



European Securities and
Markets Authority

Consultation Paper

On the clearing obligation for financial counterparties with a limited volume of activity



Responding to this paper

ESMA invites comments on all matters in this paper and in particular on the specific questions summarised in Annex 1. Comments are most helpful if they:

1. respond to the question stated;
2. indicate the specific question to which the comment relates;
3. contain a clear rationale; and
4. describe any alternatives ESMA should consider.

ESMA will consider all comments received by **5 September 2016**.

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

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 counterparties of OTC derivatives transactions which are subject to the clearing obligation.

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Acronyms used

CCP	Central Counterparty
CDS	Credit Default Swap
CRR	Capital Requirements Regulation
EMIR	European Market Infrastructure Regulation
ESMA	European Securities and Markets Authority
ESRB	European Systemic Risk Board
FC	Financial Counterparty
IRS	Interest Rate Swap
LEI	Legal Entity Identifier
MiFIR	Markets in Financial Instruments Regulation
NFC	Non-Financial Counterparty
OTC	Over-the-counter
RTS	Regulatory Technical Standards
TR	Trade Repository

Executive Summary

Reasons for publication

This consultation paper seeks stakeholders' views on a proposal to amend the phase-in period of the clearing obligation for financial counterparties with a limited volume of activity as established in several Commission Delegated Regulations on the clearing obligation under Regulation (EU) No 648/2012 of the European Parliament and Council on OTC derivatives, central counterparties and trade repositories (the European Market Infrastructure Regulation, EMIR).

The input from stakeholders will help ESMA in deciding whether to proceed and, if that is confirmed, in finalising the amending technical standards to be drafted and submitted to the European Commission for endorsement in the form of Commission Delegated Regulations, i.e. a legally binding instrument directly applicable in all Member States of the European Union. One essential element in the development of draft technical standards is the analysis of the costs and benefits that those legal provisions will imply. Input in this respect and any supportive data will be highly appreciated and kept confidential where required.

Contents

Section 2 provides some background information on the current compliance schedule for the clearing obligation, on the issues of access to CCPs faced by financial counterparties with a limited volume of activity and on how those issues could be addressed. Section 3 includes a quantitative analysis of the activity of financial counterparties in OTC derivative markets and how the volume is allocated between large and small financial counterparties. Finally, Section 4 sets out the proposal to amend the date of application of the clearing obligation for the smallest financial counterparties.

Next Steps

ESMA will consult the European Systemic Risk Board (ESRB) and, where relevant, the competent authorities of third-countries as required when developing technical standards on the clearing obligation. ESMA will consider the feedback it received to this consultation and expects to publish in Q4 2016 a final report including draft technical standards to be endorsed by the European Commission.

1 Introduction

1. With the overarching objective of reducing systemic risk, EMIR introduces the obligation to clear certain classes of OTC derivatives in central counterparties (CCPs) that have been authorised (for European CCPs¹) or recognised (for third-country CCPs²) under the EMIR framework. Ensuring that the clearing obligation reduces systemic risk requires a process of identification of classes of OTC derivatives that should be subject to mandatory clearing.
2. Following the first CCP authorisations, the process of identification of those classes started in Q1 2014. The corresponding analysis by ESMA of the classes of OTC derivatives cleared by authorised or recognised CCPs has been on-going since.
3. Based on this work, several delegated acts on the clearing obligation of certain interest rate swaps and credit default swaps have already entered into force. Since 21 June 2016, clearing members are required to clear their OTC interest rate swaps denominated in the G4 currencies (EUR, GBP, JPY and USD) and the clearing obligation will gradually become applicable to the other categories of counterparties.
4. The purpose of this consultation paper is to collect feedback on a proposal to extend the phase-in period for the clearing obligation to the smallest financial counterparties (those in Category 3), justified by the difficulties that those counterparties are facing in establishing the necessary clearing arrangements to meet their compliance deadline and the limited impact in terms of systemic risk that these counterparties represent.

2 Current status of the clearing obligation for financial counterparties

2.1 Compliance deadlines for the clearing obligation

5. Under EMIR, the clearing obligation is established via Commission Delegated Regulations based on draft regulatory technical standards (RTS) developed by ESMA.
6. On the basis of the criteria defined in EMIR, ESMA has already submitted to the Commission for approval three draft RTS covering two different asset classes: OTC interest rate derivatives and OTC credit derivatives.
7. As of the date of publication of this paper, those draft RTS have been endorsed by the European Commission. Two of them have already entered into force, while the third one is

¹ The [list of authorised EU CCPs](#) is published on the ESMA website

² The [list of recognised third-country CCPs](#) is published on the ESMA website

currently under review by the European Parliament and the Council³. Further details on the clearing obligation are available in the [Public Register for the clearing obligation](#).

8. The compliance deadlines for the clearing obligation are summarised below:

- 1st Commission Delegated Regulation⁴ covering interest rate derivatives in the G4 currencies:
 - Category 1 (clearing members): 21 June 2016;
 - Category 2 (largest groups of financial counterparties and funds that are non-financial counterparties): 21 December 2016;
 - Category 3 (smallest groups of financial counterparties and funds that are non-financial counterparties): 21 June 2017;
 - Category 4 (non-financial counterparties): 21 December 2018.
- 2nd Commission Delegated Regulation⁵ covering European index CDS:
 - Category 1: 9 February 2017;
 - Category 2: 9 August 2017;
 - Category 3: 9 February 2018;
 - Category 4: 9 May 2019.
- Expected 3rd Commission Delegated Regulation⁶ covering interest rate derivatives in NOK, PLN and SEK:
 - Category 1: [entry into force of the regulation] + 6 months;
 - Category 2: [entry into force of the regulation] + 12 months;
 - Category 3: [entry into force of the regulation] + 18 months;
 - Category 4: [entry into force of the regulation] + 3 years.

2.2 Access to clearing for financial counterparties

9. To comply with the clearing obligation, counterparties which do not have pre-existing clearing arrangements can become a clearing member, a client, or establish indirect clearing arrangements with a clearing member.

10. Although counterparties have had elements to start preparing for the clearing obligation for a relatively long period of time, ESMA is aware that the access to CCP clearing (and hence the compliance with the clearing obligation) remains an issue for many financial counterparties, and in particular the smallest ones. This has been highlighted inter alia by

³ http://ec.europa.eu/finance/financial-markets/derivatives/index_en.htm

⁴ Commission Delegated Regulation (EU) 2015/2205

⁵ Commission Delegated Regulation (EU) 2016/592

⁶ ESMA/2015/1629 - Draft RTS submitted to the European Commission on 10 November 2015 and endorsed on 10 June 2016

stakeholders in their responses to the ESMA consultation on Indirect clearing arrangement published on 5 November 2015⁷.

11. According to ESMA's current understanding, counterparties are facing several issues in relation to the access to central clearing.
12. First of all, for the financial counterparties with a limited volume of activity, it is not feasible to access CCPs directly by becoming a clearing member, because of a range of reasons, in particular: cost (e.g. minimum capital requirements), risk (e.g. mutualisation of default fund resources) and other legal issues. For those counterparties, it is therefore necessary to become the client of a clearing member, or to establish indirect clearing arrangements.
13. Second, the clearing members' appetite to provide client clearing services beyond the most important and biggest clients for their franchise and/or beyond the most active clients has so far been relatively limited. Stakeholders argue that one of the most significant reasons thereof appears to be the costs, and in particular the capital allocation for this business line as a result of the leverage ratio framework being developed under Basel III and the Capital Requirements Regulation (CRR). These capital requirement considerations are usually quoted as being the main reason why several market participants have stopped providing this service, although other factors that can be specific to each individual firm can also play a part in these decisions. It should be noted that although the framework for the leverage ratio is not fully developed, the uncertainty over it is apparently preventing banks from extending their client clearing offering.
14. Third, the conclusion of indirect clearing arrangements is well established in the exchange traded derivatives market, but no similar development has yet occurred in the OTC derivative market. In order to address this situation in the OTC derivative market, ESMA conducted a review⁸ of the requirements for indirect clearing arrangements for OTC derivatives that are set in Commission Delegated Regulation (EU) 149/2013. ESMA then submitted to the Commission on 26 May 2016 amending draft RTS with the objective to address the issues raised by stakeholders and to also simplify the account structures, which should contribute to the development of these types of arrangements in the OTC derivative market. Although the recent regulatory initiative seeks to further develop indirect clearing for the OTC derivative market, the timing associated to the approval process, up to the point it enters into force, might not be consistent with the compliance deadlines for the clearing obligation for the counterparties that would want to rely on these types of arrangements.
15. It appears that the issue of access to CCP clearing is partly linked to the size of the counterparty's activity. Indeed, taking into consideration the costs associated with the onboarding of clients and the on-going management of the client cleared positions (including risk and compliance monitoring, trade management, collateral management, client

⁷ Consultation paper on indirect clearing arrangements under EMIR and MiFIR, ESMA/2015/1628, 5 November 2015

⁸ The review was conducted at the same time that ESMA was working on the draft RTS on indirect clearing arrangements under MiFIR which are required to be consistent.

reporting, client service), versus the revenues of the clearing member for offering this service that are somewhat correlated to the level of clearing activity, counterparties with the smallest activity would likely face the greatest difficulties in finding a clearing member. They are also likely to have limited negotiation powers when interacting with clearing members and, a fortiori, to have even more difficulties finding a second or more clearing members, including a back-up clearing member.

