



European Securities and
Markets Authority

Final Report

**EMIR RTS on the novation of contracts for which the clearing obligation
has not yet taken effect**



Table of Contents

| | | |
|-----|---|----|
| 1 | Executive Summary | 3 |
| 2 | Final report..... | 5 |
| 2.1 | Background..... | 5 |
| 2.2 | Rationale..... | 5 |
| 2.3 | Proposed amendments | 6 |
| 3 | Annexes | 8 |
| 3.1 | Annex I - ESMA mandate to develop draft technical standards | 8 |
| 3.2 | Annex II - Impact assessment | 9 |
| 3.3 | Annex III - Draft technical standards..... | 12 |



Acronyms used

| | |
|-----------------|---|
| CCP | Central Counterparty |
| EMIR | European Market Infrastructures Regulation – Regulation (EU) 648/2012 of the European Parliament and Council on OTC derivatives, central counterparties and trade repositories |
| ESMA | European Securities and Markets Authority |
| ESMA Regulation | Regulation (EU) Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC |
| ESRB | European Systemic Risk Board |
| NCA | National Competent Authority |
| OTC | Over-the-counter |
| RTS | Regulatory Technical Standards |
| TEU | Treaty on the European Union |

1 Executive Summary

Reasons for publication

This final report presents new draft regulatory technical standards (RTS) on the clearing obligation, that ESMA has developed under Article 5(2) of Regulation (EU) No 648/2012 of the European Parliament and Council on OTC derivatives, central counterparties and trade repositories (EMIR). The draft RTS relate to the treatment of OTC derivative contracts novated from a counterparty established in the United Kingdom to a counterparty established in another Member State, as a consequence of the notification of its intention to withdraw from the Union.

In the context of the withdrawal of the United Kingdom, stakeholders have asked for a general grandfathering for legacy OTC derivatives contracts between UK and EU counterparties, but ESMA does not consider it to be appropriate to provide for a general grandfathering and it is not in its mandate.

However, ESMA considers it to be appropriate to preserve the characteristics of contracts for which clearing was not required, and which contracts are subsequently novated from one counterparty authorised in the UK to another counterparty authorised in another Member State, in order to address the situation whereby the original UK counterparty may no longer be authorised to provide certain services across the EU after the UK has withdrawn from the EU.

There are currently three Commission Delegated Regulations on the clearing obligation, which mandate a range of interest rate and credit derivative classes to be cleared. ESMA's proposal includes an amendment of these three Commission Delegated Regulations, in order to facilitate certain novations during a specific time-window.

Given the urgency with which it is necessary to provide this regulatory solution in order to facilitate the transfer of contracts to counterparties located in the EU in view of the withdrawal, where counterparties decide to do so, in accordance with Article 10(1) of ESMA Regulation¹, ESMA has not conducted any open public consultation.

Contents

This paper provides explanations on the draft RTS amending the current Commission Delegated Regulations on the clearing obligation with respect to the treatment of novated contracts from a counterparty established in the United Kingdom to a counterparty in another Member State. Section I explains the background to our proposals, Section II details the rationale for the RTS amendments and Section III outlines ESMA's proposal.

Next Steps

The Final Report is sent to the European Commission to submit the draft technical standards presented in Annex for endorsement in the form of Commission Delegated Regulations, i.e. a legally binding instrument applicable in all Member States of the European Union. Following the endorsement, they are then subject to the review of the European Parliament and of the Council.

¹ Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC, OJ L 331, 15.12.2010, p. 84–119

