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ESMA consults for a fourth time on EMIR Clearing Obligation

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Financial Services and Regulation

Introduction

On May 11, 2015, the European Securities and Markets Authority (ESMA) published its latest consultation[1] on classes of Over The Counter (OTC) interest rate derivatives to which the clearing obligation under the European Union's Regulation on OTC derivatives transactions, central counterparties (CCPs) and trade repositories, also known as the European Markets Infrastructure Regulation or EMIR, will apply. The consultation paper sets out additional classes of OTC interest rate derivatives denominated in six specific European Economic Area (EEA) currencies which ESMA now proposes for mandatory clearing, as well as providing an explanation of the draft text of the required regulatory technical standards (RTS) to implement this. ESMA has requested feedback from stakeholders (and in particular from financial and non-financial counterparties) on its proposals and the deadline for any comments is July 15, 2015.

Background

The overarching aim of EMIR is to reduce systemic risk in the OTC derivatives markets by introducing, amongst other controls, a mandatory clearing obligation on standardised OTC derivatives trades. To achieve this, EMIR requires that certain classes of OTC derivatives are cleared centrally via CCPs that have been authorised (if located within the European Economic Area) or recognised (if a third country CCP) under the requirements of the Regulation[2]. Under Article 5(2), EMIR, ESMA is mandated, following public consultation, to propose the precise classes of OTC derivatives which must be subject to central clearing and to submit the relevant RTS specifying them to the European Commission for endorsement.

In accordance with Article 5(2), ESMA has published a series of consultation papers over the last year on certain classes of OTC derivative, including interest rate swaps[3]; credit default swaps[4]; and foreign exchange non-deliverable forwards[5]. In the Final Report on its first

[1] ESMA Consultation Paper on the Clearing Obligation under EMIR (no. 4) ESMA/2015/807, dated 11 May 2015

[2] Article 4, EMIR

[3] ESMA Consultation Paper on the Clearing Obligation under EMIR (no. 1) ESMA/2014/799, dated 11 July 2014

[4] ESMA Consultation Paper on the Clearing Obligation under EMIR (no. 2) ESMA/2014/800, dated 11 July 2014

[5] ESMA Consultation Paper on the Clearing Obligation under EMIR (no. 3) ESMA/2014/1185, dated as amended on 10 October 2014. Please note that following its consultation on this, ESMA has decided against including foreign exchange non-deliverable forwards in the mandatory clearing obligation for the moment.

consultation on interest rate derivatives published in October 2014[6], ESMA stated that the clearing obligation should apply to classes of interest rate swaps denominated in EUR, GBP, JPY and USD and the European Commission has subsequently confirmed this[7]. However, ESMA also mentioned in the Final Report that it would be considering further classes of OTC interest rate derivatives denominated in other currencies for mandatory clearing.

What is in the consultation paper?

The new consultation paper is the result of this further work and presents ESMA's analysis of OTC interest rate derivative classes cleared by specific CCPs, including CME Clearing Europe (UK) and LCH.Clearnet Ltd. ESMA now proposes to submit new RTS to the European Commission on the clearing obligation for the following additional classes of OTC interest rate derivatives:

- fixed-to-float interest rate swaps denominated in CZK, DKK, HUF, NOK, SEK and PLN[8]; and
- forward rate agreements denominated in NOK, SEK and PLN.

ESMA expects that the proposed new RTS, once finalised, will sit alongside the first RTS relating to OTC interest rate derivatives in the G4 currencies as described in the Background section above. The text of the new RTS in the latest consultation paper closely tracks the text of the first RTS (as amended by ESMA in March 2015). However, there are some minor differentiations discussed in the consultation and included in the new RTS to take account of the specifics relating to the particular classes of derivatives concerned.

ESMA explains that the analysis provided in the new consultation paper uses additional data sets to those reviewed in preparing the first RTS on interest rate derivatives. In particular, it utilises new data from European trade repositories, which allows for a much more detailed assessment of the criteria to which ESMA must refer when considering which classes of derivatives should be subject to the clearing obligation requirements[9]. The relevant analysis and rationale is set out in Section 5 of the new paper.

The consultation also describes the approach ESMA has taken in defining the categories of counterparty to whom the clearing obligation will apply in relation to the new classes of OTC interest rate derivatives and the date(s) from which the obligation will take effect (including any possible phase-in). These are discussed in Section 6 of the paper. Section 7 provides explanations on the definition of the minimum remaining maturities for the application of frontloading. ESMA intends to set the minimum remaining maturities at 15 years for interest rate swaps and 2 years for forward rate agreements entered into or novated before two months after the entry into force of the RTS.

[6] ESMA Final Report on the Clearing Obligation under EMIR (no. 1) ESMA/2014/1184, dated 1 October 2014

[7] The European Commission has now indicated that it intends to adopt the RTS relating to the OTC interest rate derivatives classes outlined in ESMA's first consultation in July 2014 with certain amendments. In response to this, ESMA submitted a Revised Opinion containing an amended draft of the RTS relating to these classes in March 2015 (ESMA/2015/511).

[8] ESMA refers to these six currencies as the "EEA currencies".

[9] under Article 5(4) EMIR and Article 7 of the RTS on the Clearing Obligation contained in Regulation 149/2013/EU

With regard to when these new provisions should take effect once adopted for counterparties within scope, ESMA has provided two separate timelines in Article 3 of the new RTS. These two parallel timelines are designed to ensure that there is a gap of at least three months between the implementation of the first set of RTS, relating to the interest rate derivatives denominated in the G4 currencies, and these new proposed RTS. It will depend upon when the first set of RTS are published and implemented as to which timeline is pursued.

Next steps

The closing date for feedback and comments on the consultation is July 15, 2015.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our Financial Services and Regulation practice group:

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