16. As a result, with this consultation paper, ESMA seeks to further identify and quantify the difficulties that counterparties may be facing in the preparation for the central clearing obligation. This assessment will help ESMA determining whether further action is needed to address this problem.
17. To speed up the process in view of the upcoming compliance deadlines on the clearing obligation, ESMA is consulting at the same time on a proposed way forward addressing the issue that financial counterparties with a limited volume of activity may be facing, as developed in Section 4.

Question 1: To which category of counterparties does your organisation belong: (1) in the context of the 1st Commission Delegated Regulation on the clearing obligation, and (2) in the context of the 2nd Commission Delegated Regulation on the clearing obligation?

Please indicate the likely category of counterparties if the determination has not been done yet. For respondents that are in none of the four categories, please indicate the nature of the activity performed in relation to the clearing obligation (e.g. CCP). For associations, please indicate the category of counterparties that you mainly represent.

Question 2: If you offer clearing services, please provide evidence on the constraints that would prevent you from offering clearing services to a wider range of clients.

Question 3: Have you already established clearing arrangements (1) for interest rate swaps? (2) for credit default swaps? If not, please explain why (including the difficulties that you may be facing in establishing such arrangements) and provide an estimation of the time needed to finalise the arrangements.

2.3 Addressing the issue of access to CCP clearing by financial counterparties with a limited volume of activity

18. EMIR does not foresee a specific exemption for financial counterparties with limited activity. In this respect, the situation in Europe is different than that in most jurisdictions where a clearing obligation is either already in place or envisaged, where various systems are established to exclude the smallest counterparties from the scope of the clearing mandates. The exemptions can be based on quantitative thresholds (de-minimis exemptions) or on specific definitions of counterparties.

19. The purpose of this consultation paper is not to discuss the possibility of introducing a permanent exemption for small financial counterparties, nor to define what could be a “small financial counterparty” with this objective in mind, as this is not in ESMA’s mandate for the clearing obligation.
20. However under EMIR, the clearing obligation procedure⁹ gives a mandate to ESMA to develop draft RTS specifying which class of OTC derivatives should be subject to the clearing obligation. The mandate also gives the possibility to ESMA to define different categories of counterparties, and to set specific dates on which the clearing obligation shall take effect for each of those categories.
21. ESMA also has the possibility to propose, on its own initiative, amendments to Commission Delegated Regulations which are based on draft RTS that it has developed.
22. Therefore, to address the issue of access to CCP clearing by certain financial counterparties, ESMA has the possibility to draft RTS proposing amendments to the Commission Delegated Regulations on the clearing obligation and to provide a longer phase-in for the counterparties that are facing difficulties in meeting the current compliance deadlines.
23. This approach is consistent with the reason why ESMA introduced different phase-in periods and the way in which the categories of counterparties were designed in the first place: the objective was to allow an orderly and timely implementation of the clearing obligation by requiring the most sophisticated counterparties, which are also the most active and systemically relevant, to clear first.
24. In addition, counterparties have been classified into categories in which sufficiently similar counterparties become subject to the clearing obligation at the same time.
25. As a result, considering that (1) certain financial counterparties with a limited volume of activity appear to be facing difficulties in getting access to CCP clearing and; (2) there is a legal tool for ESMA to address this issue if necessary, ESMA has made further analysis of the activity of financial counterparties in the relevant OTC derivatives markets (Section 3). This analysis served as a basis to develop a regulatory proposal to extend the phase-in period for the clearing obligation for counterparties in Category 3 (Section 4).

⁹ Article 5 of EMIR

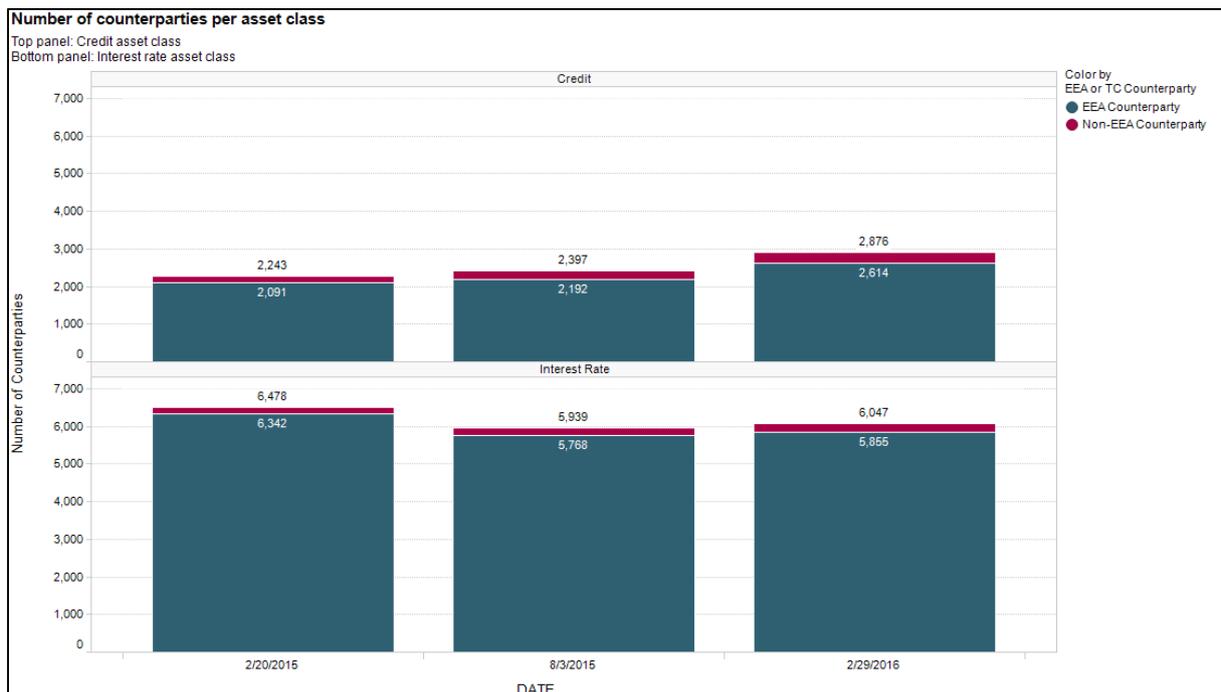
3 Activity of financial counterparties in the relevant OTC derivative asset classes

3.1 Overview of the market

26. To make an assessment of the activity of financial counterparties in the OTC derivative market, ESMA has used data from European trade repositories (TR), on three different dates covering a timespan of one year: 20 February 2015, 3 August 2015 and 29 February 2016. More information on the dataset and cleaning methodology can be found in Annex 2.

27. The number of active European financial counterparties in the OTC interest rate asset class is important, around 6,000, this number being relatively stable on the three dates of the study. In the OTC credit asset class the number of active European counterparties oscillated between around 2,000 in February 2015 and 2,800 one year later (see Figure 1).