2 Final report

2.1 Background

1. In the context of the future withdrawal of the United Kingdom from the EU, stakeholders have asked for a general grandfathering for OTC derivative contracts, and an exemption from certain requirements stemming from EMIR.
2. Post-withdrawal, counterparties established in the United Kingdom will no longer be able to provide investment services in the EU under the current passport regime, so they might not be in a position to execute certain operations in relation to derivative contracts they have with EU clients, in particular certain so-called “life-cycle events” that can be construed in certain jurisdictions as the entering into new transactions (such as novations, unwinding by entering into an offsetting transaction, compression with new replacement contracts, etc.).
3. This means that after the withdrawal the performance of certain restructuring operations on certain contracts would require authorisation in some Member States, in line with national third country regimes. Those counterparties established in the State that withdrew from the EU would then face 27 national third country regimes.
4. In order to address this situation, these counterparties might have to novate their contracts to entities established and authorised in the EU, which would benefit from the single passport in financial services.
5. However, the resulting new contracts might be subject to new obligations that were not applicable at the time the original contracts were signed and for which, in the absence of such withdrawal, they might have continued enjoying an exemption (please see Section 2.2 below for more details on the rationale of the proposed amendments).
6. This would represent a clear disincentive to transfer contracts to firms established in the EU and ESMA has thus considered some actions aiming at facilitating the transfer of contracts by the private sector to counterparties established in the EU (please see Section 2.3 below, for more details on the proposed amendments), to ensure that the regulatory characteristics of the original contracts are preserved.

2.2 Rationale

7. This final report focuses on bilateral non-centrally cleared OTC derivative contracts currently benefitting or that would benefit from the grandfathering arrangements under EMIR, i.e. contracts which, to this date, have not become subject to the clearing obligation, either because the respective dates of taking effect set out in the Commission Delegated

Regulations for each type of derivative contracts have not occurred yet, or because the contracts have not been novated after those dates (often referred to as “legacy contracts”).

8. If, due to the withdrawal from the EU of the United Kingdom in which one of the counterparties is established, the parties decide to novate their legacy contracts from that counterparty to a new counterparty established in the EU, the novation of the contracts will trigger the clearing obligation set out in Article 4(1) of EMIR if such novation occurs “*on or after the date from which the clearing obligation takes effect*” for that type of contract. As a result, the parties will have to clear that contract in an authorised or recognised CCP.
9. Therefore, the novation of such legacy contracts in the EU would make, *ceteris paribus*, the overall performance of the contracts more costly for the parties, due to the application of the clearing obligation.
10. Given that these shortcomings are a direct consequence of the withdrawal of the United Kingdom from the EU, an event that is beyond the control of the parties, and that this may put the EU counterparties facing UK counterparties at a disadvantage compared to EU counterparties facing other EU counterparties, ESMA considers that it is relevant to maintain a level playing field and it is proposing amendments to the existing Commission Delegated Regulations that would allow these counterparties to novate their contracts to EU counterparties without triggering the EMIR clearing obligation.

2.3 Proposed amendments

11. Under Article 5 of EMIR ESMA has been entrusted to develop 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).
12. This mandate has led to three Commission Delegated Regulations on the clearing obligation (Commission Delegated Regulations (EU) No 2015/2205, No 2016/592 and No 2016/1178), which are based on the corresponding three draft RTS developed by ESMA. They cover a range of OTC derivative classes in the interest rate and credit derivative asset

classes. The details of the classes subject to the clearing obligation and the associated implementation calendar are maintained in a dedicated Public Register².

13. ESMA has investigated the possibility to set out an exemption from the clearing obligation under EMIR, which would create a time-window to relocate trades in the EU27 without triggering EMIR. This final report contains the proposed amendments to each of the three Commission Delegated Regulations on the clearing obligation mentioned in the previous paragraph.
14. ESMA's proposal (see Annex III) is to create de facto a transversal sub-class of contracts, in respect of which the clearing obligation has not been triggered at the time of entry into force of this amending regulation and a window for the counterparties to novate them to an EU counterparty without triggering the application of the clearing obligation.
15. Nonetheless, this exemption should not allow parties to fully restructure their transactions to take advantage of a pure business opportunity without ever being subject to the clearing obligation. To this end, such exemption is proposed:
 - a. For a limited scope: it would only apply to the novation to a new EU counterparty, which would not trigger EMIR clearing obligation, and would not extend to other life-cycle events performed by the parties in relation to such contract, and
 - b. For a limited period of time, which we have defined as going from the date of application of this amending regulation until twelve months after the withdrawal, in order to allow for the repapering.
16. In order to benefit from this exemption, parties should thus start negotiating the novations of their transactions which are in the scope of this amending regulation as soon as possible, given the 12-month time period to benefit from it. Should the parties agree on the terms of a novation before the date of application of this amending regulation, they should provide that these novations would take effect only upon the occurrence of Brexit to benefit from the exemption.
17. Finally, given the urgency with which it is necessary to provide this regulatory solution in order to facilitate these novations and to reduce some of the legal uncertainty attached to the situation described above, ESMA has not conducted any open public consultation in accordance with the second subparagraph of Article 10(1) of ESMA Regulation. That urgency has also rendered the prior consultation of the Securities and Markets Stakeholder Group (SMSG) impossible.

