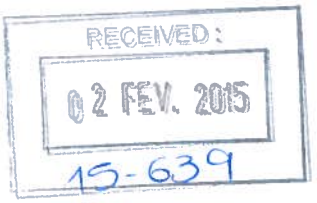
EUROPEAN COMMISSION
Directorate-General for Financial Stability, Financial Services and Capital Markets Union

Director General



Brussels, 29. 01. 2015 – 352881
DG FISMA C2 PP/PSDM/acg (2015) 391796

Mr Steven Maijoor
Chairman
European Securities and Markets Authority
103, rue de Grenelle
F-75007 Paris

By e-mail :
Steven.Maijoor@esma.europa.eu

Subject: Corrigendum

Dear Steven,

Please find attached as a corrigendum a revised letter to that sent to you on 18 December 2014 informing you of the Commission's intention to endorse with amendments the draft regulatory technical standards on the clearing obligation for Interest Rate Swaps (IRS) pursuant to Article 5 of Regulation (EU) No 648/2012.

For your convenience, I am attaching again the amended draft regulatory technical standards attached to the letter sent on 18 December 2014 which remain unchanged.

Yours sincerely,

Jonathan Faull

EUROPEAN COMMISSION
Directorate-General for Financial Stability, Financial Services and Capital Markets Union

Director General

29. 01. 2015 - 352831

Brussels,
DG FISMA C2 PP/PSDM/acg (2015) 391796

Mr Steven Maijoor
Chairman
European Securities and Markets Authority
103, rue de Grenelle
F-75007 Paris

By e-mail :
Steven.Maijoor@esma.europa.eu

Dear Mr Maijoor,

On 1 October 2014, ESMA submitted to the Commission draft regulatory technical standards (draft RTS) on the clearing obligation for Interest Rate Swaps (IRS) pursuant to Article 5 of Regulation (EU) No 648/2012.

I would like to inform you of the European Commission's intention to endorse with amendments the draft RTS submitted by ESMA. An amended draft RTS containing the amendments the Commission intends to adopt is attached to this letter.

The draft RTS submitted by ESMA lay down the classes of IRS that will be subject to mandatory clearing, as well as the different dates from which the clearing obligation will take effect for the four different categories of counterparties identified, for which different phase-in periods are laid down.

In addition, the draft RTS lay down the minimum remaining maturities determining which contracts entered into or novated before the clearing obligation takes effect will have to be cleared when the clearing obligation takes effect ("frontloading"). ESMA proposes frontloading to be applied to contracts concluded by financial counterparties in category 1 or 2 from the date of publication of the RTS in the Official Journal. In particular, ESMA proposes to differentiate between counterparties in Category 2 and Category 3, depending on their level of activity in OTC derivatives – to be measured against a quantitative threshold – and not to apply the frontloading requirement to counterparties in Category 3.

The Commission nevertheless considers that in order for the draft RTS submitted by ESMA to take full account of the fundamental principles of the internal market for financial services as reflected in Union financial services legislation in general, and in Regulation (EU) No 648/2012 in particular, the following amendments are required.

1. Postponing the starting date of the frontloading requirement

ESMA proposes the frontloading requirement to start from the publication of the RTS in the Official Journal. However, the proposed starting date would not allow counterparties to implement the practical arrangements necessary for frontloading to take place. In particular, counterparties have to calculate the price of frontloading in order to include it in their contracts, and communicate their counterparties whether they are subject to the frontloading requirement. Therefore, the starting date of frontloading should be delayed until counterparties can become aware of whether the contracts they enter into are subject to the clearing obligation, and until they can implement the necessary arrangements for frontloading to take place.