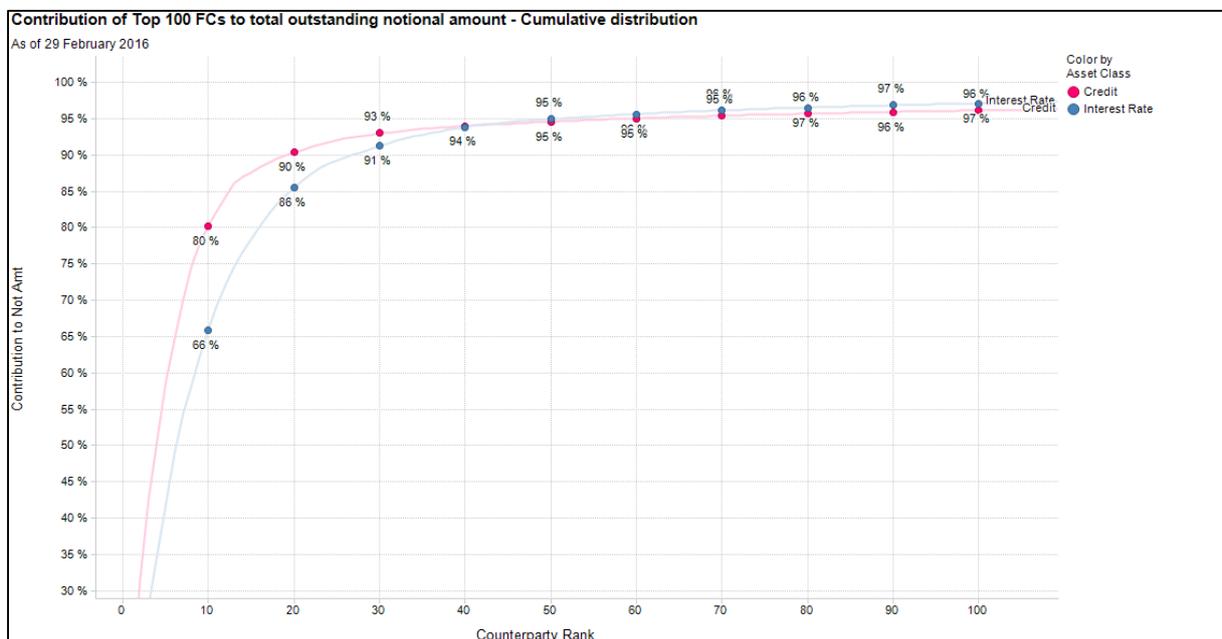
Figure 1



3.2 Distribution of volumes across financial counterparties

28. It comes as no surprise that the distribution of trades among financial counterparties is highly concentrated, i.e. that a relatively small number of counterparties account for an important share of the total market (see e.g. the impact assessments of the first two final reports on the clearing obligation on interest rate swaps (IRS) and credit default swaps (CDS)¹⁰).
29. This asymmetry was one of the justifications for the adoption of a phased-in implementation schedule for the clearing obligation, i.e. starting with the few but most active counterparties (clearing members) and adding progressively an increasing number of less active counterparties.
30. As shown in Figure 2, this asymmetric distribution is present in both the interest rate and the credit asset classes.
31. Based on the trades outstanding on 29 February 2016, the largest 50 counterparties accounted for 95% of the credit and interest rate OTC derivative volume; and the largest 100 counterparties accounted for 96%-97% of the credit and interest rate OTC derivative volume, measured by outstanding notional amounts.

Figure 2



¹⁰ ESMA/2014/1184 published on 1 October 2014 and ESMA/2015/1481 published on 1 October 2015

32. To go further into this analysis, counterparties are bucketed depending on the size of their portfolios per asset class, see Table 1 for the interest rate derivative asset class and Table 2 for the credit derivative asset class.
33. Both markets show important levels of concentration on a small number of large counterparties. For example, in the interest rate derivative asset class, less than 500 counterparties (the ones with portfolios of OTC interest rate derivatives above EUR 5bn) represent 99.4% of the activity, and 8.4% in terms of number of counterparties.
34. Similarly, in the credit derivative asset class, less than 400 counterparties (the ones with portfolios of OTC credit derivatives above EUR 500mn) represent 98.6% of the activity, and 14.5% in terms of number of counterparties.
35. Looking at it from the other side of the coin, this means that an important number of counterparties account for only a small fraction of the total volume.

Table 1: Interest rate derivative asset class, as of 29 February 2016

	Cumulated number of counterparties	Cumulated % of counterparties	Cumulated Notional Amount (EUR Bn)	Cumulated Notional Amounts (%)
0. Above 1,000bn	33	0.6%	310,921	92.26%
1. Above 500bn	41	0.7%	316,912	94.04%
2. Above 100bn	88	1.5%	326,149	96.78%
3. Above 50bn	130	2.2%	329,162	97.67%
4. Above 5bn	490	8.4%	335,009	99.41%
5. Above 500mn	1,453	24.8%	336,652	99.90%
6. Above 100mn	2,551	43.6%	336,924	99.98%
7. Above 30mn	3,545	60.5%	336,984	99.99%
8. Above 5mn	4,839	82.6%	337,003	100.00%
9. Below 5mn	5,855	100.0%	337,005	100.00%
Grand Total	5,855	100.0%		100.0%

Table 2: Credit derivative asset class, as of 29 February 2016

	Cumulated number of counterparties	Cumulated % of counterparties	Cumulated Notional Amount (EUR Bn)	Cumulated Notional Amounts (%)
0. Above 1,000bn	3	0.1%	5,180	42.85%
1. Above 500bn	8	0.3%	9,055	74.91%
2. Above 100bn	13	0.5%	10,412	86.14%
3. Above 50bn	20	0.8%	10,919	90.33%
4. Above 5bn	58	2.2%	11,479	94.97%
5. Above 500mn	379	14.5%	11,917	98.59%
6. Above 100mn	915	35.0%	12,046	99.66%
7. Above 30mn	1,431	54.7%	12,076	99.91%
8. Above 5mn	2,113	80.8%	12,086	99.99%
9. Below 5mn	2,614	100.0%	12,087	100.00%
Grand Total	2,614	100.0%		100.0%

3.3 Current level of CCP clearing experience of financial counterparties

36. As presented in Figure 3 and Figure 4 below, in both the credit and the interest rate OTC derivative asset classes, the vast majority of counterparties have not reported any CCP cleared transactions yet; at the same time, the percentage of the total volume in the hands of counterparties with no clearing experience (i.e. those that have never reported a cleared trade) is relatively limited.
37. This finding is very much pronounced in the OTC interest rate derivative asset class, where the counterparties with at least one reported cleared IRS trade represent around 10% of the total number of counterparties but account for more than 97% of the total volume.
38. In the OTC credit derivative asset class, counterparties with at least one reported cleared CDS trade represent around 12-15% of the total number of counterparties and account for 80-95% of the total volume.
39. Those proportions have proved relatively stable over the three dates of the analysis.

Figure 3

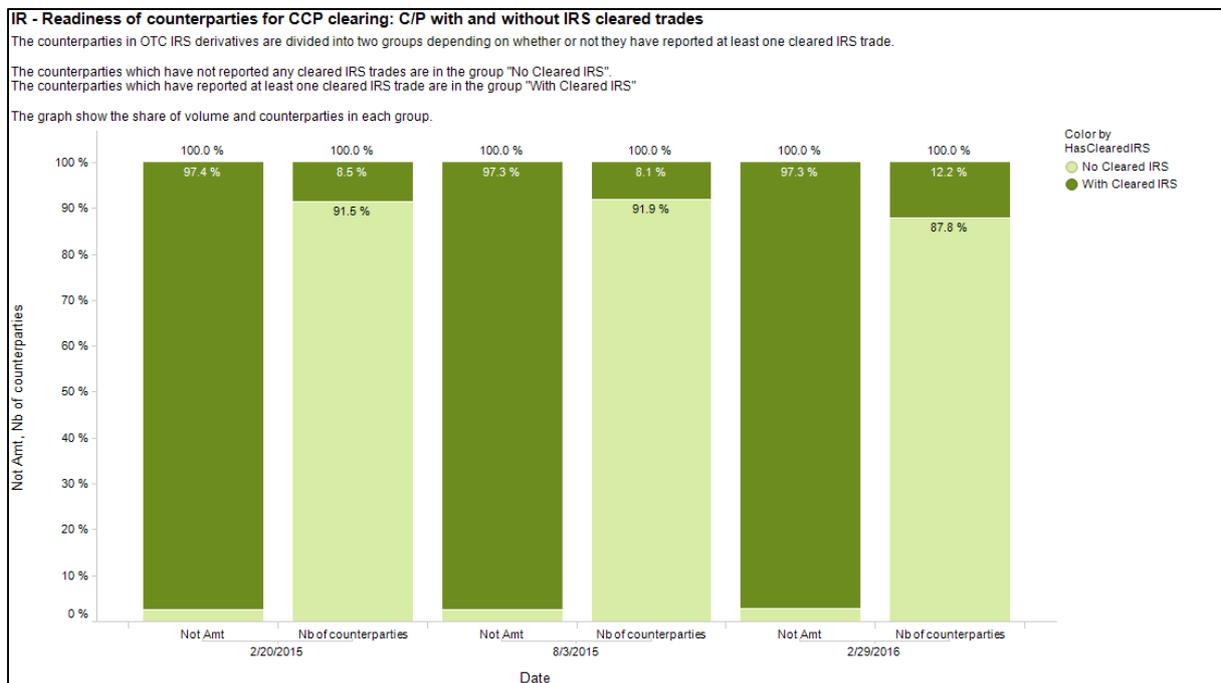
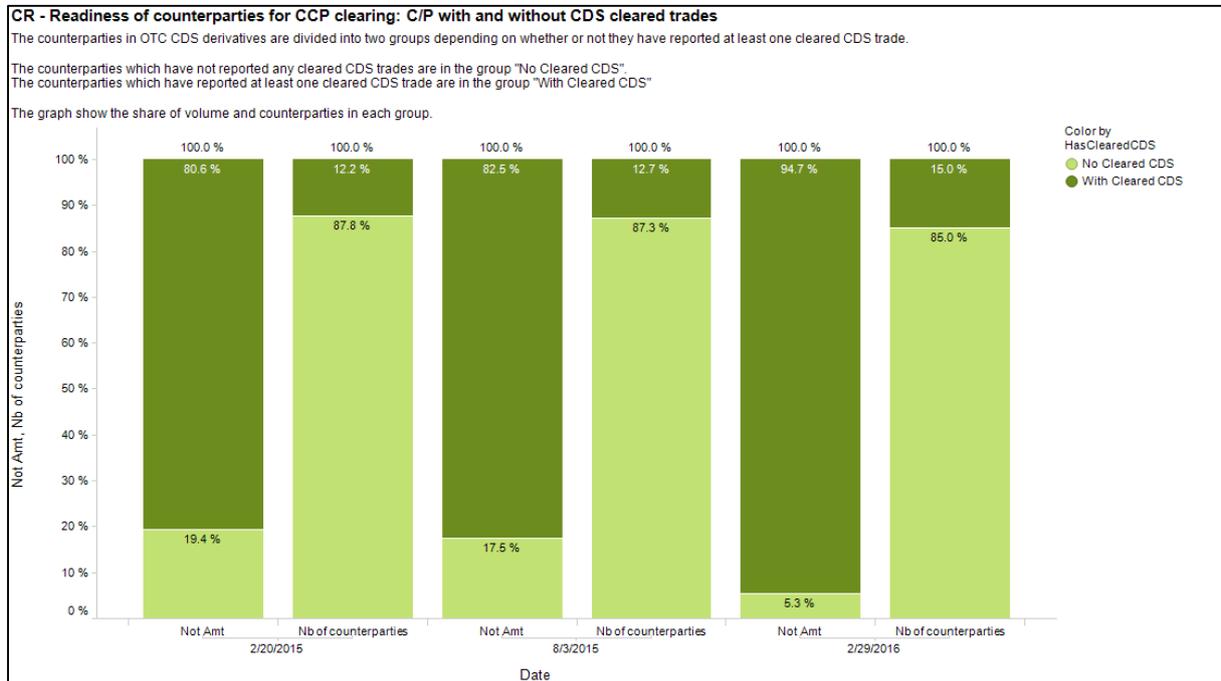


