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June 5, 2015

EU Regulators Issue Consultation Paper on Clearing Obligation for Additional Classes of Interest Rate Derivatives

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TO: CLOSED-END INVESTMENT COMPANY MEMBERS No. 19-15
DERIVATIVES MARKETS ADVISORY COMMITTEE No. 40-15
ICI GLOBAL MEMBERS No. 20-15
INTERNATIONAL MEMBERS No. 20-15
INVESTMENT ADVISER MEMBERS No. 14-15 RE: EU REGULATORS ISSUE CONSULTATION PAPER ON CLEARING OBLIGATION FOR ADDITIONAL CLASSES OF INTEREST RATE DERIVATIVES

On May 11, 2015, the European Securities and Markets Authority (“ESMA”) issued its fourth consultation on central clearing of OTC derivatives within the European Union. [\[1\]](#) The Consultation Paper follows ESMA’s publication of three prior consultation papers on the clearing obligation for: certain interest rate derivative classes, [\[2\]](#) certain credit derivative classes, [\[3\]](#) and certain classes of foreign exchange non-deliverable forward derivatives (“NDFs”). [\[4\]](#) ESMA has also published a final report on the clearing obligation for certain interest rate derivative classes, [\[5\]](#) as well as a feedback statement on NDFs. [\[6\]](#)

The Consultation Paper seeks views on the draft regulatory technical standards (“second RTS”) for the clearing of additional classes of interest rate swaps (“IRS”) and forward rate agreements (“FRA”) that were not included in the first draft RTS on the clearing obligation for IRS (“first RTS”). [\[7\]](#) After the consultation, ESMA will submit the second RTS to the European Commission for endorsement.

Classes Proposed to be Subject to Clearing Obligation

The first RTS covered certain classes of such derivatives denominated in the G4 currencies (EUR, GBP, JPY, USD). The second RTS would include additional classes of OTC interest rate derivatives denominated in certain non-G4 European currencies (CZK, DKK, HUF, NOK, PLN, and SEK). The second RTS would include six classes of fixed-to float IRS and three classes of FRA to be subject to central clearing (based on the non-G4 European currencies listed above and a range of underlying indices). The following tables provide the classes that are proposed to be subject to the clearing obligation.

Fixed-to-float interest rate swaps class

Type	Reference Index	Settlement Currency	Maturity	Settlement Currency	Type	Optionality
Notional Type	Fixed-to-Float	PRIBOR CZK	28D-5Y	Single currency	No Constant or Variable	
Fixed-to-Float	CIBOR DKK	28D-5Y	Single currency	No Constant or Variable	Fixed-to-Float	
BUBOR HUF	28D-5Y	Single currency	No Constant or Variable	Fixed-to-Float	NIBOR NOK	
28D-5Y	Single currency	No Constant or Variable	Fixed-to-Float	WIBOR PLN	28D-5Y	Single currency
No Constant or Variable	Fixed-to-Float	STIBOR SEK	28D-15Y	Single currency	No Constant or Variable	

Forward rate agreement class

Type	Reference Index	Settlement Currency	Maturity	Settlement Currency	Type	Optionality
Notional Type	FRA	NIBOR NOK	3D-1Y	Single currency	No Constant or Variable	FRA WIBOR
PLN	3D-1Y	Single currency	No Constant or Variable	FRA	STIBOR SEK	3D-2Y
Single currency	No Constant or Variable					

Phase-in Period

The clearing obligation will take effect following a phased implementation depending on the type of counterparty. ESMA proposes to use the same categories of counterparties and phase-in periods as it proposed in the first RTS, subject to several adjustments.

Specifically, the proposed categories are:

- Category 1: Clearing members that, on the effective date of the second RTS, have existing clearing arrangements with any central counterparty (“CCP”) to clear at least one of the classes of derivatives proposed to be subject to the clearing obligation under the second RTS.
- Category 2: Financial counterparties and Alternative Investment Funds (“AIFs”) that are Non-Financial Counterparties above the clearing threshold (“NFC+”), not included in Category 1, and which belong to a group whose aggregate month-end average of outstanding gross notional amount of non-centrally cleared derivatives for [the three months after the publication of the second RTS in the Official Journal of the European Union (“Official Journal”) excluding the month of publication] is above EUR 8 billion. [\[8\]](#)
- Category 3: Financial counterparties and AIFs that are NFC+, and are not included in Category 1 or Category 2.
- Category 4: NFC+ not included in Category 1, Category 2, or Category 3.

ESMA recognizes that it could be burdensome to counterparties active in derivatives subject to both the first RTS and the second RTS to be subject to compliance deadlines close in time if the RTS were adopted shortly after one another. Accordingly, ESMA proposes an extra three-month phase-in period if the second RTS is published in the Official Journal less than three months after the first RTS. The dates of application of the clearing obligation are therefore proposed to be as follows:

- The date 6/12/18/36 months after the entry into force of the second RTS for categories 1 to 4, respectively, if the second RTS is published in the Official Journal more than three months after the first RTS is published in the Official Journal; or
- The date 9/15/21/39 months after the entry into force of the second RTS for categories 1 to 4, respectively, if the second RTS is published in the Official Journal less than three months after the first RTS is published in the Official Journal.

Frontloading

EMIR imposes an obligation to clear the OTC derivatives contracts (relating to a class of

OTC derivatives that has been declared subject to the clearing obligation) that are entered into after the notification to ESMA of the authorization of a CCP by the national competent authorities and before the date of application of the clearing obligation. ESMA proposes an approach to frontloading that is consistent with the approach under the first RTS, as modified under an opinion issued by ESMA earlier this year. [9] The approach under the second RTS would apply frontloading only to financial counterparties in Category 1 and Category 2, and would postpone the frontloading start date by a few months after the entry into force of the second RTS. Specifically, ESMA proposes that:

- For counterparties in Categories 1 and 2, the minimum remaining maturity applicable to contracts concluded between (1) the date of entry into force of the second RTS plus [two months (if Category 1) or five months (if Category 2)] and (2) the date of application of the clearing obligation for those counterparties, is proposed to be six months.
- For other contracts and counterparties, the minimum remaining maturities would be set at a level so that no contract will be subject to frontloading.

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endnotes

[1] European Securities Markets Authority, Consultation Paper, Clearing Obligation under EMIR (no. 4) (May 11, 2015), available at http://www.esma.europa.eu/system/files/esma-2015-807_-_consultation_paper_no_4_on_the_clearing_obligation_irs_2.pdf ("Consultation Paper"). The deadline for comments on the Consultation Paper is July 15, 2015.

[2] See ICI Memorandum No. 28277 (July 17, 2014), available at http://www.ici.org/my_ici/memorandum/memo28277.

[3] Id.

[4] See ICI Memorandum No. 28439 (Oct. 8, 2014), available at http://www.ici.org/my_ici/memorandum/memo28439.

[5] Id.

[6] See ICI Memorandum No. 28722 (Feb. 6, 2015), available at <http://www.iciglobal.org/iciglobal/pubs/memos/memo28722>.

[7] See supra notes 2 and 5.

[8] Under the second RTS, ESMA would use the same three month period for the assessment of a counterparty's status as under the first RTS, so that if a counterparty determined it was in Category 2 for purposes of the first RTS, it would fall within Category 2 for purposes of the second RTS.

[9] See ESMA, Opinion, Draft RTS on the Clearing Obligation on Interest Rate Swaps (January 29, 2015), available at http://www.esma.europa.eu/system/files/2015-223_opinion_on_draft_rts_on_the_clearing_ob

[ligation.pdf](#).

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