



EUROPEAN COMMISSION

Directorate General for Financial Stability, Financial Services and Capital Markets Union

Director General

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Mr Steven Maijoor  
Chairman  
European Securities and Markets  
Authority - ESMA  
103, rue de Grenelle  
F-75345 Paris

Dear Mr Maijoor,

On 1 October 2014, ESMA sent the Commission draft regulatory technical standards (draft RTS) on the clearing obligation for Interest Rate Swaps (IRS) pursuant to Article 5 of Regulation (EU) No 648/2012.

I would like to inform you of the European Commission's intention to endorse with amendments the draft RTS submitted by ESMA. An amended draft RTS containing the amendments the Commission intends to adopt is attached to this letter.

The draft RTS submitted by ESMA lay down the classes of IRS that will be subject to mandatory clearing as well as the different dates from which the clearing obligation will take effect for the four different categories of counterparties identified, for which different phase-in periods are laid down.

In addition, the draft RTS lay down the minimum remaining maturities determining which contracts concluded or novated before the clearing obligation takes effect will have to be cleared when the clearing obligation takes effect ("frontloading"). ESMA proposes frontloading to be applied to contracts concluded by financial counterparties in category 1 or 2 from the date of publication of the RTS in the Official Journal. In particular, ESMA proposes to differentiate between counterparties in Category 2 and Category 3, depending on their level of activity in OTC derivatives – to be measured against a quantitative threshold – and not to apply the frontloading requirement to counterparties in Category 3 (which are below that threshold) by determining specific remaining maturities which de facto exclude frontloading for Category 3.

The Commission considers that the draft RTS submitted by ESMA raise some important issues which require the following amendments of the draft RTS.

***1. Postponing the starting date of the frontloading requirement***

ESMA proposes the frontloading requirement to start from the publication of the RTS in the Official Journal. However, the proposed starting date will not allow counterparties to implement the practical arrangements necessary for frontloading to take place. In particular, counterparties have to calculate the price of frontloading to include it in their contracts and

communicate their counterparties whether they are subject to the frontloading requirement. Therefore, the starting date of frontloading should be delayed until counterparties can become aware of whether the contracts they enter into are subject to and until they can implement the necessary arrangements for frontloading to take place.

In particular, intragroup transactions between counterparties in Category 1 which benefit from the exemption from the clearing obligation pursuant to Article 4.2 (a) of Regulation (EU) No 648/2012 are not subject to frontloading. Therefore, frontloading should not start for counterparties in category 1 until they can know whether they benefit from the exemption from clearing pursuant to Article 4(2)(a) of that Regulation. Postponing the start date of frontloading for counterparties in Category 1 until two months after the entry into force of the RTS will provide those counterparties with sufficient time to know whether they benefit from that exemption before the frontloading takes effect.

Financial counterparties other than Category 1 should not be subject to frontloading before they can know whether they reach the threshold to fall under Category 2 and before they have sufficient time after that to make the necessary arrangements for frontloading to take place. In particular, those financial counterparties need to implement the necessary arrangements to carry out the calculations of the threshold. Moreover, after a financial counterparty knows that it falls within Category 2, it has to adopt the necessary arrangements to be able to frontload contracts, including providing the appropriate representations to its counterparties and making the appropriate changes to its systems, controls and internal procedures to reflect these determinations and representations.

Postponing the start date of the frontloading requirement for financial counterparties in Category 2 until five months after the entry into force of the RTS will provide those counterparties with sufficient time to implement the necessary arrangements to calculate the threshold and after that, implement the necessary arrangements for frontloading.

The postponement of the starting date of the frontloading requirement for counterparties in Category 2 would also require an adaptation of the period to be taken into account for the calculation of the threshold, so that the threshold is calculated taking into account the most recent period before frontloading starts, to be aligned with the period for the calculation of the threshold proposed by ESMA. The period to take into account for the calculation of the threshold should be the three months following the publication of the RTS in the Official Journal, excluding the month of the publication.

## **2. Clarifying the calculation of the threshold for investment funds**

The Commission considers that it is necessary to provide some clarification regarding the application of the quantitative threshold for determining counterparties falling in category 2. In particular, it is proposed to include a recital clarifying that, for investment funds, the threshold should be calculated per single fund instead of at group level provided that in the event of fund insolvency or bankruptcy, the funds are distinct legal entities that are not collateralised, guaranteed or supported by other investment funds or the investment advisor itself.

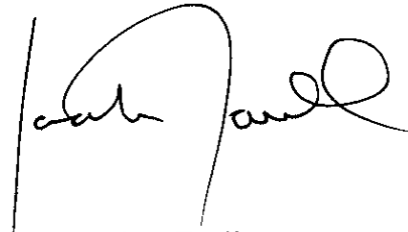
## **3. Excluding from the scope of the clearing obligation non-EU intragroup transactions**

OTC derivative transactions entered into between two counterparties established in a Member State and in a third country and belonging to the same group should not be subject to the clearing obligation for a period of three years. In fact, those transactions can be exempted from clearing pursuant to Article 4.2 (b) of Regulation (EU) No 648/2012 when equivalence decisions pursuant to Article 13 of Regulation (EU) No 648/2012 are adopted. However, those equivalence decisions cannot be adopted before the RTS enter into force.

Therefore, transactions entered into between two counterparties established in a Member State and in a third country and belonging to the same group should be excluded from the clearing obligation for a sufficient period of time allowing the Commission to adopt those equivalence decisions or until those decisions are adopted, whichever happens the earlier.

I therefore inform you that the Commission, acting in accordance with the procedure set out in the fifth and sixth subparagraphs of Article 10(1) of Regulation (EU) No 1095/2010, intends to endorse with amendments the draft regulatory technical standard submitted by ESMA on the clearing obligation for IRS, as proposed in the amended draft RTS attached.

Yours sincerely,



Jonathan Faull