Figure 4



40. Based on the above analysis, we can conclude that in the two asset classes on which a clearing obligation currently exists, the large majority of the volume is done by only a small number of counterparties.

41. Therefore, an extension of the phase-in period for small market players should not compromise the primary objective of the clearing obligation, which is the reduction of systemic risk.

42. In addition, the quantitative elements provided above do not allow establishing whether counterparties are actively preparing for the clearing obligation. However, the relatively small number of market participants which are reporting some cleared transactions provides an indication that only few have completed all the steps and have started to clear on a voluntary basis ahead of the compliance deadline.

Question 4: Please provide information and data you may have that could complement this analysis on the level of experience and preparedness of financial counterparties with CCP clearing.

43. Based on this outcome, Section 4 below details the proposal to extend the phase-in period for the smallest financial counterparties (Category 3) and addresses the following questions: (1) how to identify financial counterparties with a limited volume of activity, (2) by how long should the clearing obligation be postponed for them; and (3) for which delegated regulations on the clearing obligation should the postponement be proposed.

4 Proposal to modify the phase-in period for Category 3

4.1 Existing classification of financial counterparties

44. The approach for defining the categories of counterparties for the purpose of the clearing obligation has been discussed on several occasions, in the discussion paper and consultation papers released on this topic.

45. Taking into account the feedback received from stakeholders, the retained option has been to rely as much as possible on classifications already established in Level 1 (i.e. clearing members, financial counterparties, and non-financial counterparties). It was also decided to introduce a further classification between large and small financial counterparties, via a quantitative threshold.

46. This has led to the definition of four categories of counterparties¹¹:

- Category 1: clearing members
- Category 2: financial counterparties (and certain funds which are classified as non-financial counterparties) belonging to a group whose aggregate positions in OTC derivatives are above EUR 8bn;
- Category 3: financial counterparties (and certain funds which are classified as non-financial counterparties) belonging to a group whose aggregate positions in OTC derivatives are below EUR 8bn;
- Category 4: non-financial counterparties not included in Category 1, 2 or 3.

47. The objective of the present proposal is to provide additional time to financial counterparties with a limited volume of activity to comply with the relevant clearing obligation, whilst not compromising the overall objective of the clearing obligation, which is the reduction of systemic risk.

48. Therefore, the proposal on which stakeholders are consulted should minimise the share of OTC derivative transactions in respect of which the clearing obligation will be postponed.

49. For reasons which are detailed in the following paragraphs, the proposal on which ESMA is consulting is to delay the phase-in period for the counterparties included in Category 3.

¹¹ See Article 2 of Delegated Regulation 2015/2205 and 2016/592

4.2 Identification of Financial Counterparties with a limited volume of activity

50. The existing system of counterparty classification was designed taking into consideration the criteria set up in EMIR, in particular the level of sophistication of the counterparties, the type and number of counterparties active in the relevant OTC derivative markets¹² and the differences in the legal and operational capacities of the counterparties¹³.
51. Besides clearing members, financial counterparties have been grouped according to their levels of legal and operational capacity regarding OTC derivatives, which was approximated by the level of activity of the counterparties in OTC derivatives. A quantitative threshold was defined to distinguish Category 2 from Category 3: the threshold was set at an appropriate level to differentiate small from large market participants, while still capturing a significant level of risk under the second category¹⁴.
52. Therefore, the classification system adopted in the Delegated Regulations on the clearing obligation already establishes a distinction between small and large market participants, although this distinction is made at group level.
53. In the following paragraphs we are providing quantitative elements to measure how the current classification system distinguishes small from large counterparties.
54. Figure 5 (for Interest rate derivatives) and Figure 6 (for Credit derivatives) provide an overview at EU level of the share of each of the 3 existing categories of counterparties, in terms of volume and number of counterparties.
55. It should be noted that counterparties in Category 1 can be easily identified¹⁵, but the counterparty classification between Category 2 and 3 is much more complex and could only be approximated on the basis of a number of assumptions¹⁶.
56. Under the simplified assumptions that had to be taken (in particular the fact that positions are not aggregated at group level), the number of counterparties in the “Estimated Category 2” is expected to be underestimated and the number of counterparties in the “Estimated Category 3” is expected to be overestimated, compared to the actual Categories 2 and 3 as defined in the Delegated Regulation on the clearing obligation.

¹² Criteria (d) of Article 5(5) of EMIR

¹³ Criteria (f) of Article 5(5) of EMIR

¹⁴ See Recital (6) of the 1st Delegated Regulation on the clearing obligation, and Recital (5) of the second Delegation Regulation on the clearing obligation

¹⁵ The classification of counterparties in Category 1 (Clearing Members) was made publicly available by all CCPs which are clearing the OTC derivatives subject to the clearing obligation, see the Public Register for the clearing obligation under EMIR.

¹⁶ For counterparties in Category 2 and 3, the positions in OTC derivatives should be aggregated at group level and across all asset classes. In the absence of sufficient information on the group structure, the classification used in this paper does not rely on aggregation of positions at group level. It also only includes the non-cleared trades in the credit and interest rate asset classes.

57. Indeed, with the methodology used in this paper, a financial counterparty with a portfolio of OTC derivatives below EUR 8bn will be classified under “Estimated Category 3” whereas in reality, it may belong to Category 2 because it is part of a larger group.
58. In the Interest rate derivative asset class, clearing members (Category 1) represent 94.5% of the volume and 1.2% of the number of counterparties; counterparties classified in the “Estimated Category 2” (i.e. with individual portfolios above EUR 8bn) represent 4.4% of the volume and 4.5% of the number of counterparties; and counterparties classified in the “Estimated Category 3” (i.e. with individual portfolios below EUR 8bn) represent 1.1% of the volume and 94.3% of the number of counterparties.
59. In the Credit derivative asset class, clearing members (Category 1) represent 85.6% of the volume and 0.7% of the number of counterparties; counterparties classified in the “Estimated Category 2” (i.e. with individual portfolios above EUR 8bn) represent 9.3% of the volume and 5.9% of the number of counterparties; and counterparties classified in the “Estimated Category 3” (i.e. with individual portfolios below EUR 8bn) represent 5.1% of the volume and 93.5% of the number of counterparties.
60. Those numbers should be adjusted to take into account the fact that there are three types of transactions (transactions between 2 large entities, transactions between 1 large and 1 small entity, and transactions between 2 small entities) and that postponing the clearing obligation for small entities means a postponement of the second and third types.
61. Taking the example of the interest rate derivative market, if the clearing obligation is postponed for Category 3, this means that 2.2% (maximum¹⁷) of the volume will be delayed for the clearing obligation.
62. Based on those figures and even with the adjustment described above, it can be concluded that the current system of counterparty classification is quite efficient in identifying, in Category 3, the small and less systemically important counterparties (1-5% of the volume), which actually account for the vast majority of the counterparties (93-94%).