In particular, intragroup transactions between counterparties in Category 1 which benefit from the exemption from the clearing obligation pursuant to Article 4(2)(a) of Regulation (EU) No 648/2012 are not subject to frontloading. Therefore, frontloading should not start for counterparties in category 1 until they can know whether they benefit from the exemption from clearing pursuant to Article 4(2)(a) of that Regulation. Postponing the start date of frontloading for counterparties in Category 1 until two months after the entry into force of the RTS would provide those counterparties with sufficient time to know whether they benefit from that exemption before the frontloading takes effect.

IRS OTC derivatives concluded between financial counterparties other than Category 1 should not be subject to frontloading before those counterparties can know whether they reach the threshold to fall under Category 2, and before they have sufficient time after that to make the necessary arrangements for frontloading to take place. In particular, those counterparties need to implement the necessary arrangements to carry out the calculations of the threshold. Moreover, after a financial counterparty knows that it falls within Category 2, it has to adopt the necessary arrangements to be able to frontload contracts, including providing the appropriate representations to its counterparties and making the appropriate changes to its systems, controls and internal procedures to reflect these determinations and representations.

Postponing the start date of the frontloading requirement for financial counterparties in Category 2 until five months after the entry into force of the RTS would provide those counterparties with sufficient time to implement the necessary arrangements to calculate the threshold and subsequently implement the necessary arrangements for frontloading.

The postponement of the starting date of the frontloading requirement for counterparties in Category 2 would also require an adaptation of the period to be taken into account for the calculation of the threshold, so that the threshold is calculated taking into account the most recent period before frontloading starts, in line with the period for the calculation of the threshold proposed by ESMA. The period to take into account for the calculation of the threshold should be the three months following the publication of the RTS in the Official Journal, excluding the month of the publication.

2. Providing intragroup transactions with third-country counterparties with a transitional period

OTC derivatives concluded between counterparties established in a Member State and in a third country and belonging to the same group are not subject to the clearing obligation where the requirements of the exemption for intragroup transactions provided for in Regulation (EU) No 648/2012 are met. However, the equivalence decisions referred to in

point (i) of Article 3(2)(a) of that Regulation cannot be adopted before the RTS specifying the classes of IRS OTC derivatives that are subject to the clearing obligation enter into force. This situation results in the impossibility for counterparties established in a Member State and in a third country of benefiting from the exemption for intragroup transactions since the requirement set out in point (i) of Article 3(2)(a) of that Regulation cannot be fulfilled until the Commission has adopted the equivalence decisions referred to therein.

In order to allow sufficient time for the adoption of implementing acts pursuant to Article 13(2) of that Regulation regarding the third countries concerned, and to allow counterparties to apply for the exemption from clearing intragroup transactions, third countries should be deemed as equivalent for the purposes of point (i) of Article 3(2)(a) of Regulation (EU) No 648/2012 up until 3 years after the date of entry into force of this Regulation or until a decision is adopted pursuant to Article 13(2) of Regulation (EU) No 648/2012 on the equivalence of the third country concerned.

I therefore inform you that the Commission, acting in accordance with the procedure set out in the fifth and sixth subparagraphs of Article 10(1) of Regulation (EU) No 1095/2010, intends to endorse with amendments the draft regulatory technical standard submitted by ESMA on the clearing obligation for IRS, as proposed in the amended draft RTS attached.

Yours sincerely,

Jonathan Faull

COMMISSION DELEGATED REGULATION (EU) No .../..

of XXX

[...]

supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on the clearing obligation
of [ ]
(text with EEA relevance)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories[1], and in particular Article 5(2) thereof,

Whereas:

(1) The European Securities and Markets Authority (ESMA) has been notified of the classes of interest rate OTC derivatives that certain central counterparties (CCPs) have been authorised to clear. For each of those classes ESMA has assessed the criteria that are essential for subjecting them to the clearing obligation, including the level of standardisation, the volume and liquidity, and the availability of pricing information. With the overarching objective of reducing systemic risk, ESMA has determined the classes of interest rate OTC derivatives that should be subject to the clearing obligation in accordance with the procedure set out in Regulation (EU) No 648/2012.

