331,129,556
Option	496	1.98	135,110,140
DKK	2	0.01	56,271,532
EUR	76	0.30	558,282
NOK	12	0.05	47,490
SEK	406	1.62	78,232,837

Data on volumes cleared by LCH.Clearnet Ltd

320. The CCP notification indicates that there are only clearing volumes for Single Name CFDs, and none for Index CFDs so far.

Table 20: Volumes in CFDs cleared by LCH.Clearnet Ltd

	2011	S1 2012	S2 2012	2013
Trade Volume (# of contract)	61,486	126,655	111,586	45,308
Notional Volume in '000 EUR	1,537,150	3,166,375	2,789,650	2,674,864
Open Interest in '000 EUR	27,231	1,053	1,087	550,131

321. Those numbers are provided in aggregate form. To evaluate the volume and liquidity of single name CFDs it is necessary to add further granularity in the analysis and to look at the liquidity of the single names. Indeed the liquidity varies significantly from one single name to the other, and it is not always the case that the liquidity of the underlying equity is fully reflected in the liquidity of the derivative associated to it. This analysis should be performed if and when those contracts are proposed to be subject to the clearing obligation.
322. As a result, ESMA has determined that for the equity OTC derivative classes that Nasdaq OMX and LCH Clearnet Ltd are authorised to clear, there is little or a moderate level of activity without evidence of any of these classes being kept OTC in volume, coupled with a smaller systemic risk relevance.

6.3.3 Criteria 3: availability of pricing information – EMIR 5(4)(c) and RTS 7(3)

323. In relation to the availability of fair, reliable and generally accepted pricing information in the relevant class of OTC derivative contracts, ESMA shall take into consideration whether the information needed to accurately price the contracts within the relevant class of OTC derivative contracts is easily accessible to market participants on a reasonable commercial basis and whether it would continue to be easily accessible if the relevant class of OTC derivative contracts became subject to the clearing obligation.

Equity OTC derivative classes cleared by Nasdaq OMX Clearing AB

(a) Lookalike contracts

324. It is unlikely that market participants would face any issue related to the availability of pricing information of lookalikes contracts, since they replicate exactly some contracts traded on exchange and become fungible with those contracts once cleared. There is a significant pre- and post-trade transparency in terms of pricing information for exchange-traded contracts, as the prices are calculated continuously during the day by the exchange and disseminated to the CCP.

325. The daily reference prices are handled according to the principles which are published in the Rules & Regulations of the CCP⁴⁵.

(b) Flexible contracts

326. Flexible options on standardised underlying's adopts the same price logic as all equity and index options, however for the flexible options where the underlying is not standardised a different volatility model is used. The conventions used for the price fixing is agreed with CCP's risk committee and communicated to the market participants.
327. The daily reference prices are handled according to the principles which are published in the Rules & Regulations of the CCP⁴⁶.

Equity OTC derivative classes cleared by LCH.Clearnet Ltd

328. All prices for CFDs are sourced from underlying regulated market prices produced by a third party data provider. Each CFD has a standard code where end-of-day and intraday prices of the underlying are used for mark-to-market and margining. Therefore pricing data is available via the regulated market.
329. In line with the analysis of their level of standardisation and that the only evidence we have received indicates they are all cleared, ESMA has determined that pricing data is available and this would not likely be affected by a clearing obligation for the equity OTC derivative classes that Nasdaq OMX and LCH Clearnet are authorised to clear.

6.4 Main findings of the assessment of the Equity classes and conclusion

330. The overarching objective of the clearing obligation is the reduction of systemic risk. Recital 15 of EMIR clarifies that "Ensuring that the clearing obligation reduces systemic risk requires a process of identification of classes of derivatives that should be subject to that obligation. That process should take into account the fact that not all CCP-cleared OTC derivative contracts can be considered suitable for mandatory CCP clearing."
331. ESMA has taken due consideration of all the relevant criteria foreseen by EMIR when assessing the equity OTC derivative classes cleared by Nasdaq OMX Clearing AB and LCH.Clearnet Ltd and, when considering them altogether, is of the view that imposing a clearing obligation on those contracts for the reduction of systemic risk is not necessary at this stage.
332. Indeed, although there is strong evidence that the contracts are sufficiently standardised and that the information related to the pricing is easily accessible, the size of the OTC equity market that the two CCPs are authorised to clear is relatively limited and therefore the first clearing obligation should primarily focus on other asset classes.
333. As reflected in the answers to the discussion paper, the equity asset class exhibits an important dichotomy between on one side, highly standardised contracts that mirror exchange listed products and on the other side, highly bespoke contracts which characteristics cannot easily be replicated into

⁴⁵ Available at <http://www.nasdaqomx.com/nordicrules/>

⁴⁶ Available at <http://www.nasdaqomx.com/nordicrules/>

a CCP solution. As the industry continues to work towards reducing the share of the latter, or developing CCP solutions to clear them, there will be room at a later stage to re-assess the suitability of the clearing obligation for those equity classes.

334. In addition, this decision is in line with views previously expressed by ESMA in the discussion paper, detailing the reasons for considering the interest-rate and credit derivative asset classes as a priority for the clearing obligation, including the availability of data, the clearing experience and the international convergence.
335. Given that in this case, the systemic relevance of the classes appears to be relatively limited at least in comparison with other asset classes, the clearing obligation would not add any immediate benefits and it would be disproportionate to propose it at this point in time on the OTC equity classes that Nasdaq OMX Clearing AB and LCH.Clearnet Ltd are authorised to clear.
336. As a conclusion, 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 does 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.
337. In accordance with OTC Question 17 of the Q&A on the implementation of EMIR, the consequence of this negative determination is that the equity classes analysed above may become subject to the clearing obligation at a later point in time if:
- (a) another CCP is authorised to clear the same class. In this case, the frontloading start date would be the date of notification under Article 5 of this other CCP; or
 - (b) ESMA proposes on the basis of its initial empowerment to amend the RTS on the clearing obligation to include those classes, following e.g. market developments. In this case, frontloading would not be applicable.

Question 10: Do you have any comment on the analysis on the Equity OTC derivative classes presented in Section 6?

7. OTC Interest rate future and option classes that are proposed not to be subject to the clearing obligation

7.1 OTC Interest rate future and option classes notified to ESMA

338. On 18 March 2014 Finansinspektionen has notified ESMA of a number of OTC interest rate option classes which Nasdaq OMX Clearing AB is authorised to clear.
339. On 12 June 2014, the Bank of England has notified ESMA of a number of OTC interest rate future classes which LCH.Clearnet Ltd is authorised to clear.
340. The details of those classes are available in the public register for the clearing obligation⁴⁷.