¹⁷ Assuming that the share of transactions between 2 large entities is A (not postponed), the share of transactions between 1 large and 1 small entity is B (postponed), and the share of transactions between 2 small entities is C (postponed). To maximise the postponed volumes we assume that C=0. We have $B + C = B + 0 = 1.1\%$ and $A+B = 98.9\%$ hence $A = 98.9 - 1.1 = 97.8\%$. Hence the non-postponed volumes are 97.8% and the postponed volumes are 2.2%.

Figure 5

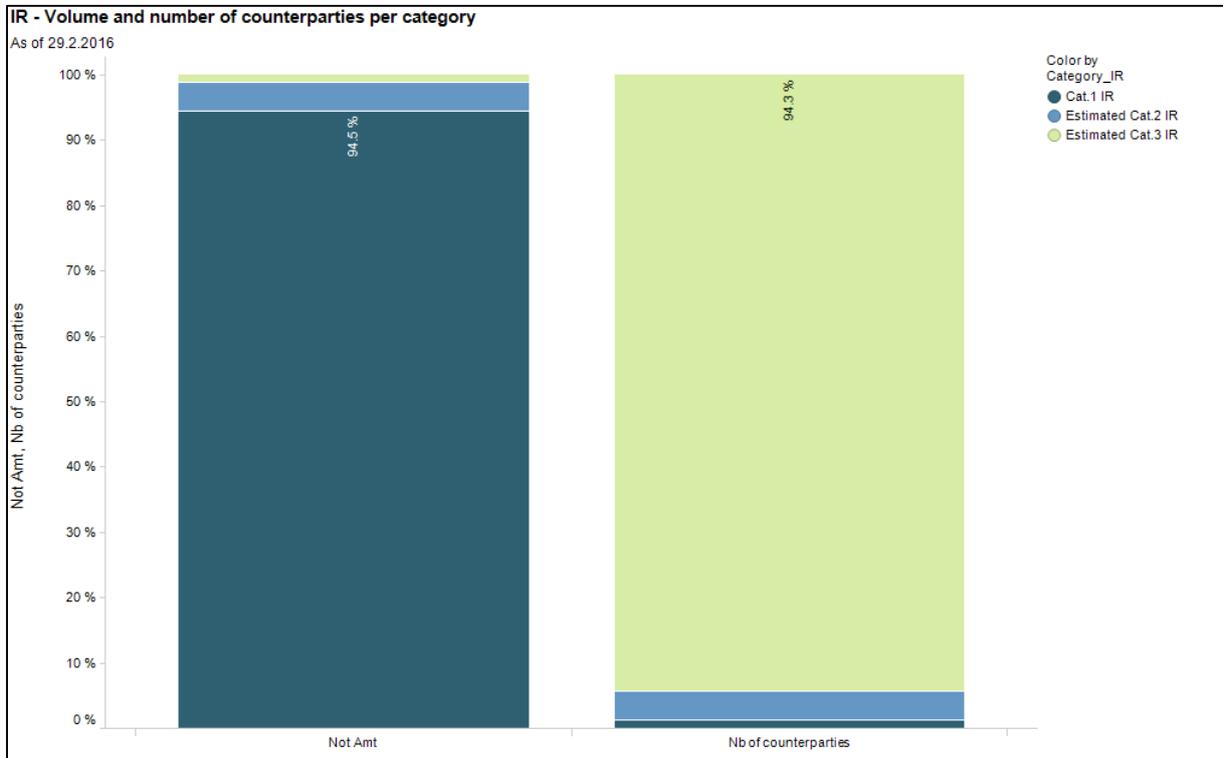
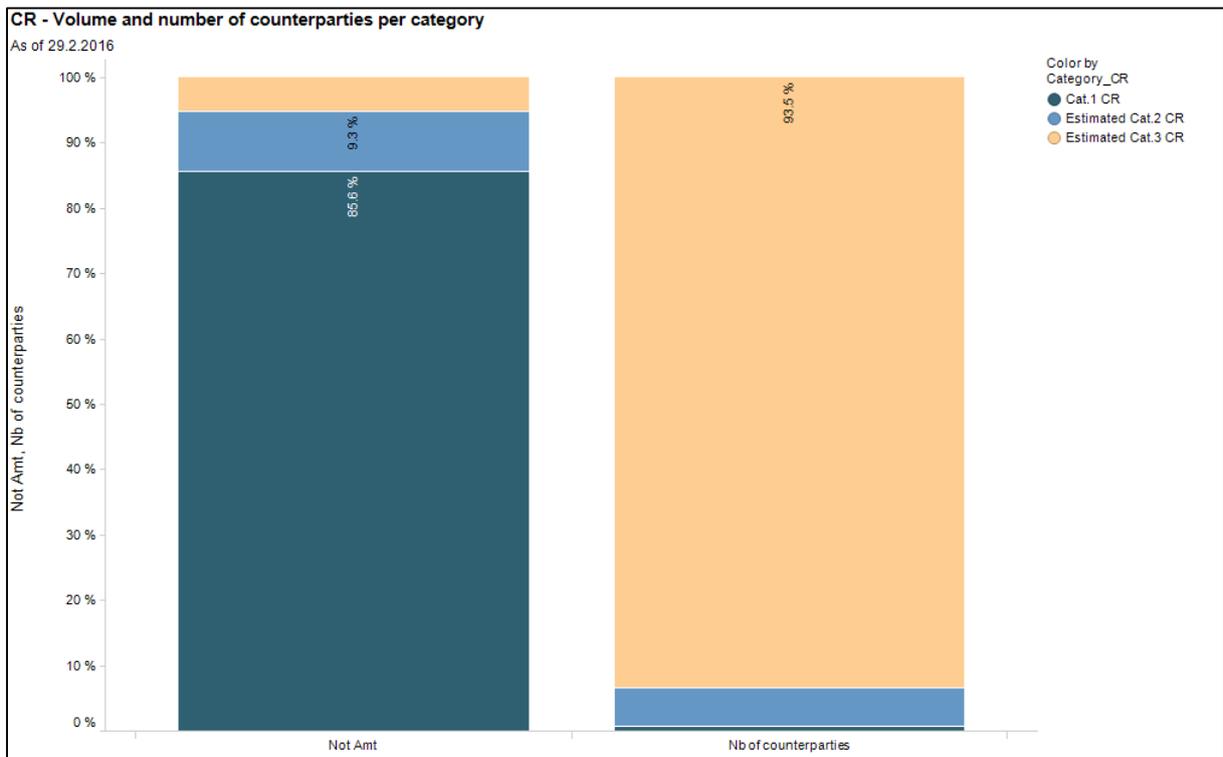


Figure 6



63. Figure 7 (for Interest rate derivatives) and Figure 8 (for Credit derivatives) below provide additional information on the percentage of counterparties and the volume in each of the three categories, this time broken down per EU country.

64. The classification leads to a number of counterparties in the Estimated Category 3 that is so important (and even more so because of the approximation previously discussed) that, in a number of countries, all counterparties are classified in the Estimated Category 3: there are 9 such countries in the Interest rate derivative asset class (Figure 7) and 5 such countries in the Credit derivative asset class (Figure 8).

65. The consequence is that, in those countries, delaying the application of the clearing obligation for counterparties in Category 3 could result in delaying the entire application of the clearing obligation. In reality however, it is possible that some counterparties are ultimately classified in Category 2 because they belong to a larger group.

66. For example, focusing on the Credit asset class in some countries where the number of relatively small counterparties is important, a significant proportion of counterparties are classified in the Estimated Category 3, and the aggregate volume of those small counterparties adds up to the majority of the volume in those countries.

