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12 September 2013

European Securities and Markets Authority
103 Rue de Grenelle
75007 Paris
France

Submitted via www.esma.europa.eu

Re: **Discussion Paper: The Clearing Obligation under EMIR**

Dear Sir/Madam:

Markit[1] is pleased to submit the following comments to the European Securities and Markets Authority ("***ESMA***") in response to its Discussion Paper on *The Clearing Obligation under EMIR* (the "***Discussion Paper***" or the "***DP***").[2]

Introduction

Markit is a provider of financial information services to the global financial markets, offering independent data, valuations, risk analytics and related services across regions, asset classes and financial instruments. Our products and services are used by a large number of market participants to reduce risk, increase transparency, and improve the operational efficiency in their financial markets activities.

In the context of the introduction of a Clearing Obligation ("***CO***") for certain categories of OTC derivatives Markit's relevant involvement includes being the sponsor of several credit default swap ("***CDS***") indices and a provider of processing and connectivity services for OTC derivatives across asset classes:

- Markit is a sponsor and administrator of various index families across regions and asset classes, including bonds, CDS and loans. CDS that reference the Markit iTraxx and Markit CDX indices are among the most actively traded credit derivatives in the world and are centrally cleared by several CCPs today.[3]

- The MarkitSERV processing platforms offer confirmation, connectivity, and reporting services to the global OTC derivatives markets, making it easier for participants in these markets to interact with each

[1] Markit is a financial information services company with over 3,000 employees in Europe, North America and Asia Pacific. The company provides independent data and valuations for financial products across all asset classes in order to reduce risk and improve operational efficiency. Please see www.markit.com for additional information.
[2] ESMA Discussion Paper: "The Clearing Obligation Under EMIR." 12 July 2013.
[3] Based on information available from the Depository Trust and Clearing Corporation Trade Information Warehouse ("***DTCC TIW***"), as of August 2013, CDS referencing the various Markit CDS indices total USD $11.1 trillion notional (including $ 1.6 trillion of tranched products). Further information is available here.

other.[4] Specifically, MarkitSERV provides trade processing, confirmation, and matching services for OTC derivatives across regions and asset classes, as well as universal middleware connectivity for downstream processing such as clearing and reporting. Given the connectivity that we have established with the many CCPs around the globe that offer clearing services for OTC derivatives, the MarkitSERV platforms are a key operational tool to enable the timely and efficient introduction of mandatory central clearing in various jurisdictions across a range of market participants and asset classes.[5]

Markit has been actively and constructively engaged in the discussion regarding regulatory reform of the financial markets. We regularly provide regulatory authorities with our insights on current market practice, for example in relation to valuation methodologies, the provision of scenario analysis, the use of reliable and secure means to provide daily marks, or pre-trade credit checks. We have also advised regulatory bodies on potential approaches to enable the timely and cost-effective implementation of newly established requirements, for example through the use of multi-layered phase-in or by providing participants with a choice of means for satisfying regulatory requirements. Over the last several years, we have submitted over 90 comment letters[6] to regulatory authorities around the world and participated in numerous stakeholder meetings.

We welcome the publication of ESMA's Discussion Paper on *The Clearing Obligation under EMIR* and we appreciate the opportunity to provide ESMA with our comments. Specifically, we recommend that ESMA (i) use Option B to determine which Index CDS have to be cleared; (ii) carefully consider the competitive landscape when making CO determinations, specifically where a product is only offered for clearing by a single CCP; (iii) utilize the ISDA Transaction Matrix for product characterization; (iv) use Option B to determine which single name CDS should be subject to the CO; (v) reference the list of "liquid shares" to make CO determinations for equity derivatives; (vi) phase in the CO within 6, 12, and 18 months post effective date for the different categories of market participants; (vii) add clearing membership as additional factor to the existing FC and NFC categorization when defining categories for the introduction of the CO; and (viii) base any determination on the cutoff maturity date for frontloading on a thorough cost/benefit analysis while considering that some firms might want to frontload a larger universe of transactions into CCPs.

Responses to ESMA's questions

a) Index CDS

Question 1 (Series for Index CDS): Please indicate your preference between the options presented. Do you believe that the possibility for a new series to exhibit low liquidity is a risk worth being considered when defining the classes of Index CDS? Under Option C, which criteria do you believe are relevant and how should they be calibrated?

In the Discussion Paper, ESMA presented three options that could be used to determine which series of Index CDS should be subject to the Clearing Obligation:[7] Under Option A, ESMA would determine the first series of the Index CDS to be subject to the CO, with all subsequent series also falling within the scope of

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[4] Such services, which are offered also by various other providers, are widely used by participants in these markets today and are recognized as tools to increase efficiency, reduce cost, and secure legal certainty. With over 2,600 firms globally using the MarkitSERV platforms, including agents for over 30,000 buy-side fund entities, our legal, operational, and technological infrastructure plays an important role in supporting the OTC derivatives markets in Europe, the Asia-Pacific region, and North America. In 2012, over 20 million OTC derivative transaction processing events were processed using MarkitSERV.

