



European Securities and
Markets Authority

Reply form to the Consultation Paper on the Clearing Obligation under EMIR (no. 1)



Responding to this paper

The European Securities and Markets Authority (ESMA) invites responses to the questions listed in the Consultation Paper on the Clearing Obligation under EMIR (no. 1), published on ESMA's website.

Comments are most helpful if they:

- respond to the question stated;
- contain a clear rationale; and
- describe any alternatives ESMA should consider.

To help you navigate this document more easily, bookmarks are available in "Navigation Pane" for Word 2010 and in "Document Map" for Word 2007.

ESMA will consider all comments received by **18 August 2014**.

All contributions should be submitted online at www.esma.europa.eu under the heading 'Your input - Consultations'.

How to use this form to reply

Please note that, in order to facilitate the analysis of the responses, ESMA will be using an IT tool that does not allow processing of responses which do not follow the formatting indications described below.

Therefore, in responding you are kindly invited to proceed as follows:

- use this form to reply and send your response in Word format;
- type your response in the frame "TYPE YOUR TEXT HERE" and do not remove the tags of type <ESMA_QUESTION_1> Your response should be framed by the 2 tags corresponding to the question; and
- if you have no response to a question, do not delete the tags and leave the text "TYPE YOUR TEXT HERE" between the tags.

Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publically disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESMA's rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESMA's Board of Appeal and the European Ombudsman.

Data protection

Information on data protection can be found at www.esma.europa.eu under the heading 'Legal Notice'.

Who should read this paper

All interested stakeholders are invited to respond to this consultation paper. In particular, responses are sought from financial and non-financial counterparties of OTC derivatives transactions which will be subject to the clearing obligation, as well as central counterparties (CCPs).

General information about respondent

Name of the respondent	The Asset Management Group of the Securities Industry and Financial Markets Association
Are you representing an association?	Yes
Activity	Investment Services
Country/Region	International

Introduction

Please make your introductory comments below:

<ESMA_COMMENT_1>

The Asset Management Group of the Securities Industry and Financial Markets Association welcomes the opportunity to respond to the questions contained in the Consultation Paper on the Clearing Obligation under EMIR (no. 1). The Asset Management Group has also submitted a response to the questions contained in the Consultation Paper on the Clearing Obligation under EMIR (no. 2). The submissions are identical, save for changes to cross-referencing as a result of the differing question numbers in each Consultation Paper.

<ESMA_COMMENT_1>

1 The clearing obligation procedure

Question 1: Do you have any comment on the clearing obligation procedure described in Section 1?

<ESMA_QUESTION_1>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_1>

2 Structure of the interest rate derivatives classes

2.1 Characteristics to be used for interest rate derivative classes

Question 2: Do you consider that the proposed structure defined here for the interest rate OTC derivative classes enables counterparties to identify which contracts fall under the clearing obligation as well as allows international convergence? Please explain.

<ESMA_QUESTION_2>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_2>

2.2 Additional Characteristics needed to cover Covered Bonds derivatives

Question 3: Do you consider that the proposed approach on covered bonds derivatives ensures that the special characteristics of those contracts are adequately taken into account in the context of the clearing obligation? Please explain why and possible alternatives.

Stakeholders (CCPs and covered bond derivatives users, in particular) are invited to provide detailed feedback on paragraph 38 above. In particular: what is the nature of the impediments (e.g. legal, technical) that CCPs are facing in this respect, if any? Has there been further discussions between CCPs and covered bond derivatives users and any progress resulting thereof?

<ESMA_QUESTION_3>

TYPE YOUR TEXT HERE

<ESMA_QUESTION_3>

2.3 Public Register

Question 4: Do you have any comment on the public register described in Section 2.3?

<ESMA_QUESTION_4>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_4>

3 Determination of the OTC interest rate classes to be subject to the clearing obligation

Question 5: In view of the criteria set in Article 5(4) of EMIR, do you consider that this set of classes addresses appropriately the systemic risk associated to interest rate OTC derivatives? Please include relevant data or information where applicable.

Please include relevant data or information where applicable.

<ESMA_QUESTION_5>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_5>

4 Determination of the dates on which the obligation applies and the categories of counterparties

4.1 Analysis of the criteria relevant for the determination of the dates

Question 6: Do you have any comment on the analysis presented in Section 4.1?