Figure 7

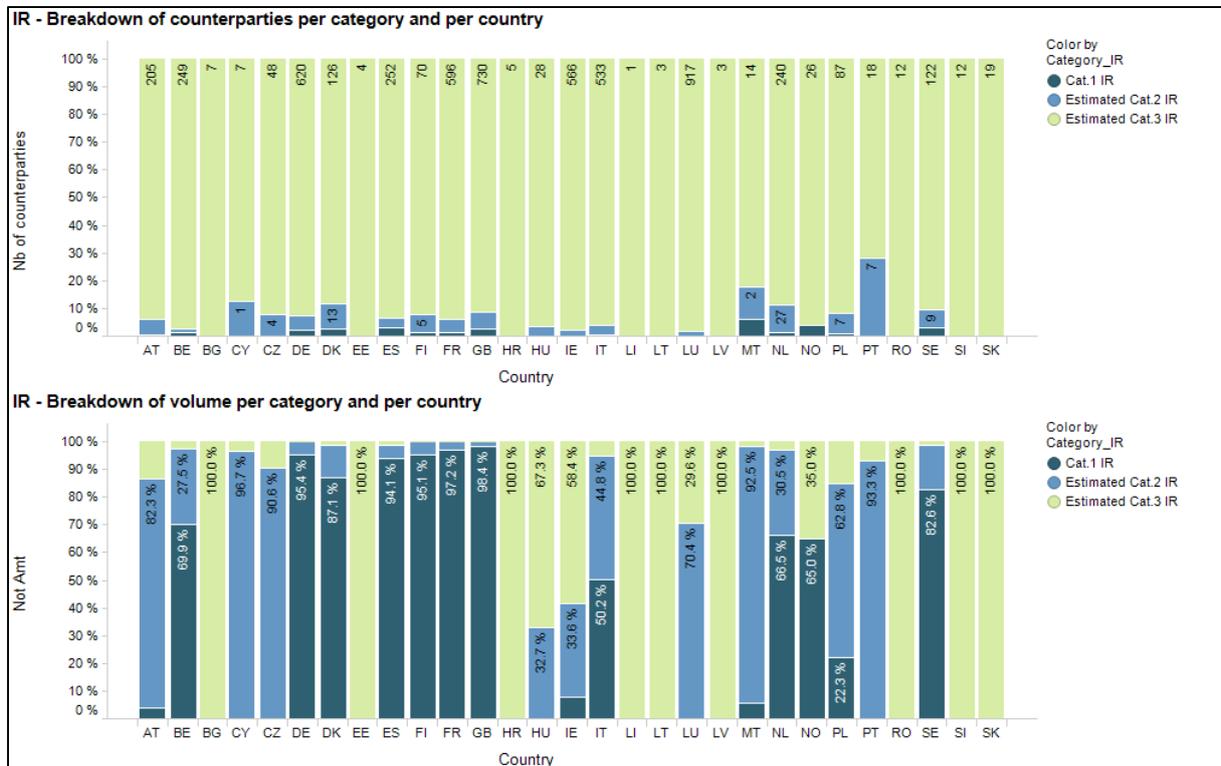
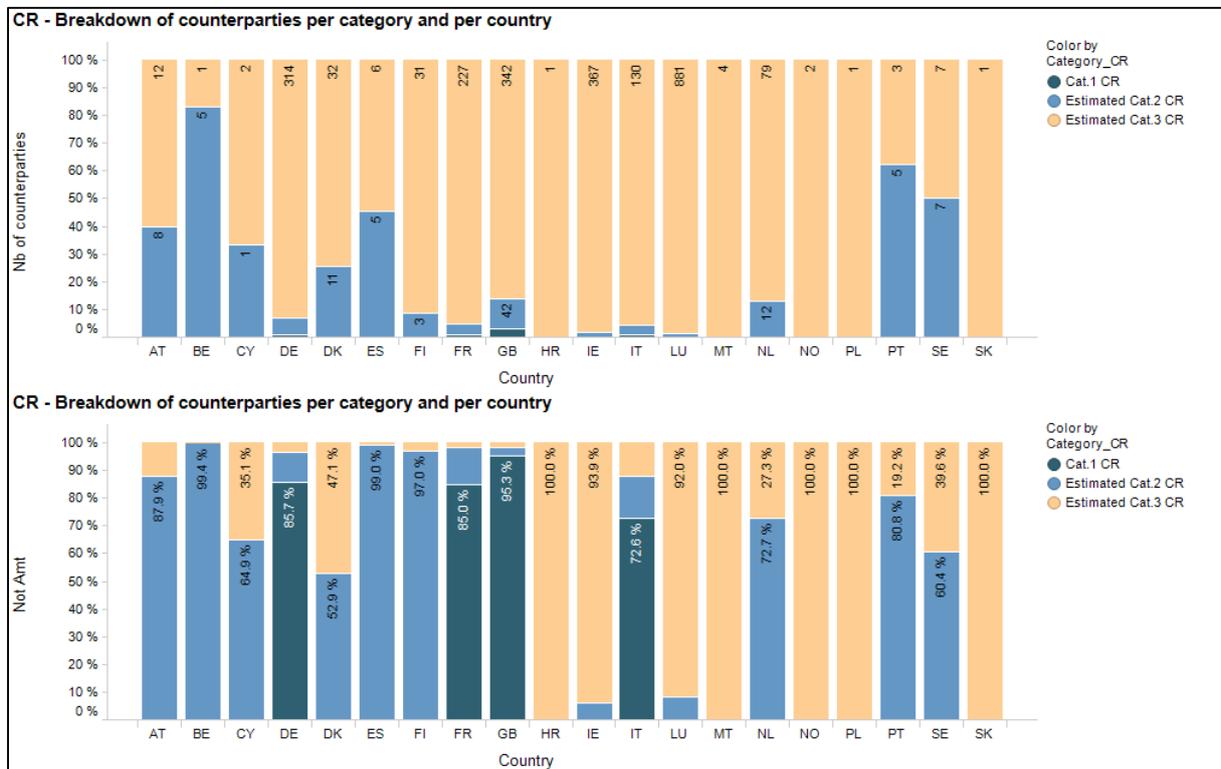


Figure 8



67. As further detailed in the Cost-Benefit Analysis (see Annex 4) a proposal to rely on the existing Category 3 to define financial counterparties with a limited volume of activity (and therefore to extend the phase-in period for Category 3) has the following advantages and limitations:

Advantages

- It is simple, as it relies on an existing system. Counterparties are expected to have already determined the category of counterparty to which they belong or at least to have started the process. This limits compliance costs;
- It is based on a quantitative threshold, and therefore it takes into account the volume of activity of the counterparties in OTC derivatives (although at group level as further discussed below);
- It is consistent with the current compliance schedule, as it affects only Category 3 (whose first compliance deadline is currently 21 June 2017). Indeed, any proposal affecting the phase-in period applicable to Category 2 would introduce unnecessary confusion shortly before the current compliance deadline for this category, which is 21 December 2016.

Limitations

- It is possible that in certain countries, all the counterparties are classified in Category 3. Under this proposal, the clearing obligation would be delayed for the whole country;
- The activity of the counterparties is assessed at group level. Therefore, a counterparty with limited activity may be in Category 2 only because it is part of a large group. However, belonging to a large group should help those financial counterparties in establishing clearing arrangements;
- The monitoring of compliance of the current classification system is complex because of (1) the absence of information on the group structure in TR data, and (2) the fact that access to trade repositories is provided to competent authorities at national level (hence competent authorities cannot aggregate the activity of international groups and replicate the classification system with TR data).

68. Given that the proposal is by nature temporary, we consider that the advantages of simplicity, compliance cost and predictability outweigh the technical limitations.

69. Indeed, even if it could result in a postponement in the application of the clearing mandate in certain member states, this approach would provide relief to a significant number of financial counterparties with a limited volume of activity while minimising, at EU level, the volume of OTC derivatives for which mandatory clearing would be postponed.

70. Therefore, the approach proposed in the draft RTS included in Annex 5 is to keep the categories of counterparties as they are, and to modify only the date of application of the clearing obligation for counterparties in Category 3.

Question 5: Do you agree with the proposal to keep the definitions of the categories of counterparties as they currently are and to postpone the date of application of the clearing obligation for Category 3? If not, which alternative would achieve a better outcome?

4.3 New phase-in period for Category 3

71. In the two Commission Delegated Regulations on the clearing obligation which have already entered into force, the date on which the clearing obligation starts to apply for counterparties in Category 3 was set 18 months after the date of entry into force of the respective regulations.

72. The phase-in periods were calculated taking into account the relevant criteria defined in EMIR and in particular:

- the period of time a counterparty subject to the clearing obligation needs in order to put in place clearing arrangements¹⁸: based on the feedback received to the public consultations and on ESMA's analysis, it was estimated that such time period was approximately 18 months for counterparties in Category 3¹⁹;
- whether more than one CCP already clear the same class of OTC derivatives²⁰: a period of 3 months was added to the phase-in in the second Delegated Regulation to take into account the fact that only one CCP was authorised to clear the index CDS classes on which a clearing obligation was proposed²¹.

73. As developed in Section 2.2, the estimated period of time that financial counterparties with a limited volume of activity need to establish clearing arrangements may have been underestimated. Indeed, the new phase-in period for Category 3 should take into account the relevant regulatory developments and the implementation thereof, in particular:

- the draft RTS on indirect clearing arrangements, submitted to the European Commission but not yet adopted. This new framework is expected to increase the possibility for financial counterparties with a limited volume of activity to indirectly access CCPs, but some time is still needed for the draft RTS to be adopted and implemented;
- the finalisation of the leverage ratio framework globally, and how this finalised framework would be taken into account in the EU under CRR, which is expected to be taking place over the coming months and years, and which will have an impact on the appetite of clearing members to provide client clearing.

74. It is assumed that those regulatory initiatives tend to increase the period of time counterparties need to finalise their preparation for the clearing obligation.