(2) Interest rate OTC derivative contracts can have a constant notional amount, a variable notional amount or a conditional notional amount. Contracts with a constant notional amount have a notional amount which does not vary over the life of the contract. Contracts with a variable notional amount have a notional amount that varies over the life of the contract in a predictable way. Contracts with a conditional notional amount have a notional amount which varies over the life of the contract in an unpredictable way. Conditional notional amounts add complexity to the pricing and risk management associated to interest rate OTC derivative contracts and thus to the ability of CCPs to clear them. Fair, reliable and generally accepted pricing information is therefore not available for interest rate OTC derivative contracts which have a conditional notional amount. This feature should be taken into account when defining the classes of interest rate OTC derivatives to be subject to the clearing obligation.

(3) In determining which classes of OTC derivative contracts should be subject to the clearing obligation, the specific nature of OTC derivative contracts which are concluded with covered bond issuers or with cover pools for covered bonds should be taken into account. In this respect, the classes of interest rate OTC derivatives subject

[1] OJ L 201, 27.7.2012, p. 1.

to the clearing obligation under this Regulation should not encompass contracts concluded with covered bond issuers or cover pools for covered bonds, provided they meet certain conditions.

(4) Different counterparties need different periods of time for putting in place the necessary arrangements to clear the interest rate OTC derivatives subject to the clearing obligation. In order to ensure an orderly and timely implementation of that obligation, counterparties should be classified into categories in which sufficiently similar counterparties become subject to the clearing obligation from the same date.

(5) A first category should include both financial and non-financial counterparties which, at the date of entry into force of this Regulation, are clearing members of at least one of the relevant CCPs and for at least one of the classes of interest rate OTC derivatives subject to the clearing obligation, as those counterparties already have experience with voluntary clearing and have already established the connections with those CCPs to clear at least one of those classes. Non-financial counterparties that are clearing members should also be included in this first category as their experience and preparation towards central clearing is comparable with that of financial counterparties included in it.

(6) A second and third category should comprise financial counterparties not included in the first category, grouped according to their levels of legal and operational capacity regarding OTC derivatives. The level of activity in OTC derivatives should serve as a basis to differentiate the degree of legal and operational capacity of financial counterparties, and a quantitative threshold should therefore be defined for division between the second and third categories on the basis of the aggregate month-end average notional amount of non-centrally cleared derivatives. That threshold should be set out at an appropriate level to differentiate smaller market participants, while still capturing a significant level of risk under the second category. The threshold should also be aligned with the threshold agreed at international level related to margin requirements for non-centrally cleared derivatives in order to enhance regulatory convergence and limit the compliance costs for counterparties.

(7) Certain alternative investment funds ("AIFs") are not captured by the definition of financial counterparties under Regulation (EU) No 648/2012 although they have a degree of operational capacity regarding OTC derivative contracts similar to that of AIFs captured by that definition. Therefore AIFs classified as non-financial counterparties should be included in the same categories of counterparties as AIFs classified as financial counterparties.

(8) A fourth category should include non-financial counterparties not included in the other categories, given their limited experience and operational capacity with OTC derivatives and central clearing.

(9) The date on which the clearing obligation takes effect for counterparties in the first category should take into account the fact that they do not necessarily have the necessary pre-existing connections with CCPs for all the classes subject to the clearing obligation. In addition, counterparties in this category constitute the access point to clearing for counterparties that are not clearing members (indirect clearing), indirect clearing being expected to increase substantially as a consequence of the entry into force of the clearing obligation. Finally, this first category of counterparties account for a significant portion of the volume of interest rate OTC derivatives already cleared, and the volume of transactions to be cleared will significantly increase after the date on which the clearing obligation set out in this Regulation will take effect. Therefore, a reasonable timeframe for

counterparties in the first category to prepare for clearing additional classes, to deal with the increase of indirect clearing, and to adapt to increasing volumes of transactions to be cleared should be set at 6 months.

