European Securities and Markets Authority

8 November 2018
ESMA71-99-1055

PRESS RELEASE

ESMA proposes a regulatory change to support the Brexit preparations of counterparties to uncleared OTC derivatives

The European Securities and Markets Authority (ESMA) has today published a final report with draft regulatory technical standards (RTS) proposing to amend the three Commission Delegated Regulations on the clearing obligation under the European Market Infrastructure Regulation (EMIR). The draft RTS propose, in the context of the United Kingdom's (UK) withdrawal from the European Union (EU), to introduce a limited exemption in order to facilitate the novation of certain non-centrally cleared OTC derivative contracts to EU counterparties during a specific time-window. The amendments would only apply if the UK leaves the EU without the conclusion of a withdrawal agreement – a no deal scenario.

In the context of the on-going withdrawal negotiations between the EU and the UK, and to address the situation where a UK counterparty may no longer be able to provide certain services across the EU, counterparties in the EU may want to novate their non-centrally cleared OTC derivative contracts by replacing the UK counterparty with an EU counterparty. However, by doing this, they may trigger the clearing obligation for these contracts, therefore facing costs that were not accounted for when the contract was originally entered into.

Limited exemption from the clearing obligation to facilitate novations

The draft RTS allows UK counterparties to be replaced with EU ones without triggering the clearing obligation. This limited exemption would ensure a level playing field between EU counterparties and the preservation of the regulatory and economic conditions under which the contracts where originally entered into.

The window for the novation of non-centrally cleared OTC derivative contracts which fall under the scope of this amending regulation would be open for twelve months following the withdrawal of the UK from the EU. Counterparties can however start repapering their contracts ahead of the application date, making the novation conditional upon a no-deal Brexit, given the conditional application date of this amending regulation.

Steven Maijoor, Chair, said:

> "ESMA and other EU authorities and institutions have been clear on the importance for market participants to be prepared for Brexit, including the possibility of a no-deal scenario. The proposed regulatory change supports counterparties' Brexit preparations and maintain a level playing field between EU counterparties, while addressing potential risks to orderly markets and financial stability.
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> "Counterparties should negotiate as soon as possible the novations of their transactions which are in the scope of this amending regulation, given the twelve month timeframe to benefit from it."

Third country regimes

ESMA is aware of the varying third country regimes across Member States and the impact it has on the provisions of services related to OTC derivative life cycle events, and has already highlighted its concerns in this respect. Market participants will need to take these varying regimes into account in their no-deal contingency plans regarding non-centrally cleared OTC derivatives. Given the limited effectiveness of supervisory convergence in the absence of a common legal basis, ESMA is proposing to reduce legal uncertainty by acting in relation to the clearing obligation.

Next steps

The draft RTS have been submitted to the European Commission for endorsement, and they are subject to the scrutiny of the European Parliament and of the Council.

Further developments on risk-mitigation techniques

ESMA, together with the European Banking Authority (EBA) and the European Insurance and Occupational Pensions Authority (EIOPA) is currently considering a similar approach to facilitate the novation of legacy contracts to EU counterparties considering that novation may also trigger the application of bilateral margin requirements.

As regards non-centrally cleared OTC derivative contracts, the above mentioned measures will be the only regulatory measures the ESAs intend to propose to help address the legal uncertainty raised by the withdrawal of the UK from the EU and to ensure a level-playing field between EU counterparties.

Notes for editors

1. Final Report:

    - ESMA70-151-1854 Final Report – EMIR RTS on the novation of contracts for which the clearing obligation has not yet taken effect

2. Commission Delegated Regulations on the clearing obligation (No 2015/2205, No 2016/592 and No 2016/1178).

3. The clearing obligation applies to EU firms that are counterparties to an OTC derivative contract including interest rate, foreign exchange, equity, credit and commodity derivatives.

4. ESMA's mission is to enhance investor protection and promote stable and orderly financial markets.

    It achieves these objectives through four activities:

    i. assessing risks to investors, markets and financial stability;

    ii. completing a single rulebook for EU financial markets;

    iii. promoting supervisory convergence; and

    iv. directly supervising specific financial entities.

5. ESMA achieves its mission within the European System of Financial Supervision (ESFS) through active cooperation with the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA), the European Systemic Risk Board, and with national authorities with competencies in securities markets (NCAs).

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