Characteristics of the OTC interest rate option classes cleared by Nasdaq OMX Clearing AB

341. Nasdaq OMX Clearing AB is clearing two types of OTC interest rate options: options on FRA as well as options in forwards in Swedish government bonds:

(a) options on FRA:

- i. options on 3-month STIBOR FRA (SEK)
- ii. options on 3-month and 6-month NIBOR FRA (NOK)

(b) options in forwards in Swedish government bonds:

- iii. options in forwards in 2-year, 5-year and 10-year Swedish government bonds (SEK)

342. The CCP offer in OTC interest rate options is limited to contracts that contain a large set of fixed attributes such as the deliverable contract, the expiry or the contract size. In fact, they are similar to exchange traded options to some extent in that the CCP is defining the set of parameters that defines them to concentrate liquidity on these and be able to process them.
343. These options are designed by the CCP for customers wishing to keep the flexibility of the OTC market from a trading aspect while benefiting from the security and efficiency of the processes of the clearing process.

Characteristics of the OTC interest rate future classes cleared by LCH.Clearnet Ltd

344. LCH.Clearnet Ltd is clearing two types of OTC futures that have been notified to ESMA:

(a) Bond Futures:

- i. Short-dated (2 year Bund), medium-dated (5 year Bobl) and long-dated (10 year Schatz) German government bond futures in EUR with physical delivery

⁴⁷ 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>

- ii. Long-dated (Gilt) UK government bond futures in GBP with physical delivery

(b) Short term interest rate futures:

- i. 3 month Euribor Futures
- ii. 3 month Sterling Futures

345. The OTC interest rate future classes cleared by LCH.Clearnet Ltd are futures executed on Nasdaq OMX NLX which operates an MTF. The contracts have ETD futures product characteristics but as they are executed outside a regulated market they qualify as OTC as per the OTC derivative definition of Article 2 of EMIR.

7.2 Analysis of the criteria for the clearing obligation

346. In accordance with Article 5(4) of EMIR, when assessing the relevance of the clearing obligation on the notified classes against the objective of the reduction of systemic risk, ESMA has taken into consideration the following criteria:

- Criteria 1: level of standardisation of the contractual terms and the operational processes – EMIR 5(4)(a) and RTS on OTC derivatives 7(1)(a) and (b)
- Criteria 2: volume and liquidity of the class – EMIR 5(4)(b) and RTS on OTC derivatives 7(2)(a) to (d)
- Criteria 3: availability of fair, reliable and generally accepted pricing information – EMIR 5(4)(c) and RTS on OTC derivatives 7(3)

347. For the OTC interest rate future and option classes cleared by Nasdaq OMX Clearing AB and LCH.Clearnet Ltd, those criteria are assessed in the following paragraphs.

7.2.1 Criteria 1: level of standardisation

7.2.1.1 Criteria 1(a): level of standardisation of the contractual terms – EMIR 5(4)(a) and RTS 7(1)(a)

OTC interest rate option classes cleared by Nasdaq OMX

348. As explained in paragraphs 342, Nasdaq OMX Clearing AB is clearing OTC interest rate options that have a standard set of attributes that have been defined by the CCP. The product definitions are available to all participants⁴⁸.
349. Most of the terms are standardised. For example, there is a limited list of underlyings whether these are FRAs or Forwards in Swedish government bonds, there is a set list of expiry dates following the IMM convention, the contract size is also defined, etc. As a result, these trades are OTC transactions

⁴⁸ The descriptions and the standard terms of these options are available at the following links:
<http://www.nasdaqomx.com/transactions/trading/fixedincome/fixedincome/derivatives/products>
http://www.nasdaqomx.com/digitalAssets/82/82710_nibor-fraoptionsquickrefguideeng.pdf
http://www.nasdaqomx.com/digitalAssets/75/75473_stibor-fraoptionsquickrefguideeng.pdf
http://www.nasdaqomx.com/digitalAssets/76/76119_r2r5r10optionsquickrefguideeng.pdf

bilaterally negotiated, but given these options correspond to a set list of standard products they can then be reported and cleared at the CCP.

350. The CCP defines the terms and conditions of these trades in its own rulebook⁴⁹, so when the trades are reported, novated and replaced by two transactions where the CCP becomes the seller to the buyer and vice versa, then the same terms and definitions continue to apply to these contracts.
351. Finally, the trade characteristics of each of these products are built in a similar way to those traded on exchange, meaning they are standardised in a way that helps concentrate and potentially create liquidity on a smaller set of contracts. The fact that there is a smaller set of standard contracts also allows the CCP to net trades on the same contracts, indeed the offsetting aspect is indicated as one of the main characteristics in the CCP description of these options. This means that counterparties can manage their open positions on these options through offsetting contracts, even potentially closing out their positions this way. This illustrates the level of standardisation of these products.

OTC interest rate future classes cleared by LCH.Clearnet Ltd

352. As explained in paragraphs 345, LCH.Clearnet Ltd is clearing OTC interest rate futures that have a standard set of attributes, indeed their product attributes are similar to those of futures traded on exchange. Their product definitions are available to all participants from NLX⁵⁰.
353. The terms of these futures are standardised. For example, the deliverables are defined, the maturities are fixed, the contract size is specified, etc. In addition, as part of the standard terms it also include the reference to the clearing rules of the CCP as these trades are sent for clearing as part of their processing.
354. These products compete with bond and short term interest rate futures executed on regulated markets. These futures are executed on an MTF but their contractual terms are standardised by design.

7.2.1.2 Criteria 1(b): Level of standardisation of the operational processes – EMIR 5(4)(a) and RTS 7(1)(b)

OTC interest rate option classes cleared by Nasdaq OMX

355. The OTC interest rate option classes cleared by Nasdaq OMX Clearing AB are handled in the same technical infrastructure that was described in paragraph 355 for the equity classes, leveraging the same APIs and FIX protocols used by the CCP with the other cleared classes.
356. As these options have standard terms they can benefit from this technology to first be reported by counterpart to the CCP and then for the rest of the lifecycle of the trade, starting with the communication of their cleared status.