<ESMA_QUESTION_6>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_6>

4.2 Determination of the categories of counterparties (Criteria (d) to (f))

Question 7: Do you consider that the classification of counterparties presented in Section 4.2 ensures a smooth implementation of the clearing obligation? Please explain why and possible alternatives.

<ESMA_QUESTION_7>
We endorse the proposal made by the International Swaps and Derivatives Association (“ISDA”) that AIFs which are non-financial counterparties above the clearing threshold (“NFC+s”) should be categorised with other NFC+s as falling within Category 3 (rather than Category 2) and refer you to the detailed analysis on this point as set out in ISDA’s response(s) to you dated August 18, 2014.
<ESMA_QUESTION_7>

4.3 Determination of the dates from which the clearing obligation takes effect

Question 8: Do you consider that the proposed dates of application ensure a smooth implementation of the clearing obligation? Please explain why and possible alternatives.

<ESMA_QUESTION_8>

The Asset Management Group (the “AMG”)¹ of the Securities Industry and Financial Markets Association welcomes the phased-in implementation of the clearing obligation. However, the AMG believes that it will be crucial that equivalence decisions under Article 13(2) of EMIR² in respect of the mandatory clearing obligation of third countries are made in good time before the application of the clearing obligation to any counterparty pair. This will give entities certainty as to what mandatory clearing requirements and which regimes will apply (essential for all entities but particularly so for entities such as certain asset managers which need to determine the scope of impacted clients, client documentation and process changes and any related client outreach) and should help prevent certain entities becoming subject to potentially conflicting mandatory clearing requirements in multiple jurisdictions. Application dates for the mandatory clearing obligation under EMIR should be set accordingly.

Early equivalence decisions are likely to be even more important to the extent that frontloading applies to Category 2 counterparties, as Category 1 dealers transacting with a Category 2 counterparty subject to frontloading are likely to favour entering into cleared rather than uncleared contracts in advance of the date on which the clearing obligation under EMIR actually takes effect for that counterparty pair (for which further, see our response on question 9 below). In such event it would be highly disruptive were such Category 2 counterparties not able to rely, where possible, on the clearing arrangements that they have already put in place in connection with other mandatory clearing regimes due to the absence of equivalence decisions.

As noted in paragraph 207 of Consultation Paper No.1, contracts entered into by third country entities not benefitting from an equivalence decision under Article 13(2) of EMIR may be indirectly captured by the clearing obligation under Article 4 of EMIR. Some of these contracts are, by virtue of the non-EU rules applicable to the relevant third country entity, likely to be subject to mandatory clearing requirements in another jurisdiction.

For example, the OTC derivatives contracts of either an EU bank or an EU branch of a U.S. bank will be subject to the mandatory clearing requirement under EMIR (i) when entered into with a financial counterparty³ or non-financial counterparty above the clearing threshold⁴ or (ii) when entered into with a third country entity if (a) that third country entity would also be subject to the mandatory clearing obligation under EMIR and (b), in the case of an EU branch of a U.S. bank, the relevant OTC derivative contract has a direct, substantial and foreseeable effect within the European Union⁵. Where such EU bank is registered as a swap dealer or major swap participant with the U.S. Commodity Futures Trading Commission (the “CFTC”), or such EU branch of a U.S. bank is either a major swap participant or similarly registered as a swap dealer⁶, the contracts of the EU bank or relevant EU branch will also be subject to the mandatory clearing requirement under Title VII of the Dodd Frank Wall Street Reform and Consumer Protection Act (the “Dodd Frank Act”) when trading with a U.S. person⁷ and may, in the absence of any substituted compliance decisions from the CFTC in this area, be subject to U.S. mandatory clearing when trading with certain other counterparty types as well (assuming that the relevant contractual class is subject to the mandatory clearing obligation under the relevant CFTC rules, for which see further below). There has been no substituted compliance granted by the CFTC in respect of the U.S. mandatory clearing obligation or EU equivalence determinations in respect of clearing as at the date of this response. Furthermore, the definition of U.S. person is broad enough to capture certain entities subject to Article 4 of EMIR: for example, a fund may be domiciled within the EU but be deemed to have its principal place of business in the United States under the CFTC rules. Such fund might therefore constitute a financial counterparty or non-financial counterparty above the clearing threshold, while its

¹ The AMG’s members represent U.S. asset management firms whose combined assets under management exceed \$30 trillion. The clients of AMG member firms include, among others, registered investment companies, endowments, state and local government pension funds, private sector Employee Retirement Income Security Act of 1974 pension funds and private funds such as hedge funds and private equity funds.