75. Although this period of time is difficult to quantify, it is expected that the implementation of the new regulatory framework will take some time. Therefore, the approach proposed in the draft RTS included in Annex 5 is to extend the phase-in period applicable to Category 3, by adding two years to the current compliance deadlines.

Question 6: Do you agree with the proposal to modify the phase-in period applicable to Category 3, by adding two years to the current compliance deadlines?

¹⁸ Criteria (e) of Article 5(5) of EMIR

¹⁹ Recital (10) of the 1st Delegation Regulation on the clearing obligation and Recital (9) of the 2nd Delegation Regulation on the clearing obligation

²⁰ Criteria (b) of Article 5(5) of EMIR

²¹ Recital (8) (for counterparties in Category 1) and Recital (9) (for counterparties in Category 2 and 3) of the 2nd Delegation Regulation on the clearing obligation

4.4 Scope of the proposed amendment

76. As of the date of publication of this paper, two Commission Delegated Regulations on the clearing obligation have entered into force, one on interest rate swaps in the G4 currencies and one on certain European index CDS.
77. In addition, on 10 November 2015 ESMA submitted to the European Commission a third draft RTS on the clearing obligation covering interest rate swaps denominated in NOK, PLN and SEK. As of the date of publication of this consultation paper, the European Commission has endorsed those RTS, but the corresponding Commission Delegated Regulation has not yet been published in the Official Journal as it is subject to a non-objection period by the European Parliament and the Council.
78. Although there is less urgency to modify the second and third Delegated Regulations -- as the dates of application included therein are set a few months after those of the first Delegated Regulations -- ESMA is proposing to modify the date of application of Category 3 in the three sets of rules at the same time.
79. Indeed, this approach would avoid that ESMA launches a similar consultation in a few months to amend the other Delegated Regulations for the same reasons.
80. Should ESMA decides to submit the proposals included in this consultation paper to the Commission, it is currently estimated that, by the time of such submission, the third Delegated Regulation on the clearing obligation will have entered into force. It should therefore be possible to amend it at the same time as the two other delegated regulations on the clearing obligation.
81. As a result, the draft RTS that are included in Annex 5 propose amendments to Commission Delegated Regulation (EU) 2015/2205, to Commission Delegated Regulation (EU) 2016/592 and also to the expected third Commission Delegated Regulation on interest rate swaps denominated in NOK, PLN and SEK.

Question 7: Do you agree with the proposal to modify the three Commission Delegated Regulations on the clearing obligation at the same time?

5 Annexes

5.1 Annex 1: Summary of the questions

Question 1: To which category of counterparties does your organisation belong: (1) in the context of the 1st Commission Delegated Regulation on the clearing obligation, and (2) in the context of the 2nd Commission Delegated Regulation on the clearing obligation?

Question 2: If you offer clearing services, please provide evidence on the constraints that would prevent you from offering clearing services to a wider range of clients.

Question 3: Have you already established clearing arrangements (1) for interest rate swaps? (2) for credit default swaps? If not, please explain why (including the difficulties that you may be facing in establishing such arrangements) and provide an estimation of the time needed to finalise the arrangements.

Question 4: Please provide information and data you may have that could complement this analysis on the level of experience and preparedness of financial counterparties with CCP clearing.

Question 5: Do you agree with the proposal to keep the definitions of the categories of counterparties as they currently are and to postpone the date of application of the clearing obligation for Category 3? If not, which alternative would achieve a better outcome?

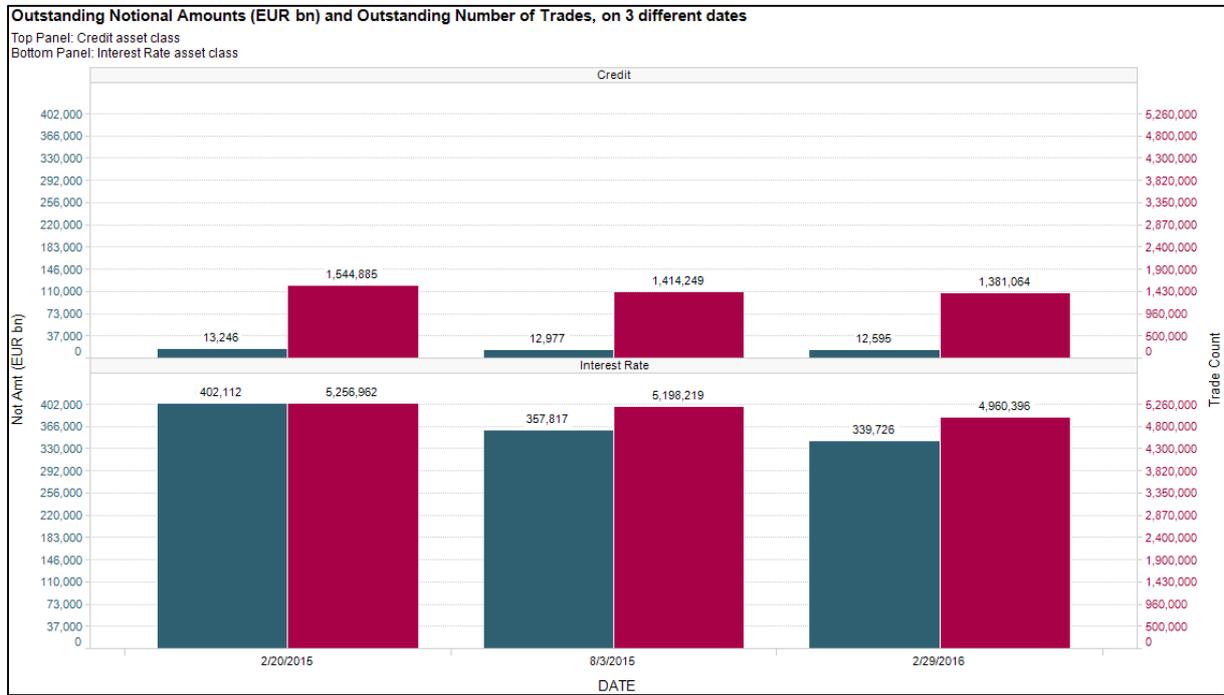
Question 6: Do you agree with the proposal to modify the phase-in period applicable to Category 3, by adding two years to the current compliance deadlines?

Question 7: Do you agree with the proposal to modify the three Commission Delegated Regulations on the clearing obligation at the same time?

5.2 Annex 2: Overview of the dataset

1. The quantitative analysis presented in this paper was performed on the basis of data sourced from all the registered European Trade Repositories, on three different dates covering a timespan of one year: 20 February 2015, 3 August 2015 and 29 February 2016. Looking at data on three different dates allows to check for the consistency of the statistics, and to establish some trends, to the extent possible.
2. The analysis relies on trade state reports, i.e. reports which represent the outstanding volume (stock), as opposed to transaction reports which represent the executed volume (flow).
3. Statistics are provided for OTC interest rate and OTC credit derivatives, as those are the two only asset classes on which a clearing obligation currently exists.
4. The analysis addresses the issues of the clearing obligation for financial counterparties (FC) hence only the transactions of FCs have been included and any reference to counterparties in the following lines shall be understood as meaning financial counterparties.
5. The data has been subject to thorough cleaning processes. The most important steps are summarised below:
 - Elimination of duplicated reports;
 - Elimination of trades where the counterparty ID is not an LEI: this ensures that each counterparty is counted only once and that the statistics on the number of counterparties are not biased to the upside. In addition, information on the country of the counterparty can only be retrieved accurately when the counterparty is identified with an LEI;
 - Elimination of compressed trades and intragroup transactions: this allows to focus on price forming transactions and avoids trade duplication (as intragroup trades are mainly a duplication of one transaction at group level);
 - Elimination of outliers based on notional amounts: for each date, product ID (CR or IR) and depending on whether the trade was cleared or not, we calculated the mean and standard deviation of the notional amounts in EUR (taken in naturel logarithms). Observations were considered as outliers and thus removed from the dataset if their notional amount in natural logarithm was more than three standard deviations above the mean.
6. The graph below provides an overview of the dataset on which this analysis is based, measured by outstanding notional amounts and outstanding number of trades (Figure 9).

Figure 9



5.3 Annex 3: Legislative mandate to develop technical standards

Article 5 of Regulation (EU) No 648/2012

Clearing obligation procedure

2. Within six months of receiving notification in accordance with paragraph 1 [of Article 5] or accomplishing a procedure for recognition set out in Article 25, ESMA shall, after conducting a public consultation and after consulting the ESRB and, where appropriate, the competent authorities of third countries, develop and submit to the Commission for endorsement draft regulatory technical standards specifying the following:

- (a) the class of OTC derivatives that should be subject to the clearing obligation referred to in Article 4;
- (b) the date or dates from which the clearing obligation takes effect, including any phase in and the categories of counterparties to which the obligation applies; and
- (c) the minimum remaining maturity of the OTC derivative contracts referred to in Article 4(1)(b)(ii).