² 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>

3 Annexes

3.1 Annex I - ESMA mandate to develop draft 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.

3.2 Annex II - Impact assessment

3.2.1 Executive Summary

Pursuant to Article 10(1) of the ESMA Regulation, ESMA shall conduct open public consultations on draft RTS and analyse the related potential costs and benefits, where appropriate. Such consultations and analyses shall be proportionate in relation to the scope, nature and impact of the draft RTS. Given the urgency with which it is necessary to provide the regulatory solution in order to address the situation described in this report, in accordance with the second subparagraph of Article 15(1) of ESMA Regulation, ESMA has not conducted any open public consultation.

3.2.2 Introduction

Under Article 5 of EMIR, ESMA is mandated to develop and submit to the European Commission for endorsement draft technical standards specifying, inter alia, 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 the minimum remaining maturity of the OTC derivative contracts referred to in Article 4(1)(b)(ii).

Three Commission Delegated Regulations on the clearing obligation, based on draft RTS developed by ESMA under Article 5 of EMIR, have now entered into force. Articles 3 of these three Commission Delegated Regulations contain dates of application of the clearing obligation.

Considering the future withdrawal of the United Kingdom from the Union, and loss of passport of the UK counterparties to OTC derivative contracts, they might decide with their EU counterparties to novate such contracts to an EU counterparty. However this would, for contracts until then exempted from clearing for various reasons, trigger the application of the clearing obligation.

In order to ensure that the regulatory and economic conditions under which the contracts were originally entered into are preserved, ESMA proposes to amend the three Commission Delegated Regulations on the clearing obligation.

3.2.3 Baseline

The purpose of the amending draft RTS proposed in Annex III hereto is to set out a limited exemption from the clearing obligation, creating a limited time-window which could allow for the novation of OTC derivative contracts from UK counterparties to EU27 counterparties without triggering the clearing obligation in respect of the newly novated contracts.

3.2.4 Cost benefit analysis

Temporary exemption from clearing obligation

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| Policy objective | <p>To ensure a level-playing field between EU counterparties to OTC derivative contracts which, until the date of entry into force of this proposed amending regulation, are not subject to the clearing obligation</p> <p>The future withdrawal of the UK from the Union creates a disadvantage for EU counterparties to OTC derivative contracts entered into with UK counterparties, as they might need to novate their contracts to a counterparty established in an EU27 Member State and this would trigger the application of the clearing obligation to their contract, if the RTS are not amended.</p> |
| Technical proposal | <p>To create an exemption from the clearing obligation, limited in two ways:</p> <ul style="list-style-type: none"> - Limited in scope: novations of OTC derivative contracts to the exclusive effect of replacing a UK counterparty by an EU27 counterparty, and not any other type of novation - Limited in time: novations carried out between the date of entry into force of this Amending regulation until one year after the withdrawal of the UK from the Union. |
| Benefits | <ul style="list-style-type: none"> - Maintain level-playing field between EU27 counterparties to OTC derivative contracts exempted from clearing obligation by preserving the regulatory and economic characteristics of the contracts as at the time it was initially entered into. - Remove a disincentive (loss of exemption) to the novation of OTC derivative contracts from a UK counterparty to a EU27 counterparty. |
| Costs | <p>The costs are linked to the loss of passport of UK investment firms, which is linked to the withdrawal of the UK from the Union. The loss of passport might result in the impossibility of UK counterparties to continue serving the relevant contracts, given that depending on national laws in EU27 Members States, certain life cycle events might require an authorisation to be provided, so the lack of an authorisation might render impossible to EU27 counterparties to exercise life cycle events. To overcome this problem, EU27 counterparties might decide to repaper their contracts with EU27 counterparties. The repapering exercise has a cost, but again this</p> |