⁴⁹ The Nasdaq OMX rules are available at the following address:

<http://www.nasdaqomx.com/nordicrules>

⁵⁰ The descriptions and the standard terms of these options are available at the following links:

<http://www.nasdaqomx.com/transactions/markets/nlx/products/>

http://www.nasdaqomx.com/digitalAssets/92/92398_q14-1198-nlx-product-short-term-guides_0508_fnl.pdf

http://www.nasdaqomx.com/digitalAssets/85/85890_nlxproducttermssgermangovernmentbondfutures_finalv1.0.pdf

http://www.nasdaqomx.com/digitalAssets/92/92398_q14-1198-nlx-product-short-term-guides_0508_fnl.pdf

357. However this information only stands for contracts cleared with Nasdaq OMX Clearing AB, and it is unclear that equivalent contracts traded on a pure bilateral basis would be subject to equivalent standardised operational processes.

OTC interest rate future classes cleared by LCH.Clearnet Ltd

358. The future classes that LCH.Clearnet Ltd has been authorised to clear are traded electronically through the NLX MTF. It provides order management, electronic processing, market data feeds, trade reporting, etc.
359. These futures are cleared at LCH.Clearnet Ltd which handles the rest of the processing, including trade and position management, delivery management, collateral management and reporting.
360. As explained in paragraph 354, these futures compete with other bond and interest rate futures executed elsewhere, in particular on NYSE Liffe and Eurex, which also have standard processes.
361. Following the definition in EMIR, these bond and interest rate futures qualify as OTC or ETD depending on where and how they are executed, but they all have a high level of standardisation in their terms and their processing.

7.2.2 Criteria 2: Volume and liquidity of the class – EMIR 5(4)(b)

362. In relation to the volume and liquidity of the classes of OTC derivatives, the RTS on OTC derivative further specify four criteria that ESMA shall take into consideration when assessing the suitability of a class to the clearing obligation. The four criteria are analysed below.

7.2.2.1 Criteria 2(a): Margins – EMIR 5(4)(b) and RTS 7(2)(a)

363. ESMA shall take into consideration whether the margins or financial requirements of the CCP would be proportionate to the risk that the clearing obligation intends to mitigate.

OTC interest rate option classes cleared by Nasdaq OMX and OTC interest rate future classes cleared by LCH.Clearnet Ltd

364. As explained in more detail above, the OTC futures and options cleared by the two CCPs are in some way similar to futures and options executed on regulated market for certain aspects. In this respect, the models and methodologies that the CCPs are using to calculate the margins are very similar to those which are used to calculate the margins of the exchange-traded derivative contracts which are also cleared by the CCPs.
365. The risk models and suitability of the resulting margins which are called from users have been thoroughly assessed and validated during the authorisation process of the CCPs, by the relevant competent authority in cooperation with the other members of the college including ESMA.
366. Therefore there is no indication that the principle of proportionality between the current margins and financial requirements of the CCPs, and the risk that the clearing obligation intends to mitigate, would not be achieved.

7.2.2.2 Criteria 2(b): Stability of the market size and depth – EMIR 5(4)(b) and RTS 7(2)(b)

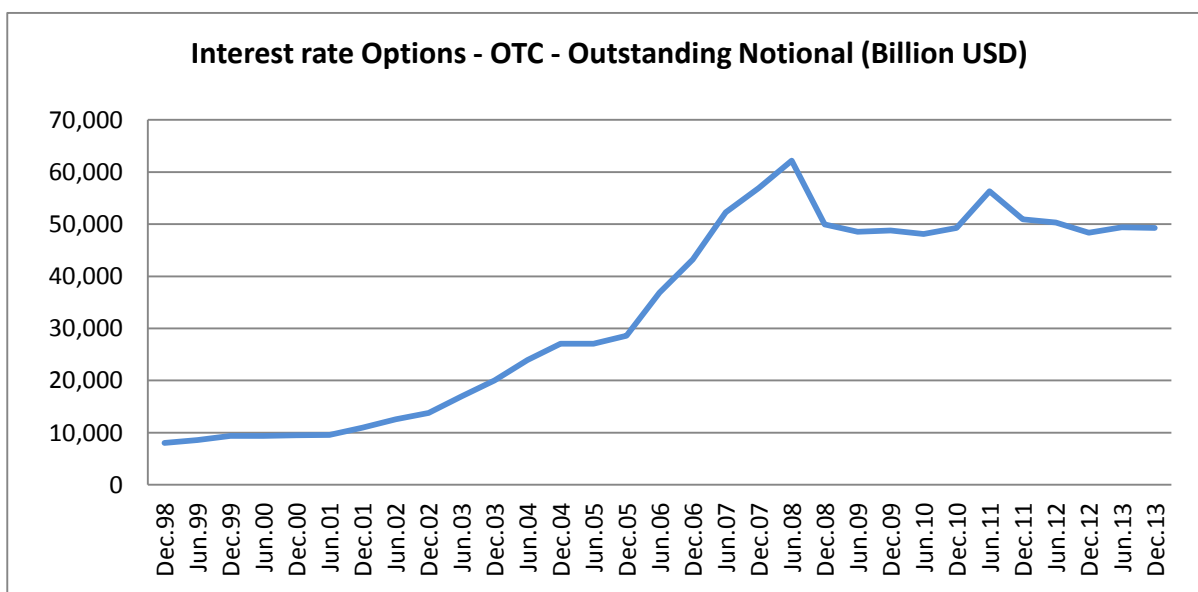
367. ESMA shall take into consideration the stability of the market size and depth in respect of the product over time.

OTC interest rate option classes cleared by Nasdaq OMX

368. As opposed to the other interest rate related classes covered in this paper, i.e. the swap classes in the main currencies that constitute the largest share of the interest rate derivative activity, the options that were notified to ESMA only represent a small part of the market, in currencies that represent an even smaller part. Therefore, the specific volumes for these options will be discussed in the Criteria 2(d) section below but to determine trends for these types of products we are looking at data at the product level.