(10) The date on which the clearing obligation takes effect for counterparties in the second and third categories should take into account the fact that most of them will get access to a CCP by becoming a client or an indirect client of a clearing member. This process may require between 12 and 18 months depending on the legal and operational capacity of counterparties and their level of preparation regarding the establishment of the arrangements with clearing members that are necessary for clearing the contracts.

(11) The date on which the clearing obligation takes effect for counterparties in the fourth category should take into account their legal and operational capacity, and their limited experience with central clearing.

(12) OTC derivatives concluded between two counterparties established in a Member State and in a third country and belonging to the same group should not be subject to the clearing obligation where the requirements of the exemption for intragroup transactions provided for in Regulation (EU) No 648/2012 are met. In order to allow sufficient time for the adoption of implementing acts pursuant to Article 13(2) of that Regulation regarding the third country concerned, and to allow counterparties to apply for the exemption from clearing intragroup transactions, third countries should be deemed to be equivalent for the purposes of point (i) of Article 3(2)(a) of Regulation (EU) No 648/2012 up until 3 years after the date of entry into force of this Regulation or until a decision is adopted pursuant to Article 13(2) of Regulation (EU) No 648/2012 on the equivalence of the third country concerned.

(13) Unlike OTC derivatives whose counterparties are non-financial counterparties, where counterparties to OTC derivative contracts are financial counterparties, Regulation (EU) No 648/2012 requires the application of the clearing obligation to contracts concluded after the notification to ESMA that follows the authorisation of a CCP to clear a certain class of OTC derivatives, but before the date on which the clearing obligation takes effect, provided the remaining maturity of such contracts at the date on which the obligation takes effect justifies it. The application of the clearing obligation to those contracts should pursue the objective of ensuring the uniform and coherent application of that Regulation, that is, ensuring financial stability and the reduction of systemic risk, as well as ensuring a level playing field for market participants when a class of OTC derivative contracts is declared subject to the clearing obligation. The minimum remaining maturity should therefore be set at a level that ensures the achievement of those objectives.

(14) Before regulatory technical standards adopted pursuant to Article 5(2) of Regulation (EU) No 648/2012 enter into force, counterparties cannot foresee whether the OTC derivative contracts they conclude would be subject to the clearing obligation on the date that obligation takes effect. This uncertainty, which remains until counterparties know whether the contracts they conclude pertain to the classes of OTC derivatives that are subject to the clearing obligation, has a significant impact on the capacity of market participants to accurately price the OTC derivative contracts they enter into since centrally cleared contracts are subject to a different collateral regime than non-centrally cleared contracts. Imposing forward-clearing to contracts concluded before the entry into force of this Regulation, irrespective of their remaining maturity on the date in which the clearing obligation takes effect, could limit counterparties' ability to hedge their market risks adequately and either impact the functioning of the market

and financial stability, or prevent them from exercising their usual activities by hedging them by other appropriate means. Moreover, contracts concluded after this Regulation enters into force and before the clearing obligation takes effect should not be subject to the clearing obligation until counterparties to those contracts can determine the category they are comprised in, whether they are subject to the clearing obligation for a particular contract, and before they can implement the necessary arrangements to conclude those contracts taking into account the clearing obligation. Therefore, in order not to create additional systemic risk which can be caused by the counterparties of such contracts adapting them in order to take into account the clearing obligation, and to preserve the orderly functioning and the stability of the market, as well as a level playing field between counterparties it is appropriate to consider that those contracts should not be subject to the clearing obligation, irrespective of their remaining maturities.