² The European Market Infrastructure Regulation (EU) No. 648/2012.

³ As defined in Article 2(7) of EMIR.

⁴ As determined under Article 10(1) of EMIR.

⁵ Commission Delegated Regulation (EU) No. 285/2014.

⁶ Each as defined in the U.S. Commodity Exchange Act.

⁷ As defined in the Cross Border Guidance of the CFTC, published in the Federal Register on July 26, 2013.

principal place of business determination would simultaneously establish it as a U.S. person. It could therefore be equally subject to the mandatory clearing requirements under both the Dodd Frank Act and EMIR.

The AMG has further considered the degree of potential overlap in the classes of contract that a non-equivalent third country entity might be obliged to clear where, continuing the above example, the relevant entity is subject to the mandatory clearing requirement under both EMIR and the CFTC rules. Assuming full implementation of the proposals in Consultation Paper No.1 and Consultation Paper No.2 and considering the CFTC rules currently in force, each and every interest rate OTC class and European untranchised CDS class listed in tables 9 to 16 at paragraph 135 of Consultation Paper No.1 and table 14 at paragraph 79 of Consultation Paper No.2 respectively would be subject to the mandatory clearing requirement under both regimes, save that overnight index swaps referencing EONIA, SONIA or FedFunds with a maturity of between two and three years will be subject to clearing under EMIR but are not subject to clearing under the CFTC rules.

The above examples reference the position between the EU and the U.S. but would apply with reference to other jurisdictions as well. Based on the above example, it is clear that a variety of entities could be subject to the mandatory clearing obligation under both EMIR and the Dodd Frank Act. Evidently, where this is the case, such an entity would face multiple mandatory clearing requirements. In the absence of an equivalence decision under Article 13(2) of EMIR, therefore, it is not clear how such an entity should comply with these parallel, and potentially conflicting, obligations, as an OTC derivative contract can obviously only be cleared once.

Overlapping or conflicting requirements may lead to significant regulatory uncertainty as market participants will be required to assess how to comply with duplicative and/or inconsistent provisions in a manner that avoids confusion and mitigates economic impact. One clear case of potential conflict, again referring to the above example, is where a contract becomes subject to the mandatory clearing requirement under both EMIR and the Dodd Frank Act and the relevant counterparty pair is, at the time of implementation of the clearing obligation under EMIR, clearing such contracts through a U.S. central counterparty that is not recognised by ESMA as a CCP under Article 25 of EMIR. The implementation of the EMIR clearing obligation would oblige the counterparties to move this contract to a CCP that was either recognised or authorised by ESMA, which may be contrary to the CFTC rules that required its submission to the U.S. central counterparty initially. This conundrum will be further compounded if the CFTC fails to recognise CCPs authorised by ESMA for substituted compliance. The conflict between the regulatory requirements could mean that the parties to an entirely legitimate, vanilla contract are forced into a regulatory breach in one jurisdiction by the act of compliance with the similar but technically different regulatory requirements of the other jurisdiction. Entities may decide to cease trading with counterparties where this risk is apparent, cutting themselves off from sections of the global market and suffering various negative consequences including risk concentration, unattractive pricing/additional expense and having to face certain risks unhedged. At a market level, the consequences would include market fragmentation and loss of liquidity.

To avoid this regulatory dilemma, we believe that it is essential that equivalence is properly considered prior to implementation of the clearing obligation under EMIR. The extent of the overlap between the contracts and counterparties subject to mandatory clearing requirements under the Dodd Frank Act and current CFTC rules on the one hand and the draft EU Regulatory Technical Standards ("**RTS**") on the other highlights the importance of establishing equivalence in good time prior to implementation. The AMG therefore believes that the dates for application of the clearing obligation under EMIR must be set bearing in mind the time it will take to undertake the equivalence determination exercise prior to the earliest such application date, taking frontloading into account to the extent it continues to apply (for which further, see our response on question 9 below).

<ESMA_QUESTION_8>

5 Remaining maturity and frontloading

Question 9: Do you consider that the proposed approach on frontloading and the minimum remaining maturity ensures that the uncertainty related to this requirement is sufficiently mitigated, while allowing a meaningful set of contracts to be captured? If not, please explain why and provide possible alternatives compatible with EMIR.