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| | <p>cost is linked to the loss of passport not to the proposed amended RTS. Therefore, there is no significant one-off or on-going additional costs to regulators or compliance costs for the relevant supervised entities linked to the amended RTS.</p> |
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3.3 Annex III - Draft technical standards

COMMISSION DELEGATED REGULATION (EU) .../..
amending Delegated Regulation (EU) 2015/2205, Delegated Regulation (EU)
2016/592 and Delegated Regulation (EU) 2016/1178 as regards the date at
which the clearing obligation takes effect for certain types of contracts

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 repositories³, and in particular Article 5(2) thereof,

Whereas:

- (1) On 29 March 2017, the United Kingdom notified the European Council of its intention to withdraw from the Union pursuant to Article 50 of the Treaty on European Union. Consequently, unless another date is established in a withdrawal agreement, or the European Council, in agreement with the United Kingdom, unanimously establishes another date, Union law will cease to apply to the United Kingdom from 30 March 2019. The United Kingdom will then become a third country.
- (2) The clearing obligation laid down in Regulation (EU) No 648/2012 does not take into account the eventuality of a Member State withdrawing from the Union. The challenges faced by those parties to an OTC derivative contract whose counterparties are established in the United Kingdom are a direct consequence of an event that is beyond their control and may put them at a disadvantage compared to other counterparties in the Union.

³ OJ L 201, 27.7.2012, p. 1.

- (3) Commission Delegated Regulation (EU) 2015/2205⁴, Commission Delegated Regulation (EU) 2016/592⁵ and Commission Delegated Regulation (EU) 2016/1178⁶ specify the dates from which the clearing obligation is to take effect for contracts pertaining to certain classes of OTC derivatives. In addition, those Regulations provide for different dates depending on the category of counterparty to those contracts.
- (4) Counterparties cannot foresee what the status of a counterparty established in the United Kingdom might become or to what extent that counterparty would be able to continue providing certain services to counterparties established in the Union. To address that situation, counterparties may want to novate the contract by replacing the counterparty established in the United Kingdom with a counterparty in a Member State.
- (5) If, due to the withdrawal from the Union of the United Kingdom in which one of the counterparties is established, the parties decide to replace their UK counterparty to their contracts with a new counterparty established in the Union, the novation of the contracts will trigger the clearing obligation if such novation occurs on or after the date from which the clearing obligation takes effect for that type of contract. As a result, the parties will have to clear that contract in an authorised or recognised CCP.
- (6) Centrally cleared contracts are subject to a different collateral regime than non-centrally cleared contracts.
- (7) In order to ensure the smooth functioning of the market and a level playing field between counterparties established in the Union, counterparties should be able to replace counterparties established in the United Kingdom with counterparties in a Member State without triggering the clearing obligation. The date from which the clearing obligation takes effect for the novation of those contracts should be 12 months after the date of application of this amending Regulation.
- (8) Delegated Regulation (EU) 2015/2205, Delegated Regulation (EU) 2016/592 and Delegated Regulation (EU) 2016/1178 should therefore be amended accordingly.
- (9) This Regulation is based on the draft regulatory technical standards submitted by the European Securities and Markets Authority to the Commission.

⁴ Commission Delegated Regulation (EU) 2015/2205 of 6 August 2015 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on the clearing obligation (OJ L 314, 1.12.2015, p. 13).

⁵ Commission Delegated Regulation (EU) 2016/592 of 1 March 2016 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on the clearing obligation (OJ L 103, 19.4.2016, p. 5).

⁶ Commission Delegated Regulation (EU) 2016/1178 of 10 June 2016 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on the clearing obligation (OJ L 195, 20.7.2016, p. 3).

- (10) It is necessary to facilitate the implementation of efficient solutions by market participants as quickly as possible. Therefore, the European Securities and Markets Authority has analysed the potential related costs and benefits but has not conducted any open public consultation in accordance with the second subparagraph of Article 15(1) of Regulation (EU) No 1095/2010 of the European Parliament and of the Council⁷ and this Regulation should enter into force on the day following that of its publication.

