

MEMO# 28606

December 22, 2014

European Commission Publishes Letter Regarding Clearing Obligation for Interest Rate Swaps

[28606]

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TO:

DERIVATIVES MARKETS ADVISORY COMMITTEE No. 90-14
ICI GLOBAL MEMBERS No. 59-14
ICI GLOBAL TRADING & MARKETS COMMITTEE No. 6-14
INTERNATIONAL MEMBERS No. 50-14

RE:

EUROPEAN COMMISSION PUBLISHES LETTER REGARDING CLEARING OBLIGATION FOR INTEREST RATE SWAPS

On December 20, the European Commission published a letter to the European Securities and Markets Authority (“ESMA”) regarding the draft regulatory technical standards (“RTS”) for mandatory clearing of certain classes of interest rate swaps (“IRS”). [\[1\]](#) The European Commission states that it intends to endorse the draft RTS submitted by ESMA to the Commission with amendments. The amendments generally focus on the requirement for market participants to clear subsequently contracts concluded or novated before the clearing obligation has taken effect (“frontloading”).

Specifically, the amendments would delay the start date for two categories of counterparties. [\[2\]](#) Regulated funds would generally fall within Category 2 if they engage in derivatives transactions above a certain threshold. [\[3\]](#) The start date of the frontloading requirement for financial counterparties in Category 2 is postponed until five months after the entry into force of the RTS. The European Commission believes that this extension would provide Category 2 counterparties with sufficient time to implement the necessary arrangements to calculate the threshold and for frontloading. Moreover, the European Commission intends to amend the period to be taken into account for the calculation of the threshold so that the threshold would take into account the most recent period before

frontloading starts. The period for the calculation of the threshold would be the three months following the publication of the RTS in the Official Journal, excluding the month of publication.

In addition, in the letter, the European Commission states that it intends to provide clarification with respect to the application of the quantitative threshold for determining counterparties falling in Category 2. In particular, the European Commission will 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 collateralized, guaranteed, or supported by other funds or the investment adviser.

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endnotes

[1] Letter from Jonathan Faull, Director General, Directorate General for Financial Stability, Financial Services and Capital Markets Union, to Steven Maijoor, Chairman, ESMA, dated December 18, 2014, available at http://www.esma.europa.eu/system/files/rts_for_irs_-_lettre_signee.pdf. For a summary of ESMA's final report on draft RTS on IRS, see ICI Memorandum No. 28439 (Oct. 8, 2014), available at http://www.ici.org/my_ici/memorandum/memo28439.

[2] ESMA proposed four categories of counterparties for a phased implementation. Category 1 (Clearing Members) would include counterparties that are clearing members for at least one of the classes of OTC derivatives subject to the clearing obligation and of at least one of the central counterparties ("CCPs") authorized or recognized under the European Markets Infrastructure Regulation ("EMIR") to clear at least one of those classes. Category 2 would include counterparties not included in Category 1 that belong to a group whose aggregate month-end average notional amount of non-centrally cleared derivatives is above EUR 8 billion and which are: (i) financial counterparties; or (ii) AIFs that are non-financial counterparties subject to the clearing obligation ("NFC+"). Category 3 would include counterparties not included in Category 1 or Category 2 that are: (i) financial counterparties; or (ii) AIFs that are NFC+. Category 4 would include non-financial counterparties. Third-country entities would determine their categories based on the categories to which they would belong if they were established in the European Union.

[3] For purposes of calculating the group aggregate month-end average notional value, all of the group's non-centrally cleared derivatives, including foreign exchange forwards, swaps and currency swaps, must be included.

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