<ESMA_QUESTION_9>

Summary

The AMG is concerned that, while many of the uncertainties inherent in frontloading are mitigated by the approach set out in the consultation papers, the mere fact that frontloading applies is an issue. In particular, it is likely to encourage Category 1 dealers who are subject to EMIR to prefer to enter cleared rather than uncleared contracts from the earliest possible date following the commencement of the frontloading period, in order to avoid difficulties in agreeing pricing and margin requirements, the uncertainty involved in the necessary subsequent renegotiation of contracts and the administrative burden of turning uncleared contracts into cleared ones. This risks accelerating the timeline by which non-Category 1 counterparties who are caught by frontloading will be obliged to put in place the necessary legal, risk management and operational arrangements for clearing. This would then neuter the effect of the decision to stagger the application date of the clearing obligation by reference to counterparty type. For this reason, the AMG believes that frontloading should not apply to any Category 2 counterparty.

Discussion

The AMG welcomes the decision to phase-in the clearing obligation under EMIR by reference to categories of counterparty. This reflects the extensive changes that entities who are not already clearing members will be obliged to go through prior to the date on which the clearing obligation under EMIR takes effect. These changes will include an education and due diligence process (both internally and, in the case of asset managers, in relation to their clients), an operational process (building and gaining access to the necessary systems to support clearing), a risk-assessment process (diligencing the different models and the levels of client protection available) and a legal process (establishing the terms of the documentation necessary for clearing arrangements and obtaining necessary legal opinions). This is in addition to the various choices that must be made about which central counterparty to clear through, who to engage as clearing member and so on. These processes will take a considerable amount of time and should be properly taken into consideration in assessing frontloading. The extended date of application for Category 2 counterparties set out in Article 3(1) of the RTS recognises this.

However, to the extent a Category 2 counterparty is not a non-financial counterparty, the benefits of such extended period are at risk of being negated by the prospect of frontloading. From the commencement of Period B, counterparties will have more certainty on which types of contracts will need to be cleared upon the date on which the clearing obligation takes effect (unlike in Period A). It would be natural for parties who have sufficient infrastructure in place to support clearing at the commencement of Period B (for example Category 1 dealers) to prefer to enter into a cleared contract as opposed to entering into an uncleared contract that it is known will need ultimately to be cleared within 18 months. In such a way, there is likely to be pressure on Category 2 counterparties to enter into cleared trades rather than uncleared ones from the commencement of Period B. This runs contrary to the intention of RTS to give such entities greater time in order to come to terms with their new obligations and corresponding arrangements.

Conclusions and proposals

We are of the view that a phase-in period for Category 2 and Category 3 counterparties is crucial to ensure a smooth implementation of the clearing obligation. Because of the risk that the application of

frontloading poses to this, the AMG believes that frontloading should not apply to any Category 2 counterparty. We suggest that this could be achieved by setting the minimum remaining maturity of contracts entered into by Category 2 counterparties for the purposes of Article 4(1)(b)(ii) of EMIR at a level such that no such contract is subject to frontloading, following ESMA's approach in connection with contracts entered into during Period A.

If deemed necessary in order for frontloading to be disapplied for Category 2 counterparties, we believe it could be appropriate to reduce the phase-in period for the application of the clearing obligation. In such case, we would propose the clearing obligation apply from the date that is 9 months from the date the relevant RTS enters force (rather than the 18 month phase-in currently proposed), subject to our comments in respect of equivalence determinations as above.

In respect of the foregoing, we are in agreement with the analysis of ISDA as set out in ISDA's response(s) to you dated August 18, 2014 and refer you to such response(s).
<ESMA_QUESTION_9>

6 OTC equity derivative classes that are proposed not to be subject to the clearing obligation

Question 10: Do you have any comment on the analysis on the Equity OTC derivative classes presented in Section 6?

<ESMA_QUESTION_10>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_10>

7 OTC Interest rate future and option classes that are proposed not to be subject to the clearing obligation

Question 11: Do you have any comment on the analysis on the OTC Interest rate future and options derivative classes presented in Section 7?

<ESMA_QUESTION_11>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_11>

Annex I - Commission mandate to develop technical standards

Annex II - Draft Regulatory Technical Standards on the Clearing Obligation

Question 12: Please indicate your comments on the draft RTS other than those already made in the previous questions.

<ESMA_QUESTION_12>
TYPE YOUR TEXT HERE



<ESMA_QUESTION_12>

Annex III - Impact assessment

Question 13: Please indicate your comments on the CBA.

<ESMA_QUESTION_13>
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<ESMA_QUESTION_13>