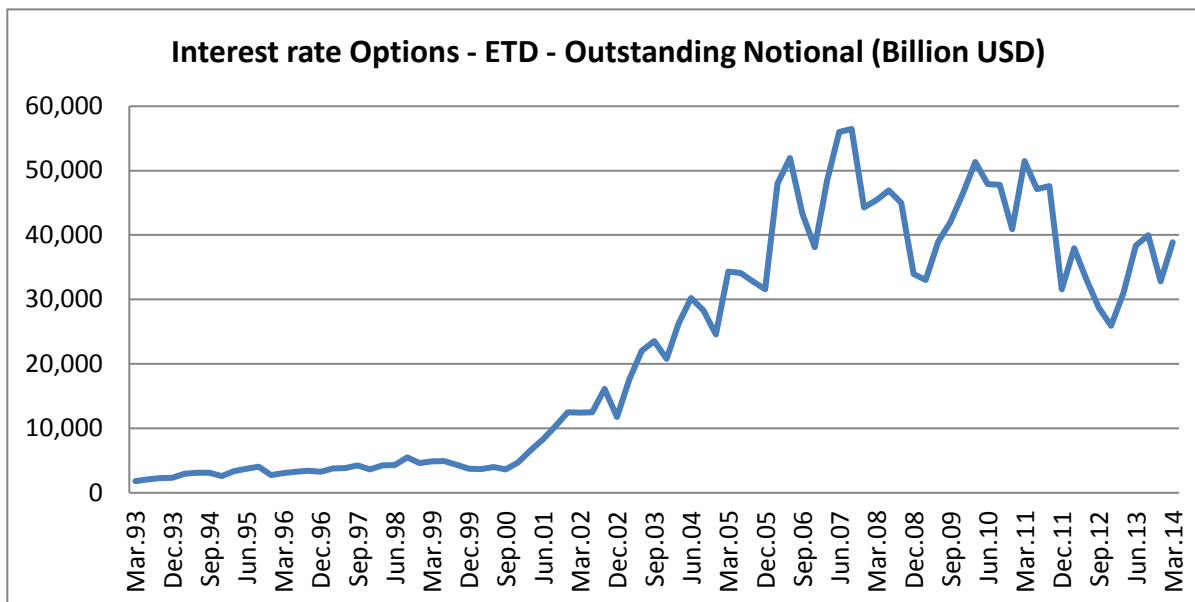
369. As these options are OTC because negotiated bilaterally but resemble exchange traded options on certain aspects as explained in the previous paragraphs, we are doing the analysis on both OTC and exchange traded options data to see the stability of the market size and depth of this product across both execution types.

Figure 12: Outstanding Notional in OTC interest rate options over time



Source: BIS Semi-annual survey

Figure 13: Outstanding Notional in ETD interest rate options over time



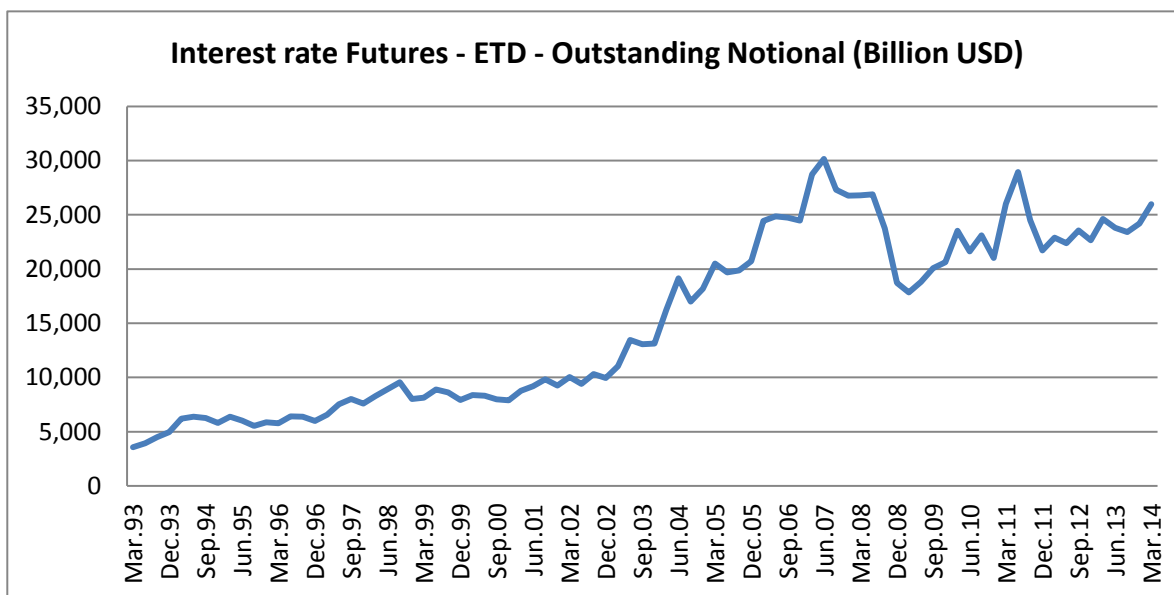
Source: BIS statistics

370. Whether OTC or ETD, interest rate options have experienced similar trends and in the same order of magnitude over the recent years. The outstanding notional has increased until the late 2000s and has remained within a relatively limited range since, but with significant changes within that range.
371. The overall trajectory for the options as a product type can give an indication of the possible trends for the few option classes notified, but given their low volume it is difficult to establish whether this applies with certainty and in any case would not modify our overall assessment for these classes.

OTC interest rate future classes cleared by LCH.Clearnet Ltd

372. In line with the analysis in paragraphs 354 and 360, the notified interest rate future classes compete with other interest rate futures executed elsewhere than NLX. In fact, NLX is a relatively recent offering for these classes, about a year old, as it started on 31 May 2014. Therefore, in order to determine stability or changes in trading activity over a longer period in these classes, we look at the evolution in the ETD interest rate futures market.

Figure 15: Outstanding Notional in ETD interest rate futures over time



Source: BIS statistics

373. The analysis over time of the outstanding notional in interest rate futures gives a similar picture to the analysis of options in paragraph 370, they have also experienced growth until the latter part of the years 2000 and have been within a certain range since, but with significant changes within that range.
374. Within the futures category, some are more active than others, but the notified classes had competing futures with the same underlyings but executed elsewhere in the top 20 of interest rate futures and options contracts⁵¹, thus making these products important constituents of the overall futures market. As a result, we can estimate that the volume trends described in the paragraph above are a good indicator of the stability of the market size and depth for the notified classes.

7.2.2.3 Criteria 2(c): Market dispersion – EMIR 5(4)(b) and RTS 7(2)(c)

375. ESMA shall take into consideration the likelihood that market dispersion would remain sufficient in the event of the default of a clearing member.

OTC interest rate option classes cleared by Nasdaq OMX

376. The Default management process and EMIR related requirements have been reviewed by the College as part of the authorisation of Nasdaq OMX Clearing AB. In addition, ESMA has looked at the list of clearing members⁵² of Nasdaq OMX Clearing AB that are part of this offering. The membership includes some of the largest banks in the Nordic region. Given these options have as underlyings FRAs on the STIBOR and NIBOR indices or on Swedish government bonds, it is quite

⁵¹ The top 20 interest rate futures and options contracts is on page 25 of the FIA Annual Volume Survey report from March 2014, which is available at the following link: <http://www.futuresindustry.org/files/css/magazineArticles/article-1612.pdf>

⁵² List of Nasdaq OMX Clearing AB clearing members for Fixed Income is available at the following address: <http://www.nasdaqomx.com/transactions/markets/nordic/membership/fixed-income/fixedincome-memberlist>

relevant to see that many of the most active local participants are included. In addition, these clearing members also include large and international banks which can also contribute to the default management process.