HAS ADOPTED THIS REGULATION:

Article 1
Amendments to Delegated Regulation (EU) 2015/2205

Delegated Regulation (EU) 2015/2205 is amended as follows:

- (1) in Article 3, the following paragraph is added:

“3. By way of derogation from paragraphs 1 and 2, in respect of contracts pertaining to a class of OTC derivatives set out in the Annex the clearing obligation shall take effect 12 months from the date of application of this amending Regulation where the conditions laid down in the second subparagraph are fulfilled.

The derogation laid down in the first subparagraph shall only apply where the following conditions are fulfilled:

(a) the clearing obligation has not been triggered by [*OP: Insert the date of entry into force of this amending Regulation*];

(b) the contracts are novated for the sole purpose of replacing the counterparty established in the United Kingdom with a counterparty established in a Member State.”;

- (2) in Article 4, paragraph 3 is replaced by the following:

“3. For financial counterparties in Category 3 and for transactions referred to in Article 3(2) and (3) of this Regulation concluded between financial counterparties, the minimum remaining maturity referred to in point (ii) of Article 4(1)(b) of Regulation (EU) No 648/2012, at the date the clearing obligation takes effect, shall be:

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

⁷ Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC (OJ L 331, 15.12.2010, p. 84).

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

Article 2

Amendments to Delegated Regulation (EU) 2016/592

Delegated Regulation (EU) 2016/592 is amended as follows:

(1) in Article 3, the following paragraph is added:

“3. By way of derogation from paragraphs 1 and 2, in respect of contracts pertaining to a class of OTC derivatives set out in the Annex the clearing obligation shall take effect 12 months from the date of application of this amending Regulation where the conditions laid down in the second subparagraph are fulfilled.

The derogation laid down in the first subparagraph shall only apply where the following conditions are fulfilled:

(a) the clearing obligation has not been triggered by [*OP: Insert the date of entry into force of this amending Regulation.*];

(b) the contracts are novated for the sole purpose of replacing the counterparty established in the United Kingdom with a counterparty established in a Member State.”;

(2) in Article 4, paragraph 3 is replaced by the following:

“3. For financial counterparties in Category 3 and for transactions referred to in Article 3(2) and (3) of this Regulation concluded between financial counterparties, the minimum remaining maturity referred to in point (ii) of Article 4(1)(b) of Regulation (EU) No 648/2012, at the date the clearing obligation takes effect, shall be 5 years and 3 months.”.

Article 3

Amendments to Delegated Regulation (EU) 2016/1178

Delegated Regulation (EU) 2016/1178 is amended as follows:

(1) in Article 3, the following paragraph is added:

“3. By way of derogation from paragraphs 1 and 2, in respect of contracts pertaining to a class of OTC derivatives set out in the Annex the clearing obligation shall take effect 12 months from the date of application of this amending Regulation where the conditions laid down in the second subparagraph.

The derogation laid down in the first subparagraph shall only apply where the following conditions are fulfilled:

(a) the clearing obligation has not been triggered by [*OP: Insert the date of entry into force of this amending Regulation.*];

(b) the contracts are novated for the sole purpose of replacing the counterparty established in the United Kingdom with a counterparty established in a Member State.”;

(2) in Article 4, paragraph 3 is replaced by the following:

“3. For financial counterparties in Category 3 and for transactions referred to in Article 3(2) and (3) of this Regulation concluded between financial counterparties, the minimum remaining maturity referred to in point (ii) of Article 4(1)(b) of Regulation (EU) No 648/2012, at the date the clearing obligation takes effect, shall be:

(a) 15 years for contracts that belong to the classes in Table 1 set out in Annex I;

(b) 3 years for contracts that belong to the classes in Table 2 set out in Annex I.”.

Article 4 *Entry into force and application*

This Regulation shall enter into force on the day following that of its publication in the *Official Journal of the European Union*.

It shall apply from the date following that on which Union law ceases to apply to the United Kingdom pursuant to Article 50(3) of the Treaty on European Union.

However, this Regulation shall not apply if any of the following conditions is fulfilled:

(a) a withdrawal agreement concluded with the United Kingdom in accordance with Article 50(2) of the Treaty on European Union has entered into force by that date;

(b) a decision has been taken to extend the two year period referred to in Article 50(3) of the Treaty on 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]