

September 30, 2022

European Securities and Markets Authority
201-203 rue de Bercy
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VIA Electronic Submission: www.esma.europa.eu

Re: Consultation Paper on the Clearing and Derivative Trading Obligations in View of the 2022 Status of the Benchmark Transition

We appreciate the opportunity to respond to the European Securities and Markets Authority (“ESMA”) on its proposal to amend the classes of interest rate swaps that are subject to the clearing obligation (“CO”) and the derivatives trading obligation (“DTO”).¹ We support ESMA’s proposal to extend the CO to additional maturities of Overnight Index Swaps (“OIS”) referencing the Secured Overnight Financing Rate (“SOFR”). We also support ESMA’s proposal to apply the DTO to certain classes of OIS referencing €STR and, as discussed below, we also believe it is appropriate for ESMA to apply the derivatives trading obligation to OIS referencing SOFR.

The clearing and trading obligations are central pillars of the post-crisis reforms to the OTC derivatives markets. Central clearing is not only an important tool to mitigate systemic risk, it also promotes market liquidity, increases transparency, and protects investors. As the global interest rate derivatives market transitions away from referencing interbank offered rates (such as USD LIBOR) to referencing new risk-free reference rates, it is critical that the post-crisis reforms, including the clearing and trading obligations, are applied to these new OTC derivative contracts.

I. Amendments to the CO

We believe it is appropriate to extend the CO to OIS referencing SOFR with maturities up to 50 years, and agree with ESMA’s determination that the relevant criteria are met.² SOFR now accounts for more than 20% of the overall outstanding volume in interest rate derivatives denominated in USD in the European markets, a significant increase compared to January 2021 where only 1.5% of volume in USD denominated interest rate derivatives referenced SOFR.³ The rate of adoption of SOFR is also increasingly rapidly. In Q1 2022, the consultation paper notes that more than 60% of new USD swaps executed in the E.U. market referenced SOFR.⁴

¹ Consultation Paper on the Clearing and Derivative Trading Obligations in View of the 2022 Status of the Benchmark Transition (Jul. 11, 2022) available at https://www.esma.europa.eu/sites/default/files/library/esma70-446-369_consultation_paper_on_co_and_dto_referencing_estr.pdf.

² The CO currently applies to SOFR OIS with maturities up to 3 years.

³ Consultation Paper at 30-31.

⁴ *Id.* (citing Kirston Winters, IBOR reform: LIBOR deadlines, where are we now – global outlook Q1 2022 review, Osttra (May 10, 2022) available at <https://osttra.com/articles/ibor-reform-libor-deadlines-where-we-are-now-global-outlook-q1-2022-review/>).

Importantly, liquidity in these contracts is spread across the entire curve, including contracts with maturities up to 50 years.⁵

We further agree with ESMA’s view that there is no need to introduce an additional phase-in period to ensure an orderly and timely implementation. Market participants have in place the operational and technological infrastructure to support clearing the extended maturities of USD SOFR OIS and, as the consultation paper notes, a large majority of USD SOFR OIS are already voluntarily cleared.⁶ Significant voluntary clearing demonstrates the confidence market participants have in the current clearing offerings.

Lastly, we support ESMA’s efforts to harmonize clearing obligations with the U.S. Commodity Futures Trading Commission (“CFTC”). In August, the CFTC published a rule that requires clearing of SOFR OIS with maturities ranging from 7 days to 50 years, and this rule went into effect on September 23.⁷ Thus, ESMA’s proposal would align the scope of the E.U. and U.S. COs, which will contribute to a smoother transition globally.

II. *Amendments to the DTO*

We agree with ESMA’s proposal to include contracts referencing €STR in the DTO, and with the corresponding analysis set forth in the consultation paper. With regard to the DTO for contracts referencing SOFR, the consultation paper notes increasing trading activity in SOFR, but suggests it is premature to consider contracts referencing SOFR for the DTO because the transition is still on-going and the CFTC has not included contracts referencing SOFR in its trading mandate.

However, we believe there is sufficient liquidity to support applying the DTO to contracts referencing SOFR. While the consultation paper references the status of the U.S. clearing and trading requirements, as noted above, the CFTC’s clearing mandate for SOFR OIS only became effective September 23. Under the U.S. framework, now that the clearing mandate is in effect, a swap execution facility may submit a determination that triggers the trade execution requirement, which is expected to occur in the near future.⁸ Given the significant volume and liquidity of E.U. trading in SOFR OIS, we believe now is an appropriate time to also consider contracts referencing SOFR for the trading obligation. The DTO has delivered material improvements to pre- and post-trade transparency and led to a more open, level and competitive playing field. We believe applying the trading obligation to SOFR OIS will result in the same benefits.

⁵ *Id.* at 31.

⁶ *Id.* at 39.

⁷ “Clearing Requirement Determination Under Section 2(h) of the Commodity Exchange Act for Interest Rate Swaps To Account for the Transition From LIBOR and Other IBORs to Alternative Reference Rates,” 87 Fed. Reg. 52,182 (Aug. 24, 2022).

⁸ See Letter from Elisabeth Kirby, Head of Market Structure, Tradeweb to Christopher Kirkpatrick, Secretary, CFTC (Jan. 21, 2021) (“Tradeweb believes that RFR-linked contracts that satisfy the Mandatory Clearing Criteria are also likely to meet the MAT criteria and would be subject to a MAT determination . . . Tradeweb has seen a significant increase in SOFR-linked swap transactions, and we would similarly expect any additional RFRs exhibiting sufficient liquidity to require clearing under the Mandatory Clearing Criteria would also be MAT on our SEFs”) available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=65917&SearchText=>.

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We appreciate the opportunity to provide comments to ESMA on the clearing and trade obligation in view of the benchmark transition. Please feel free to call the undersigned with any questions regarding these comments.

Respectfully,

/s/ Stephen John Berger
Managing Director
Global Head of Government & Regulatory Policy