377. As a result, based on the types of options that have been notified and the composition of the clearing membership, ESMA has determined that there is likelihood that market dispersion would remain sufficient in the event of the default of a clearing member.

OTC interest rate future classes cleared by LCH.Clearnet Ltd

378. The Default management process and EMIR related requirements have been reviewed by the College as part of the authorisation of LCH.Clearnet Ltd. In view of the NLX executed future classes cleared it can be interesting to look at the composition of the membership.
379. At the time of this paper, after one year of operation, LCH.Clearnet Ltd has nine clearing members for the NLX offering⁵³. It includes several of the large European Banks and some international ones that are active participants in this market.
380. As a result, based on the types of futures that have been notified and the composition of the clearing membership, ESMA has determined that there is likelihood that market dispersion would remain sufficient in the event of the default of a clearing member.

7.2.2.4 Criteria 2(d): Number and value of the transactions – EMIR 5(4)(b) and RTS 7(2)(d)

OTC interest rate option classes cleared by Nasdaq OMX Clearing AB

381. ESMA shall take into consideration the number and the value of the transactions. As explained before, the options Nasdaq OMX Clearing AB has been authorised to clear have been designed by the CCP to be standard in order to concentrate trading on these few contracts and create liquidity on them. Although two counterparties could negotiate the same trade and keep it bilateral, we have not received evidence this is the case. We are thus looking at the cleared volume to consider the number and values of transactions for these classes.
382. ESMA looked at the number of transactions in 2012 and 2013 collectively across these options as well as the corresponding notionals. This data has indicated low volumes, with trade count in the hundreds when taking all the contracts together, as well as periods without trading. Confirming this analysis, similar results are drawn from the review of the daily activity and open interest which is available on Nasdaq OMX Clearing AB website⁵⁴. These figures vary day on day, but they indicated relatively small or zero open interest for the various contracts.

⁵³ The list of members of LCH.Clearnet Ltd. that are part of the NLX clearing offering is available at the following address:
http://www.lchclearnet.com/membership/ltd/current_membership.asp

⁵⁴ Daily activity and open interest for Nasdaq OMX Clearing AB for fixed income is available at the following address:
<http://www.nasdaqomx.com/transactions/trading/fixedincome/fixedincome/derivatives/dailyvolumeandopeninterest>

OTC interest rate future classes cleared by LCH.Clearnet Ltd

383. The interest rate futures LCH.Clearnet Ltd has been authorised to clear are cleared by design. The competing futures executed elsewhere on regulated markets are also cleared. So far, no other notification of interest rate futures traded OTC has been made either. In addition, we have not received evidence of trades on these classes that are kept OTC. We will thus look at the cleared volumes to consider the number and values of the transactions.

Table 21: Open interest and average daily volume for the notified OTC interest rate future classes

Future (underlying)	Open Interest (30/05/2014)	Average Daily Volume (over 10 days, 28/05/2014 - 10/06/14)
EURIBOR	28,915	78,095
STERLING	24,831	6,881
GILT	-	9
BUND	3,867	548
BOBL	245	576
SCHATZ	917	7,077

Source: Nasdaq OMX NLX, ESMA calculations

384. Open interest and volume on these future classes is available from NLX⁵⁵. One year after the launch of the offering, there are different levels of activity across the futures traded on NLX and cleared at LCH.Clearnet Ltd as per Table 21. It ranges from a significant and daily activity on the 3 month Euribor future to little activity on the Gilt future and some days without trading or open interest.
385. These could be compared to the volume of the competing futures executed elsewhere in order to estimate the number and values of transactions across both markets, i.e. executed on regulated market and outside but the clearing obligation focuses on the OTC trades.

7.2.3 Criteria 3: availability of pricing information – EMIR 5(4)(c) and RTS 7(3)

386. In relation to the availability of fair, reliable and generally accepted pricing information in the relevant class of OTC derivative contracts, ESMA shall take into consideration whether the information needed to accurately price the contracts within the relevant class of OTC derivative contracts is easily accessible to market participants on a reasonable commercial basis and whether it would continue to be easily accessible if the relevant class of OTC derivative contracts became subject to the clearing obligation.

OTC interest rate option classes cleared by Nasdaq OMX Clearing AB

387. The two types of deliverables or underlying for these options are FRAs or Swedish Government Bonds and the prices for both are available and reliable. The general framework for FRAs was discussed earlier in this paper along with other interest rate derivatives classes such as swaps, and

⁵⁵ Open interest and volume of these classes is available at the following address:
<http://www.nasdaqomx.com/transactions/markets/nlx/marketdata/historic-market-data>

government bond prices are also available from multiple sources such as market data providers, dealers and electronic platforms. The pricing of the options could be derived from these and their volatility or directly obtained from similar sources. The daily reference prices are handled according to the principles which are published in the Rules & Regulations of the CCP⁵⁶.

388. As these products are cleared and correspond to small volumes, it is unlikely that a clearing obligation would affect this pricing framework and data availability.

OTC interest rate future classes cleared by LCH.Clearnet Ltd

389. Similar to the analysis above for the option classes Nasdaq OMX Clearing AB is authorised to clear, for the future classes LCH.Clearnet Ltd is authorised to clear, pricing data on the underlyings of these futures (whether on Euribor and Sterling or on these German and UK government bonds) is widely available. In fact, data on these is reliable and has been available continuously as these indices or government bonds are amongst the most important ones.
390. Future prices can be derived from pricing data on the underlyings or obtained directly. In particular, the settlement prices of the interest rate futures executed on NLX and cleared at LCH.Clearnet Ltd are published by NLX⁵⁷.
391. As these products are already cleared, it is unlikely that a clearing obligation would affect this pricing framework and data availability.