(15) OTC derivative contracts concluded after counterparties can know whether those contracts are subject to clearing and can implement the necessary arrangements to clear them should be cleared unless they are not significantly relevant for systemic risk, or unless subjecting those contracts to the clearing obligation could otherwise jeopardise the uniform and coherent application of Regulation (EU) No 648/2012. Counterparty credit risk associated to interest rate OTC derivative contracts with longer maturities remains in the market for a longer period and, consequently, those contracts pose higher risks to the market. On the contrary, interest rate OTC derivatives with low remaining maturities pose lower risks to the market. Imposing the clearing obligation on the latter would imply a burden on counterparties disproportionate to the level of risk mitigated. In addition, interest rate OTC derivatives with low remaining maturities represent a relatively small portion of the total market. The minimum remaining maturities should therefore be set at a level ensuring that contracts with remaining maturities of no more than a few months are not subject to the clearing obligation.

(16) Counterparties in the third category bear a relatively limited share of overall systemic risk and have a lower degree of legal and operational capacity regarding OTC derivatives than counterparties in the first and second categories. Essential elements of the OTC contracts, including the pricing of interest rate OTC derivatives subject to the clearing obligation and concluded before that obligation takes effect, will have to be adapted within short timeframes in order to incorporate the clearing that will only take place several months after the contract is concluded. This process of forward-clearing involves important adaptations to the pricing model and amendments to the documentation of those OTC derivatives contracts. Counterparties in the third category have a very limited ability to incorporate forward-clearing in their OTC derivative contracts. Thus, imposing the clearing of contracts concluded before the clearing obligation takes effect for those counterparties could limit their ability to hedge their risks adequately and either impact the functioning and the stability of the market or prevent them from exercising their usual activities if they cannot continue to hedge. Therefore, contracts concluded by counterparties in the third category before the date on which the clearing obligation takes effect should not be cleared.

(17) This Regulation is based on the draft regulatory technical standards submitted by ESMA to the Commission.

(18) ESMA has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits, requested the opinion of the Security and Markets Stakeholder Group established by

Article 37 of Regulation (EU) No 1095/2010 of the European Parliament and of the Council[2], and consulted the European Systemic Risk Board.

HAS ADOPTED THIS REGULATION:

Article 1– Classes of OTC derivatives subject to the clearing obligation

1. The classes of OTC derivatives set out in Annex I shall be subject to the clearing obligation.

2. The classes of OTC derivatives set out in Annex I shall not include contracts concluded with covered bond issuers or with covered pools for covered bonds, provided those contracts satisfy all of the following conditions:

(a) they are used only to hedge the interest rate or currency mismatches of the cover pool in relation with the covered bond;

(b) they are registered or recorded in the cover pool of the covered bond in accordance with national covered bond legislation;

(c) they are not terminated in case of resolution or insolvency of the covered bond;

(d) the counterparty to the OTC derivative concluded with covered bond issuers or with covered pools for covered bonds ranks at least pari-passu with the covered bond holders except where the counterparty to the OTC derivative concluded with covered bond issuers or with covered pools for covered bonds is the defaulting or the affected party, or waives the pari-passu rank;

(e) the covered bond referred to in point (a) meets the requirements of Article 129 of Regulation (EU) No 575/2013;

(f) the covered bond referred to in point (a) is subject to a regulatory collateralisation requirement of at least 102%.

Article 2 – Categories of counterparties

1. For the purposes of Article 3, the counterparties subject to the clearing obligation shall be divided in the following categories:

(a) Category 1, comprising counterparties which, on the date of entry into force of this Regulation, are clearing members, within the meaning of Article 2(14) of Regulation (EU) No 648/2012, for at least one of the classes of OTC derivatives set out in Annex I, of at least one of the CCPs authorised or recognised before that date to clear at least one of those classes;

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[2] Regulation (EU) No 1095/2010 of THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC OJ L 331, 15.12.2010, p.84

(b) Category 2, comprising counterparties not belonging to Category 1 which belong to a group whose aggregate month-end average of outstanding gross notional amount of non-centrally cleared derivatives for *[three months after the publication of the RTS in the OJ excluding the month of publication]* is above EUR 8 billion and which are any of the following:

(i) financial counterparties;

(ii) alternative investment funds as defined in Article 4(1)(a) of Directive 2011/61/EU that are non-financial counterparties.