Power is delegated to the Commission to adopt regulatory technical standards referred to in the first subparagraph in accordance with Articles 10 to 14 of Regulation (EU) No 1095/2010.

5.4 Annex 4: Cost Benefit Analysis

1. This cost-benefit analysis was conducted by ESMA while developing the amendments to the delegated regulations on the clearing obligation.
2. The scope of the cost-benefit analysis is strictly limited to the elements of the delegated regulations on the clearing obligation which are proposed to be amended, i.e. the phase-in period for counterparties with a limited volume of activity in OTC derivatives.

Policy Objective	Determine the categories of counterparties in respect of which the date of application of the clearing obligation should be postponed
Option 1	Rely on the existing classification of counterparties (defined in the delegated regulations on the clearing obligation) and postpone the date of application for the counterparties in Category 3.
Option 2	Define a new system of counterparty classification to replace the existing one, and postpone the date of application for one of the new categories.
Preferred Option	Option 1

Option 1	Rely on the existing classification of counterparties (defined in the delegated regulations on the clearing obligation) and postpone the date of application for the counterparties in Category 3.
	Qualitative description
<i>Benefits</i>	The option is simple as it fully relies on an existing system of counterparty classification. This existing system is based on the level of activity in OTC derivatives of counterparties at group level. Therefore, it is linked, to some extent, to the level of legal and operational capacity of counterparties regarding OTC derivatives, but in an imperfect way. Indeed, even when the degrees of sophistication of two counterparties belonging to the same group are different, they will be classified in the same category of counterparties and be subject to the clearing obligation at the same time.
<i>Costs to regulator</i> One-off ²²	This option is the baseline scenario and does not add any compliance costs compared to the existing framework. Counterparties are already required to perform this counterparty classification under the delegated

²² On-going costs are irrelevant with respect to phase-in.

<p><i>Compliance costs</i></p> <p>One-off</p>	<p>regulations on the clearing obligation. It should however be noted that for the regulators monitoring the activity of financial counterparties at group level is not immediate and not possible through the data collected by trade repositories.</p>
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<p>Option 2</p>	<p>Define a new system of counterparty classification to replace the existing one, and postpone the date of application for one of the new categories.</p>
	<p>Qualitative description</p>
<p><i>Benefits</i></p>	<p>This option provides more flexibility to design an ad hoc framework, with the specific purpose of identifying the counterparties that are facing the most difficulties in setting up their clearing arrangements.</p> <p>For example, several thresholds could be set at asset class level, and the clearing obligation would be postponed only for the counterparties with individual portfolio size below the threshold, in each asset class. With such a framework, the differences in the absolute sizes of each asset class would be addressed more appropriately than with Option 1.</p> <p>With this option it would be possible to target more precisely the counterparties with a limited volume of activity, hence to postpone the clearing obligation for a more limited share of OTC derivative markets, which in turn is positive for the global reduction of systemic risk.</p>
<p><i>Costs to regulator</i></p> <p>One-off²³</p>	<p>The costs would be proportionate to the level of complexity of the adopted classification system. In the example taken above, regulators would need to check the classification at individual level, which is expected to be less costly for regulators than Option 1.</p>
<p><i>Compliance costs</i></p> <p>One-off</p>	<p>The costs would be proportionate to the level of complexity of the adopted classification system. In all cases, the overall costs are expected to be significant as it would require several thousands of counterparties to perform, once more, a self-classification based on quantitative elements, and to communicate this information to all their counterparties.</p> <p>Furthermore, a new classification system would introduce uncertainty for entities classified in different categories than category 3 and this uncertainty would remain until the publication in the official journal of</p>

²³ On-going costs are irrelevant with respect to phase-in.

	the amended technical standards. This uncertainty would further exacerbate the compliance cost.
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5.5 Annex 5: Draft technical standards

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

of [.]

amending Commission Delegated Regulation (EU) 2015/2205 of 6 August 2015, Commission Delegated Regulation (EU) 2016/592 of 1 March 2016 and Commission Delegated Regulation (EU) [yyyy/xxx] of dd mm yyyy, supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on the clearing obligation

(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 ⁽²⁴⁾, and in particular Article 5(2) thereof,

Whereas:

- (1) To ensure a timely and orderly application of the clearing obligation, different phase-in periods apply to different categories of counterparties.
- (2) The categories of counterparties are defined in Commission Delegated Regulation (EU) 2015/2205 of 6 August 2015 supplementing Regulation (EU) No 648/2012²⁵, Commission Delegated Regulation (EU) 2016/592 of 1 March 2016 supplementing Regulation (EU) No 648/2012²⁶ and Commission Delegated Regulation (EU) [yyyy/xxx] [Insert reference to the 3rd Delegated Regulation on the clearing obligation] supplementing Regulation (EU) No 648/2012²⁷ (the Delegated Regulations on the clearing obligation) for the purposes of the respective clearing obligations. In those categories, counterparties are grouped according to their levels of legal and operational capacity regarding OTC derivatives, which is related to their levels of activity in OTC derivatives.
- (3) The date on which the clearing obligation takes effect for counterparties in Categories 2 and 3 takes into account the fact that most of them can only get access to a CCP by becoming a client or an indirect client of a clearing member.
- (4) However, counterparties with the smallest level of activity in OTC derivatives (i.e. those in Category 3) are facing important difficulties in preparing the arrangements with clearing members that are necessary for clearing the contracts, due to complexities affecting both types

⁽²⁴⁾ [OJ L 201, 27.7.2012, p. 1.](#)

⁽²⁵⁾ OJ L 314, 1.12.2015, p. 13.

⁽²⁶⁾ OJ L 103, 19.4.2016, p. 5.

⁽²⁷⁾ [Insert OJ reference to the 3rd Delegated Regulation on the clearing obligation]

of access, client clearing and indirect client clearing which were not foreseen at the time the proposals related to the clearing obligation were developed.

- (5) First, in relation to client clearing, recent evidence suggests that clearing members find little incentives to develop extensively their client clearing offer because of cost issues, and even more so for clients with limited activity in OTC derivatives. In addition, the final regulatory framework on the capital requirements applicable in relation to exposure from client clearing activity has not been finalised yet, and this creates uncertainties that act as an impediment to a broad development by clearing members of their client clearing offer.
- (6) Second, in relation to indirect clearing arrangements, counterparties are currently unable to access CCPs by becoming an indirect client of a clearing member, because of the scarcity of the offer. ESMA has reviewed the rules set out in Commission Delegated Regulation (EU) No 149/2013²⁸ and has submitted amending draft technical standards to the Commission on 26 May 2016. One objective of these new draft rules is to promote and simplify this type of access for counterparties, with the expectation that the indirect clearing offer could increase.
- (7) To take those difficulties and regulatory developments into account, it is necessary to modify the dates on which the clearing obligation takes effect for counterparties in Category 3 in the Delegated Regulations on the clearing obligation and to provide those counterparties with an additional period of time to finalise the necessary clearing arrangements.
- (8) The regulatory framework influencing the capacity of counterparties to access CCPs via client or indirect client clearing arrangements is still evolving and is not expected to be fully implemented in the short to medium term. The dates on which the clearing obligation takes effect for counterparties in Category 3 should therefore be set in accordance with this timing uncertainty.
- (9) Given that counterparties in Category 3 account for a relatively limited share of the global volume in OTC derivative market, the modification of the dates of application for this category does not compromise the overarching objective of the clearing obligation, which is the reduction of systemic risk.
- (10) This Regulation is based on draft regulatory technical standards submitted by the European Securities and Markets Authority (ESMA) to the Commission.
- (11) ESMA has conducted an open public consultation on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits, requested the opinion of the Securities and Markets Stakeholder Group established by Article 37 of Regulation (EU) No 1095/2010, and consulted the European Systemic Risk Board,

HAS ADOPTED THIS REGULATION:

Article 1

Amendment to Commission Delegated Regulation (EU) 2015/2205

⁽²⁸⁾ OJ L 52, 23.2.2013, p. 11.

Point (c) to Article 3(1) of Commission Delegated Regulation (EU) 2015/2205 is replaced by the following:

'(c) 21 June 2019 for counterparties in Category 3;'

Article 2

Amendment to Commission Delegated Regulation (EU) 2016/592

Point (c) to Article 3(1) of Commission Delegated Regulation (EU) 2016/592 is replaced by the following:

'(c) 9 February 2020 for counterparties in Category 3;'

Article 3

Amendment to Commission Delegated Regulation (EU) [yyyy/xxx]

Point (c) to Article 3(1) of Commission Delegated Regulation (EU) [yyyy/xxx] [Insert reference to the 3rd Delegated Regulation on the clearing obligation] is replaced by the following:

'(c) [entry into force of the regulation + 3.5 years] for counterparties in Category 3;'

Article 4

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