7.3 Main findings of the assessment of these OTC interest rate option and future classes and conclusion

392. The overarching objective of the clearing obligation is the reduction of systemic risk. Recital 15 of EMIR clarifies that “Ensuring that the clearing obligation reduces systemic risk requires a process of identification of classes of derivatives that should be subject to that obligation. That process should take into account the fact that not all CCP-cleared OTC derivative contracts can be considered suitable for mandatory CCP clearing.”
393. ESMA has taken due consideration of all the relevant criteria foreseen by EMIR when assessing the OTC interest rate option classes cleared by Nasdaq OMX Clearing AB and the OTC interest rate future classes cleared by LCH.Clearnet Ltd, when considering them altogether, is of the view that imposing a clearing obligation on those contracts for the reduction of systemic risk is not necessary at this stage.
394. Indeed, based on the information received, the options Nasdaq OMX Clearing AB has been authorised to clear have standard contract terms, are already cleared, have with a relatively limited volume, and therefore do not constitute a good candidate for the clearing obligation.
395. With regards to the futures LCH.Clearnet Ltd has been authorised to clear, they are standard with some of them experiencing bigger trading volumes than others. Yet, they are reviewed here because they are executed on an MTF and not a regulated market as some of the futures they directly

⁵⁶ Available at <http://www.nasdaqomx.com/nordicrules/>

⁵⁷ Settlement prices for the interest rate futures executed on NLX is available at the following address:
<http://www.nasdaqomx.com/transactions/markets/nlx/marketdata/historic-market-data>
<http://www.nasdaqomx.com/transactions/markets/nlx/marketdata/open-interest-and-settlement-prices>

compete with. Aside from how and where they are executed, they are cleared futures. Taking all this into consideration these futures do not constitute a good candidate for the clearing obligation.

396. As a conclusion, following the notification of 18 March 2014 whereby Finansinspektionen has notified ESMA that Nasdaq OMX Clearing AB is authorised to clear some OTC interest rate 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 OTC interest future classes, ESMA does 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.

Question 11: Do you have any comment on the analysis on the OTC Interest rate future and options derivative classes presented in Section 7?

Annex I - Commission 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 repositories⁵⁸, and in particular Article 5(2) thereof,

Whereas:

- (1) 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 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. In particular, the legal documentation of some derivative contracts prevents the termination of the contract in case of default of the covered bond issuer. Central clearing would not preserve this feature and therefore those contracts should not be subject to the clearing obligation.
- (2) 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.

⁵⁸ OJ L 201, 27.7.2012, p. 1.

- (3) 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.
- (4) In particular, clearing members of the classes subject to the clearing obligation constitute a group of entities which already have an experience with voluntary clearing and have already established the connections with at least some of the relevant CCPs. These entities 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 direct clearing members. Therefore they should be included in the first category to which the clearing obligation is applicable (Category 1). This category should be defined in such a way that counterparties which are clearing members only for classes not covered by the clearing obligation are not captured. To ensure legal certainty, this category should only encompass clearing members of CCPs authorised at the time this Regulation enters into force.
- (5) Conversely, the period of time a counterparty subject to the clearing obligation needs to put in place arrangements to clear its OTC derivative contracts through a CCP is expected to be the longest for non-financial counterparties because those counterparties generally do not have an experience with central clearing. Therefore they should be included in a category of counterparty to which the longest implementation period is granted (Category 3).
- (6) However, non-financial counterparties do not form a homogeneous group with regards to the criteria that are relevant to define the categories of counterparties. In particular, certain non-financial counterparties are direct clearing members of CCPs. Those counterparties should be included in the clearing member category (Category 1) if they are clearing members meeting the conditions of this category. In addition, certain non-financial counterparties are alternative investment funds ("AIFs") not captured by the definition of financial counterparties under Regulation (EU) No 648/2012. For the purpose of the clearing obligation, those counterparties should be included in the same categories of counterparties than AIFs that are classified as financial counterparties.
- (7) Counterparties that are clearing members do not necessarily have a pre-existing CCP access for all the classes subject to the clearing obligation. The date on which the clearing obligation takes effect for this category of counterparty (i.e. the date of application) should therefore take into account the fact that they will need to decide on their type of access for the classes for which they do not have pre-existing access, and in the case they consider becoming a clearing member for the other classes subject to the clearing

obligation, a reasonable timeframe for a counterparty to become a clearing member varies from 3 to 6 months.

- (8) The date on which the clearing obligation takes effect for counterparties that are not clearing members should take into account the fact that most of those counterparties will get access to CCP by becoming client or indirect client of a clearing member.
- (9) The date on which the clearing obligation takes effect for non-financial counterparties not falling under Category 1 or Category 2 should take into account their legal and operational capacity, and the fact that most of them have limited experience with central clearing.
- (10) 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 of application of the clearing obligation. This so-called “frontloading” requirement is not applicable to non-financial counterparties because as per Regulation (EU) No 648/2012, they shall only clear contracts concluded after the date on which they become subject to the clearing obligation, and this date is necessarily on or after the date on which the clearing obligation takes effect.
- (11) The provision on frontloading is linked to the definition of the minimum remaining maturity, and applies to contracts concluded during two periods: the first period is from the notification to ESMA that follows the authorisation of a CCP to clear a certain class of OTC derivatives to the publication of this Regulation in the Official Journal; the second period is from the publication of this Regulation in the Official Journal to the date of application of the clearing obligation. The consequence of frontloading is different depending on whether the contracts were concluded during the first or the second period. During the first period, there is no legal certainty on which of the notified classes will be subject to the clearing obligation, on when the clearing obligation takes effect, and on which CCPs will be authorised to clear the notified classes. This uncertainty may have a significant impact on the capacity of market participants to accurately price the OTC derivative contracts in the notified classes, because a transaction that is centrally cleared is subject to a different collateral regime than a transaction that is not. Therefore, minimising the number of contracts subject to frontloading during the first period would reduce the level of pricing uncertainty.
- (12) To take this into account, the minimum remaining maturity applicable to contracts entered into during the first and the second period should be different. The minimum remaining maturity of the contracts concluded before the publication of this Regulation in the Official Journal should be set at a level ensuring that the number of contracts subject to

frontloading is minimal. However, the minimum remaining maturity of the contracts concluded after the publication of this Regulation in the Official Journal should be set at a level ensuring that only contracts with a meaningful remaining maturity are required to be centrally cleared. The remaining maturity of the contracts 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.