[5] MarkitSERV has established and maintains universal, timely and secure connectivity between execution venues, clearing venues and other post-trade service providers across asset classes and regions. Specifically, to support central clearing, we have already established connectivity with 14 CCPs across regions and asset classes, while we are in discussions with a further 5 about establishing connectivity and feeding transaction details to them.

[6] This number includes responses submitted by MarkitSERV, a now fully-owned subsidiary of Markit Group.

[7] ESMA DP pars. 36-38.

the CO. Under Option B any new series would be included automatically in the CO, like in Option A, while ESMA would also be able to remove certain series a posteriori. Option C would be a criteria-based approach based on a predefined set of series and a list of criteria that new Index CDS series would need to comply with in order to be subject to the CO.

We appreciate that, as part of its clearing determination, ESMA would take into account the liquidity of a new Index CDS series.[8] We agree that both the on-the-run and the most recent off-the-run Index CDS series will generally be very liquid and lend themselves to be centrally cleared.[9] This is also reflected by the fact that the relevant CCPs tend to clear newly launched Index CDS series and tenors of the relevant iTraxx and CDX indices from their launch date.[10] ESMA's Option A would therefore seem to be consistent with current practice in the marketplace.

However, we believe that there might indeed be value in ESMA considering Option B. This is because an optional "de-clearing" process would allow ESMA to remove specific index series from the CO in case that traded volumes dropped and liquidity disappeared. Our experience has shown that such situations might occur for index series once they have been off-the-run for many years but might even happen for on-the-run index series due to unforeseeable circumstances.[11] It might therefore prove useful for ESMA to have the authority to remove certain index series from the CO. Such decision should be based on ESMA conducting regular reviews of its existing clearing determinations to ensure equal regulatory treatment of similar products and to avoid any regulation-driven anti-competitive effects.

Based on current market practice and the possibility that, in unforeseen circumstances, even on-the-run or recent off-the-run series of CDS indices could turn illiquid, we believe that ESMA should adopt Option B.

Question 2 (Index CDS): Do you consider that the main characteristics of Index CDS are adequately captured by the proposed structure? Are there any other variables which you consider as relevant in the context of the clearing obligation?

ESMA presents the universe of Index CDS classes for which a clearing solution is offered today, and which may therefore become subject to the CO in the future, assuming that they fulfilled the criteria to be assessed by ESMA.[12]

We believe that ESMA's proposed structure is generally appropriate for the determination of the CO for Index CDS. However, ESMA should note that a derivative product should not be subject to the Clearing Obligation merely because a single CCP offered it for clearing. In case that only a single CCP lists a derivative product that has low liquidity, other CCPs should not be required to also offer it for clearing. We are concerned that such situation could otherwise encourage a "race to the bottom" with CCPs adding more and more complex products to their clearing offering even if they were not in a position to manage the risk.

Question 3 (Index CDS): Do you have preliminary views on the specific items within those classes which would be the best candidates for the clearing obligation, taking into consideration the overarching aim of reducing systemic risk and the criteria defined in Article 5(4) of EMIR?

We appreciate the fact that ESMA has considered current practices in the marketplace and has reviewed whether an Index CDS is already cleared by a number of CCPs.[13]

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[8] "Discussion of the inclusion of new series for Index CDS." ESMA DP, p. 14.
[9] For example, iTraxx Europe Crossover Series 19, the current on-the-run series, has 6,869 outstanding contracts compared to 3,541 for the recent off-the-run series (Series 18) and 1,702 for Series 17based on data from the DTCC TIW.
[10] DTCC TIW data seems to indicate that all new CDS index series have started clearing on the first day of trading.
[11] For example, in the financial crisis liquidity even in on-the-run series of some structured finance CDS indices evaporated and never returned.
[12] ESMA DP Tables 2-4.
[13] "CCP clearing the class" ESMA DP Table 2-4, p. 16.

However, we agree that ESMA should also take into account the actual transaction volume and liquidity of the various Index CDS products when deciding whether they should be subject to the CO. We believe that the introduction of a CO for a specific category of Index CDS is most achievable if such product is widely used and already cleared safely. We do not believe that the introduction of a clearing requirement for certain series of indices that have high volume will materially affect competition or otherwise harm the marketplace.

b) Single name CDS

Question 4 (Single name CDS): Please indicate your preference between the options presented. In relation to Option B, which geographical zones would you define, i.e. how could the currencies be grouped in geographical zones? What is the standard market practise in this respect?