(c) Category 3, comprising counterparties not belonging to Category 1 or Category 2 which are any of the following:

(i) financial counterparties;

(ii) alternative investment funds as defined in Article 4(1)(a) of Directive 2011/61/EU that are non-financial counterparties.

(d) Category 4, comprising non-financial counterparties that do not belong to Category 1, Category 2 or Category 3.

2. For the purposes of calculating the group aggregate month-end average notional amount referred to in point (b) of paragraph 1, all of the group's non-centrally cleared derivatives, including foreign exchange forwards, swaps and currency swaps, shall be included.

Article 3 – Dates from which the clearing obligation takes effect

1. In respect of contracts pertaining to a class of OTC derivatives set out in Annex I, the clearing obligation shall take effect on:

(a) [the date 6 months after the date of entry into force of this Regulation] for counterparties in Category 1;

(b) [the date 12 months after the date of entry into force of this Regulation] for counterparties in Category 2;

(c) [the date 18 months after the date of entry into force of this Regulation] for counterparties in Category 3;

(d) [the date 3 years after the date of entry into force of this Regulation] for counterparties in Category 4.

2. Where a contract is entered into between two counterparties included in different categories of counterparties, the date from which the clearing obligation takes effect for that contract shall be the later of the two.

3. For 3 years after the date of entry into force of this Regulation or until a decision is made pursuant to Article 13(2) of Regulation (EU) No 648/2012 on the equivalence of the third country referred to in point (i) of Article 3(2)(a) of that Regulation, whichever date is earlier, that third country shall be deemed equivalent within the meaning of Article 13(2) of that Regulation for the sole purpose of point (i) of Article 3(2)(a) of that Regulation.

Article 4 – Minimum remaining maturity

1. For financial counterparties in Category 1, the minimum remaining maturity referred to in point (ii) of Article 4(1)(b) of Regulation (EU) No 648/2012, at the date the clearing obligation takes effect, shall be:

(a) 50 years for contracts entered into or novated before [two months after the date of entry into force of this Regulation] that belong to the classes in Table 1 or Table 2 set out in Annex I;

(b) 3 years for contracts entered into or novated before [two months after the entry into force of this Regulation] that belong to the classes of Table 3 or Table 4 of Annex I;

(c) 6 months for OTC derivative contracts entered into or novated on or after [two months after the entry into force of this Regulation] that belong to the classes of Table 1 to Table 4 of Annex I.

2. For financial counterparties in Category 2, the minimum remaining maturity referred to in Article 4(1)(b)(ii) of Regulation (EU) No 648/2012, at the date the clearing obligation takes effect, shall be:

(a) 50 years for contracts entered into or novated before [five months after the date of entry into force of this Regulation] that belong to the classes in Table 1 or Table 2 set out in Annex I;

(b) 3 years for contracts entered into or novated before [five months after the entry into force of this Regulation] that belong to the classes of Table 3 or Table 4 of Annex I;

(c) 6 months for OTC derivative contracts entered into or novated on or after [five months after the entry into force of this Regulation] that belong to the classes of Table 1 to Table 4 of Annex I.

3. For financial counterparties in Category 3, the minimum remaining maturity referred to in Article 4(1)(b)(ii) of Regulation (EU) No 648/2012, at the date the clearing obligation takes effect, shall be:

(a) 50 years for contracts that belong to the classes of Table 1 or Table 2 of Annex I;

(b) 3 years for contracts that belong to the classes of Table 3 or Table 4 of Annex I.

4. Where a contract is entered into between two counterparties belonging to different categories, the minimum remaining maturity to be taken into account for the purposes of this Article shall be the longer of the two.

Article 5 – Entry into force

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

For the Commission
The President