- (13) This Regulation is based on the draft regulatory technical standards submitted by the European Securities and Markets Authority to the Commission.
- (14) 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 Table 1 to Table 4 of Annex I shall not include contracts associated to covered bonds programmes when such contracts satisfy all of the following conditions:
 - (a) they are not terminated in case of default of the covered bond issuer;
 - (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;
 - (c) they are registered in the cover pool of the covered bond programme in accordance with national covered bond legislation;
 - (d) they are used only to hedge the interest rate or currency mismatches of the cover pool;
 - (e) the covered bond programme to which they are associated meets the requirements of Article 129 of Regulation (EU) No 575/2013; and
 - (f) the covered bond programme to which they are associated is subject to a legal 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 which includes 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 listed in Annex I, of at least one of the CCPs authorised before that date to clear at least one of the classes of OTC derivatives listed in Annex I;
 - (b) Category 2 which includes:
 - (i) Financial counterparties not included in Category 1; and
 - (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 and that are not included in Category 1.
 - (c) Category 3 which includes 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 or Category 2.

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 of Category 1;
 - (b) [the date 18 months after the date of entry into force of this Regulation] for counterparties of Category 2;
 - (c) [the date 3 years after the date of entry into force of this Regulation] for counterparties of Category 3.
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. The minimum remaining maturity referred to in Article 4(1)(b)(ii) of Regulation (EU) No 648/2012 shall be 6 months for OTC derivative contracts entered into or novated on or after the date of publication of this Regulation in the Official Journal of the European Union.
2. The minimum remaining maturity referred to in Article 4(1)(b)(ii) of Regulation (EU) No 648/2012 for OTC derivative contracts entered into or novated before the date of publication of this Regulation in the Official Journal of the European Union shall be:
 - (a) 49 years and 6 months for Table 1: Basis swaps
 - (b) 49 years and 6 months for Table 2: Fixed-to-float interest rate swaps
 - (c) 2 years and 6 months for Table 3: Forwards rate agreement
 - (d) 2 year and 6 months for Table 4: Overnight index swaps
3. This Article shall not apply to contracts to which at least one counterparty is a non-financial counterparty.

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

Classes of OTC derivatives subject to the clearing obligation

Section 1

Interest Rate OTC derivatives

Table 1: Basis swaps class

Type	Reference Index	Settlement Currency	Maturity	Settlement Currency Type	Optionality	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 2: Fixed-to-float interest rate swaps class

Type	Reference Index	Settlement Currency	Maturity	Settlement Currency Type	Optionality	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 3: Forward rate agreement class

Type	Reference Index	Settlement Currency	Maturity	Settlement Currency Type	Optionality	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 4: Overnight index swaps class

Type	Reference Index	Settlement Currency	Maturity	Settlement Currency Type	Optionality	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

Question 12: Please indicate your comments on the draft RTS other than those already made in the previous questions.

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. This impact assessment follows the publication of a discussion paper on the clearing obligation published on 12 July 2013⁵⁹ and incorporates feedbacks and comments received from stakeholders.
5. 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.
6. 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.
7. The impact assessment presented in the tables below is of qualitative nature only, and the Final Report to be submitted to the European Commission after the consultation period should include elements of a more quantitative nature including, when possible, references to the monetary value

⁵⁹ <http://www.esma.europa.eu/content/Clearing-Obligation-under-EMIR>

attached to the identified costs and benefits. Where relevant, respondents to this consultation paper are invited to justify their answers by providing supporting evidences of a quantitative nature that may feed into the cost-benefit analysis. In particular, the type of quantitative inputs relevant for the purpose of the quantitative impact assessment may include the following assessment:

- Distribution of traded volume across clearing members
- Incremental costs linked to CCP clearing compared with equivalent bilateral practise
- Impact of central clearing on collateral demand

2. 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
<i>Benefits</i>	<p>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.</p> <p>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.</p>
<i>Costs to regulator</i>	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.
<i>Compliance costs</i>	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.
<i>Indirect costs</i>	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
<i>Benefits</i>	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.
<i>Costs to regulator</i>	With this approach, the aim would be to have one RTS per asset class which would make it easier to implement and monitor.
<i>Compliance costs</i>	With this approach, the aim would be to have one RTS per asset class which would make it easier to implement.
<i>Indirect costs</i>	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
<i>Benefits</i>	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 be 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.
<i>Costs to regulator</i>	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.
<i>Compliance costs</i>	This option is associated with the least cost compared to the other options. There would be one single RTS to implement.
<i>Indirect costs</i>	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.

3. 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
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
<i>Benefits</i>	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.
<i>Costs to regulator</i>	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).
<i>Compliance costs</i>	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 ongoing 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
	Qualitative description
<i>Benefits</i>	The approach enables to align the definition of the classes closer to the wide range of characteristics that make up the trade.
<i>Costs to regulator</i>	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.
<i>Compliance costs</i>	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.
<i>Indirect costs</i>	It would make it more difficult than option 1 in the case of trading with third country counterparties as classes would be more complex to identify and compliance with the respective requirements would be more difficult to establish.

4. 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 <u>based on qualitative criteria</u> (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 <u>based on quantitative criteria</u> (e.g. traded volumes)
Preferred Option	Option 3

Option 1	Create a single category of counterparties and apply the same phase-in to all counterparties
	Qualitative description
<i>Benefits</i>	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.
<i>Costs to regulator</i> - <i>One-off</i> ⁶⁰	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)
<i>Compliance costs</i> - <i>One-off</i>	No classification costs for counterparties
<i>Indirect costs</i>	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: <ul style="list-style-type: none"> • 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

⁶⁰ On-going costs are irrelevant with respect to phase-in.

	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
	Qualitative description
<i>Benefits</i>	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.
<i>Costs to regulator</i> - <i>One-off</i>	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)
<i>Compliance costs</i> - <i>One-off</i>	There is no additional cost linked to the classification over and above those already introduced by EMIR.
<i>Indirect costs</i>	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
<i>Benefits</i>	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.
<i>Costs to regulator</i> - <i>One-off</i>	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.
<i>Compliance costs</i> - <i>One-off</i>	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)
	Qualitative description
<i>Benefits</i>	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.
<i>Costs to regulator</i> - <i>One-off</i>	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.
<i>Compliance costs</i> - <i>One-off</i>	The classification costs would be much 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.
<i>Indirect costs</i>	This option requires ESMA to design a new categorisation of counterparties based on quantitative criteria which may be subject to interpretation.

Qualitative category of counterparties – Clearing Members

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
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	member” fall in category 1 irrespective of the fact that it is a FC, an AIF-NFC+ or a “pure” NFC+.
	Qualitative description
<i>Benefits</i>	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).
<i>Costs to regulator</i> - <i>One-off</i> ⁶¹	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.
<i>Compliance costs</i> - <i>One-off</i>	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
<i>Benefits</i>	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+).
<i>Costs to regulator</i> - <i>One-off</i> ⁶²	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.
<i>Compliance costs</i> - <i>One-off</i>	The costs for financial counterparties are identical with the two options. The costs for NFC+ are null with Option 2.

