

**MEMO# 28439**

October 8, 2014

# **EU Regulators Issue Final Report and Consultation Paper on Clearing Obligations**

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TO:

DERIVATIVES MARKETS ADVISORY COMMITTEE No. 67-14  
CLOSED-END INVESTMENT COMPANY COMMITTEE No. 30-14  
ICI GLOBAL MEMBERS No. 40-14  
INTERNATIONAL MEMBERS No. 33-14  
INVESTMENT ADVISER MEMBERS No. 29-14

RE:

EU REGULATORS ISSUE FINAL REPORT AND CONSULTATION PAPER ON CLEARING OBLIGATIONS

On October 1, 2014, the European Securities and Markets Authority (“ESMA”) issued its final report on draft regulatory technical standards (“RTS”) for mandatory clearing of certain classes of interest rate swaps (“IRS”), [\[1\]](#) and issued for public comment draft RTS for mandatory clearing of a class of foreign exchange non-deliverable forwards (“NDFs”). [\[2\]](#) The IRS Final Report will be submitted to the European Commission for endorsement. The European Commission must decide whether to endorse the draft RTS for IRS within three months. Following the consultation on the draft RTS on NDFs, ESMA will draft its final RTS on NDFs and submit them to the European Commission for endorsement. The final draft RTS for IRS and the draft RTS for NDFs are summarized briefly below.

## **Final Draft RTS for IRS**

### **Classes to be Subject to Clearing Obligation**

For IRS, ESMA’s final draft RTS, like the draft RTS on IRS, include four classes to be subject to central clearing (on a range of currencies and underlying indices). These classes are: (1) basis swaps; (2) fixed-to-float IRS; (3) forward rate agreements; and (4) overnight index

swaps. The following tables provide the classes that are proposed to be subject to the clearing obligation.



IRS Final Report, supra note 1, at 46-47.

## **Phase-in Period**

The clearing obligation will take effect following a phased implementation (proposed range from six months to three years after the entry into force of the RTS) depending on the type of counterparty. ESMA proposes four categories of counterparties for these purposes: [\[3\]](#) (1) clearing members; [\[4\]](#) (2) financial counterparties and alternative investment funds (“AIFs”) that are nonfinancial counterparties above the clearing threshold that are not included in Category 1, and which belong to a group whose aggregate month-end activity exceeds a EUR 8 billion threshold; [\[5\]](#) (3) financial counterparties or AIFs that are below the threshold; [\[6\]](#) and (4) non-financial counterparties. [\[7\]](#) As under the proposed RTS, third-country entities would determine their categories based on the categories to which they would belong if they were established in the European Union.

The date of application of the clearing obligation would be as follows: (1) six months after entry into force of the RTS for Category 1; (2) 12 months after entry into force of the RTS for Category 2; (3) 18 months after entry into force of the RTS for Category 3; and (4) three years after entry into force of the RTS for Category 4.

## **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. As under the draft RTS, for the period between the notification to ESMA and the publication in the Official Journal of the RTS, ESMA would set the minimum remaining maturity level so that no contract will be subject to frontloading. For contracts entered into between the publication in the Official Journal of the RTS and the date on which the clearing obligation takes effect (the date of application), ESMA would require contracts between counterparties included in Categories 1 and 2 with more than six months before expiration on the date of application of the clearing obligation to be subject to frontloading.

## **Draft RTS for NDFs**

### **Classes to be Subject to Clearing Obligation**

The draft RTS for NDFs would apply to a class of OTC foreign-exchange NDF cleared by LCH.Clearnet Ltd (UK). ESMA explains that this class is expected to be cleared by additional European CCPs including CME Clearing Europe Ltd, ICE Clear Europe Ltd, and OMX Clearing AB. ESMA notes that NDFs are also cleared by several third-country CCPs.

Under the draft RTS, the NDF classes authorized to be cleared are contracts with maturities between three days and two years, settled in USD, in the following 11 currencies: Brazilian Real (BRL), Chilean Peso (CLP), Chinese Yuan (CNY), Colombian Peso (COP), Indonesian Rupiah (IDR), Korean Won (KRW), Malaysian Ringgit (MYR), Philippine Peso (PHP), Russian Ruble (RUB), and Taiwan Dollar (TWD).

## Phase-in Period

The proposed clearing obligation would take effect following a phased implementation (proposed range from six months to 33 months after the entry into force of the RTS) depending on the type of the counterparty. ESMA proposes the same four categories of counterparties for purposes of the draft RTS for NDFs as it includes in the IRS Final Report. The proposed dates of application of the NDF clearing obligation are as follows: (1) six months after entry into force of the RTS for Category 1; (2) 12 months after entry into force of the RTS for Category 2; (3) 18 months after entry into force of the RTS for Category 3; and (4) 33 months after entry into force of the RTS for Category 4.

## Frontloading

Similar to the final draft RTS for IRS, for the period prior to publication in the Official Journal of the RTS, ESMA proposes to set the minimum remaining maturity level for the NDFs so that no contract will be subject to frontloading. For contracts entered into on or after publication in the Official Journal of the RTS, ESMA would require NDF contracts between counterparties included in Categories 1 and 2 with three months or more minimum remaining maturity to be subject to frontloading.

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## endnotes

[1] European Securities and Markets Authority, Final Report, Draft technical standards on the Clearing Obligation – Interest Rate OTC Derivatives (Oct. 1, 2014), available at [http://www.esma.europa.eu/system/files/esma-2014-1184\\_final\\_report\\_clearing\\_obligation\\_irs.pdf](http://www.esma.europa.eu/system/files/esma-2014-1184_final_report_clearing_obligation_irs.pdf) (“IRS Final Report”). For a summary of ESMA’s second proposed draft RTS (on IRS and credit default swaps), see ICI Memorandum No. 28277 (July 17, 2014), available at [http://www.ici.org/my\\_ici/memorandum/memo28277](http://www.ici.org/my_ici/memorandum/memo28277).

[2] European Securities and Markets Authority, Consultation Paper, Clearing Obligation under EMIR (no. 3) (Oct. 1, 2014), available at <http://www.esma.europa.eu/system/files/esma-2014-1185.pdf> (“NDF Consultation”). Comments on the NDF Consultation are due by Nov. 6, 2014.

[3] This is an increase from the three categories in the draft RTS – Category 2 was further divided into two subcategories based on comments ESMA received.

[4] Category 1 (Clearing Members) would include counterparties that, on the date of entry

into force of the RTS on the clearing obligation, are clearing members for at least one of the classes of OTC derivatives subject to the clearing obligation, of at least one of the central counterparties (“CCPs”) authorized or recognized before that date under the European Markets Infrastructure Regulation (“EMIR”) to clear at least one of those classes.

[5] 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 for [November 2014, December 2014 and January 2015] 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+”). ESMA explains that November 2014, December 2014, and January 2015 were chosen under the assumption that the RTS on the clearing obligation for IRS will enter into force during the month of February 2015. If this assumption is incorrect, the months will be adjusted so that they include the three months preceding the entry into force of the RTS, excluding the month of entry into force.

[6] Category 3 would include counterparties not included in Category 1 or Category 2 that are: (i) financial counterparties; or (ii) AIFs that are NFC+.

[7] 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, shall be included.