ESMA proposed using the same categorization as it proposed for CDS indices also for single name CDS.[14]

However we respectfully suggest that, instead of establishing a completely new categorization for single name CDS, ESMA considers relying on a categorization that is already available in the marketplace in form of the ISDA Transaction Matrix. As this matrix already publicly provides the information[15] that ESMA proposed as “key characteristics”[16] we recommend that ESMA rely on its parameters[17] to classify Single name CDS[18] rather than creating its own nomenclature.

Question 5 (Single name CDS): Please indicate your preference between the options presented. Under Option C, which criteria do you believe are relevant and how should they be calibrated?

In the DP, ESMA proposed three options on how to determine which Single Name CDS entities should be subject to the CO:[19] Under Option A ESMA would directly identify a set of single names, for example by using an entity identifier. Under Option B a more stable variable, such as membership to a specific index, would be used as a reference. Option C would use a criteria-based approach, whereby ESMA would utilize a list of criteria that the classes should fulfil to fall within the scope of the CO.

We believe that, when introducing a CO for single name CDS, ESMA should make such determination based on the liquidity of single name CDS. This could, for example, be achieved by analysis of the volume data that is captured in Trade Repositories. Given that the composition of the relevant CDS indices is based on such volumes,[20] the use of Option B would achieve a similar objective in an effective manner. However, ESMA should consider that it is possible that a single name CDS might not be clearable even if it has been included in the index.[21] We therefore recommend that ESMA choses Option B while retaining the option to exclude specific single name CDS from the CO based on its further analysis.

c) Equity derivatives

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[14] ESMA DP, par 32.
[15] ISDA Transaction Types includes information such as average trades per day, average notional trades per day, credit events, settlement methods, etc.
[16] Key characteristics include “geographical zone” and “product sub-type”. ESMA DP, Tables 5-6.
[17] The ISDA Transaction Matrix includes parameters such as the transaction type, credit events, obligation category, obligation characteristics, settlement method, and deliverable obligation category.
[18] The major types include: Standard North American Corporate, Standard European Corporate, and Standard Subordinated European Insurance. We believe that the relevant Trade Repositories would be able to provide ESMA with more information about which entities traded for which types.
[19] ESMA DP, pars. 46-50.
[20] Both Markit CDX and Markit iTraxx indices use the average weekly trading activity measured in the current DTCC Report to create a liquidity list that then forms the basis for the inclusion of single name CDS in the relevant indices. Markit CDX Index rules are available here. Markit iTraxx Europe Index rules are available here.
[21] For example, CCPs can be exposed to a self-reference risk related to the clearing of CDS that reference financial and sovereign entities. Further, some single name CDS that are included in CDS indices for the first time might have somewhat limited liquidity at that point in time on a standalone basis. Therefore, using solely index liquidity or index membership to determine the CDS single names that should be subject to the CO might lead to including names that CCPs are not capable of clearing for risk reasons.

Question 10 (Equity derivatives): Please indicate your preference between the options presented. Under Option D, which criteria do you believe are relevant and how should they be calibrated?

ESMA presented four options for the determination of which Equity Single Name Classes should be subject to the CO:[22] Under Option A, ESMA would directly identify the single names that shall be subject to the CO, for example by using an entity identifier. Under Option B, single name entities would be chosen by reference to a more stable variable, such as index membership. Under Option C a cross-reference to the MiFID list of "liquid shares" would be used. Finally, under Option D, ESMA would rely on several criteria that the classes need to fulfil to fall within the scope of the CO.

As discussed above in our response to Question 4, we believe that ESMA should make use of the transaction types from the ISDA Transaction Matrix in its classification. For the CO determination itself, we recommend that ESMA make use of Option C. This is because cross-referencing the MiFID list of liquid shares will recognize the liquidity of the underlying shares as determined by national competent authorities.

d) Implementation

Question 19 (readiness of the classes): Do you agree with this analysis?

We believe that ESMA's preliminary analysis of the readiness of the various asset classes for the introduction of the CO is generally reasonable.[23] As ESMA recognized there are a number of criteria which should be taken into account when performing this analysis. However, we believe that, even if it decided to use different factors and/or analysis, ESMA would likely reach a similar conclusion.

Question 20 (dates, phase in): What would you consider to be the shortest delay to impose a clearing obligation to a class of OTC derivatives when there are several CCPs available? And when there is only one CCP available? Please specify in your answer whether the cause of delay is due to operational issues (e.g. time for CCP/counterparties to be ready for the CO) and/or to market issues (e.g. time for a CCP to add a new product to its offering).