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 CCP, for any class including non OTC, 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 <u>for any Class+</u> of any CCP authorised to clear the Class+ falls in Category 1. Therefore a counterparty is in Category 1 for all the classes.
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.

⁶¹ On-going costs are irrelevant with respect to phase-in.

⁶² On-going costs are irrelevant with respect to phase-in.

Preferred Option	Option 3
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Option 1	A clearing member of any CCP, for any class including non OTC, falls in Category 1
	Qualitative description
<i>Benefits</i>	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.
<i>Costs to regulator</i> - <i>One-off</i> ⁶³	Options 1 to 4 are sorted by increasing level of complexity and hence, increasing costs to regulators.
<i>Compliance costs</i> - <i>One-off</i>	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
<i>Benefits</i>	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+.
<i>Costs to regulator</i> - <i>One-off</i> ⁶⁴	Options 1 to 4 are sorted by increasing level of complexity and hence, increasing costs to regulators.
<i>Compliance costs</i> - <i>One-off</i>	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 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 for any Class+ of any CCP authorised to clear the Class+ falls in Category 1. Therefore a counterparty is in Category 1 for all the classes.
	Qualitative description
<i>Benefits</i>	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

⁶³ On-going costs are irrelevant with respect to phase-in.

⁶⁴ On-going costs are irrelevant with respect to phase-in.

	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+.
<i>Costs to regulator</i> - <i>One-off</i> ⁶⁵	Options 1 to 4 are sorted by increasing level of complexity and hence, increasing costs to regulators.
<i>Compliance costs</i> - <i>One-off</i>	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 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.
	Qualitative description
<i>Benefits</i>	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.
<i>Costs to regulator</i> - <i>One-off</i> ⁶⁶	Options 1 to 4 are sorted by increasing level of complexity and hence, increasing costs to regulators.
<i>Compliance costs</i> - <i>One-off</i>	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.

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 <u>before</u> 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 <u>before</u> the entry into force of the RTS on the clearing obligation (e.g. the date of publication of the consultation paper)
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⁶⁵ On-going costs are irrelevant with respect to phase-in.

⁶⁶ On-going costs are irrelevant with respect to phase-in.

	Qualitative description
<i>Benefits</i>	<p>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.</p> <p>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.</p> <p>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.</p>
<i>Costs to regulator</i> - <i>One-off</i> ⁶⁷	There is no difference in the compliance 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 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.
<i>Compliance costs</i> - <i>One-off</i>	There is no difference in the compliance costs 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.

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
<i>Benefits</i>	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
<i>Costs to regulator</i> - <i>One-off</i> ⁶⁸	There is no difference in the compliance 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 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.
<i>Compliance costs</i> - <i>One-off</i>	There is no difference in the compliance costs 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.

Category of counterparty for Alternative investment funds

⁶⁷ On-going costs are irrelevant with respect to phase-in.

⁶⁸ On-going costs are irrelevant with respect to phase-in.

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
<i>Benefits</i>	<p>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).</p> <p>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 phase-in per categories of counterparties.</p> <p>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.</p>
<i>Costs to regulator</i> - <i>One-off</i> ⁶⁹	<p>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.</p> <p>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.</p>
<i>Compliance costs</i> - <i>One-off</i>	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

⁶⁹ On-going costs are irrelevant with respect to phase-in.

	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.
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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
<i>Benefits</i>	The approach is simple as it fully relies on the EMIR classification of counterparties, which has already been implemented by counterparties for other purposes.
<i>Costs to regulator</i> - <i>One-off</i> ⁷⁰	No specific costs were identified with this option because it relies on a pre-existing classification.
<i>Compliance costs</i> - <i>One-off</i>	No specific costs were identified with this option because it relies on a pre-existing classification.

5. Frontloading and minimum remaining maturities

Policy Objective	Define to 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
<i>Benefits</i>	<p>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.</p> <p>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</p>

⁷⁰ On-going costs are irrelevant with respect to phase-in.

	<p>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:</p> <ul style="list-style-type: none"> - date 1 (date of authorisation of CCP 1) for the Class+ cleared by this CCP, and not cleared by CCP 1, - 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. <p>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.</p> <p>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.</p> <p>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.</p>
<p><i>Costs to regulator</i></p> <ul style="list-style-type: none"> - <i>One-off</i>⁷¹ 	<p>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.</p>
<p><i>Compliance costs</i></p> <ul style="list-style-type: none"> - <i>One-off</i> 	<p>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.</p>
Option 2	Define different minimum remaining maturities depending on the dates on which the contracts are entered into or novated
	Qualitative description
<i>Benefits</i>	<p>The frontloading period can be divided into two different timeframes:</p> <ul style="list-style-type: none"> (d) 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; (e) 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). <p>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</p>

⁷¹ On-going costs are irrelevant with respect to frontloading, as this requirement is applicable only once.

	<p>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).</p> <p>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.</p> <p>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 a minimal number of contracts concluded during Period A is subject to frontloading, while a meaningful number of contracts concluding during Period B is subject to frontloading.</p> <p>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.</p>
<i>Costs to regulator</i> - <i>One-off</i> ⁷²	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.
<i>Compliance costs</i> - <i>One-off</i>	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

⁷² On-going costs are irrelevant with respect to frontloading, as this requirement is applicable only once.

<i>Benefits</i>	<p>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.</p> <p>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.</p>
<i>Costs to regulator</i> - <i>One-off</i> ⁷³	The two options are sorted by level of complexity and therefore increasing costs to regulators.
<i>Compliance costs</i> - <i>One-off</i>	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
<i>Benefits</i>	<p>Under this option, ESMA would define different minimum remaining maturities depending on the contracts e.g.</p> <ul style="list-style-type: none"> - 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” minimum remaining maturities. <p>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.</p> <p>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.</p>
<i>Costs to regulator</i> - <i>One-off</i> ⁷⁴	The two options are sorted by level of complexity and therefore increasing costs to regulators.
<i>Compliance costs</i> - <i>One-off</i>	<p>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.</p> <p>Under Option 2(a) contract should be grouped by Class+ and the corresponding minimum remaining maturity should be applied.</p> <p>Under Option 2(b) counterparties should calculate the relative remaining maturity and compare it to the threshold minimum.</p>

Question 13: Please indicate your comments on the Impact Assessment.

⁷³ On-going costs are irrelevant with respect to frontloading, as this requirement is applicable only once.

⁷⁴ On-going costs are irrelevant with respect to frontloading, as this requirement is applicable only once.