Based on our experience in helping market participants to prepare for the introduction of a mandatory clearing requirement in various jurisdictions,[24] we agree with ESMA's view that the "timing of the CO and the possibility to phase in will be of essence for all stakeholders."[25]

Specifically, we believe that both market participants and the relevant providers of market infrastructure, e.g., CCPs and middleware providers, will need to be given a reasonable period of time to prepare for the introduction of mandatory central clearing. The amount of time that is provided to various categories of market participants should mainly depend on the level of the sophistication and the resources that are available to them to prepare. Specifically, counting from the publication of the CO determination, the phase-in of the CO should be staggered as 6, 12 and 18 months respectively for the various categories of market participants that need to comply with it. Such approach should provide both market participants and infrastructure providers with sufficient time to prepare for the introduction of the CO.

Additionally, we agree with ESMA that certain factors could impede or slow down[26] the process of gaining access to clearing:

[22] ESMA DP, pars. 66-70.
[23] ESMA DP pars. 85-105.
[24] By integrating electronic allocation and trade confirmation MarkitSERV provides a single gateway for the processing of OTC derivative transactions. As a third-party middleware provider, MarkitSERV provides universal, timely, and secure connectivity between the numerous counterparties, execution venues and CCPs as well as Trade Repositories and other post-trade service providers. On that basis, our platforms have helped market participants and CCPs to prepare for the introduction of the clearing requirement in various jurisdictions around the globe.
[25] ESMA DP par. 107.
[26] ESMA DP par. 111.

- In case that a CO is also introduced in other jurisdictions concurrently, market participants are likely to have already committed the necessary resources elsewhere and might hence not be available for preparation for ESMA's CO requirement. ESMA should therefore carefully consider the international context when setting a timetable for the introduction of the CO in Europe, and, ideally, set the timing for the introduction of the CO to allow for an "international phase-in" of the CO requirement.

- A delay might also arise in a situation where the CO was to apply at a point in time when only one CCP is clearing the product category.

We urge ESMA take these considerations into account when making CO determinations and setting a timeframe for the implementation of the CO.

Question 25 (categories of counterparties): Please indicate your preference between the options presented. Would you rather use an option that is not detailed here? Under Options B and C, do you agree to base the clearing access approach on the asset class to which the counterparties have access? What should be the date on which clearing access/threshold calculations should be assessed?

ESMA proposed three options for determining the categories of counterparties that should be subject to the CO at different points in time:[27] Under Option A, ESMA would rely on the categories of counterparties as defined in EMIR, i.e., FCs and NFCs. Option B would further divide the FC category into (i) clearing members and (ii) the rest of FCs. Option C would focus on the importance of the counterparty's activity in terms of transactional volume.

ESMA states that "asset classes might be the easiest criteria to use when determining whether or not counterparties have access to clearing."[28] We agree that the setting of the CO should be performed at the asset class level as firms do not always have the same role or volume within the various asset classes. That said, we believe that Option B represents the most appropriate approach to creating categories of market participants in this context. This is because it would pragmatically rely on a relevant existing categorization while reflecting a further important factor of access to clearing.

e) Front loading

Question 28 (remaining maturity): What are your views regarding the calibration of the remaining maturity of the contracts to be subject to the CO? What criteria should ESMA take into account when defining it?

ESMA stated that "the determination of the remaining maturity of the contract may be used as an efficient tool to ensure that the frontloading requirement is proportionate"[29] and asked for comments on how to best determine the remaining maturity.

We appreciate ESMA's view that the requirement to frontload existing derivatives contracts into CCPs should be designed to be "proportionate" and we believe that, to achieve this objective, the determination of the relevant maturity cutoff must be based on a thorough cost-benefit analysis. That said it seems clear that the backloading of short-dated derivative contracts will be of rather limited value given the smaller risk they contain and the closeness to their expiration. We would therefore expect ESMA to come to the conclusion that the cost of frontloading transactions into CCPs will outweigh the potential benefits of risk reduction if their maturity is less than a certain number of years.

[27] ESMA DP par. 124-127.
[28] ESMA DP par. 126.
[29] ESMA DP par. 135.

However, while ESMA will determine a cutoff maturity for the frontloading of existing derivative contracts into CCPs, it should also acknowledge that some firms might find it challenging to reliably separate their overall trade population into different maturity buckets or might want to take advantage of netting benefits. We therefore recommend that, regardless of the cutoff maturity that ESMA eventually determines, it should also allow firms to backload *all* of their outstanding contracts into CCPs without using a maturity cutoff, if this happened to be their preference.

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Markit appreciates the opportunity to comment on ESMA's Discussion Paper on *The Clearing Obligation under EMIR.* We would be happy to elaborate or further discuss any of the points addressed above. In the event you may have any questions, please do not hesitate to contact the undersigned or Marcus Schüler at marcus.schueler@markit.com.

Yours sincerely,

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