



Briefing Note on the EU Mandatory Clearing Obligation

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Document Context

This briefing note highlights certain details in respect of the implementation of the mandatory clearing obligation for certain classes of OTC derivatives under the European Market Infrastructure Regulation (EMIR)¹. It is not an exhaustive summary of all relevant factors and it is provided for information purposes only. It is based on publically available information as at 9th September 2016, which may be subject to change. You should seek your own legal advice in respect of the implementation of the EU mandatory clearing obligation.

The European Securities and Markets Authority (ESMA) commissioned four consultations in respect of the mandatory clearing obligation covering certain:

- interest rate derivatives (IRD) denominated in the G4 currencies of USD, EUR, GBP and JPY;
- certain credit default swap (CDS) indices;
- IRD denominated in respect of certain EEA currencies; and
- Foreign exchange non-deliverable forwards (NDFs).

G4 IRD

The Regulatory Technical Standards (RTS) proposed by ESMA in respect of certain G4 IRDs were endorsed by the European Commission (EC) on 6th August 2015 and published in the Official Journal of the European Union (OJ) on 1st December 2015. The RTS can be accessed at the following link: <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32015R2205&rid=1>.

In accordance with the standard European legislative procedure the RTS entered into force 20 days after publication, on the 21st December 2015. The RTS provide for the clearing obligation to be phased in with different mandatory clearing start dates applying to different types of counterparties subject to the clearing obligation.

CDS

The RTS proposed by ESMA expanding mandatory clearing under EMIR to cover certain CDS contracts were endorsed by the EC on 1st March 2016 and published in the OJ on 19th April 2016. The RTS can be accessed at the following link: <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016R0592&from=EN>.

The RTS entered into force on 9th May 2016 (20 days after publication), and similarly provide for different phase-in dates for different counterparties.

EEA IRD

The RTS proposed by ESMA expanding mandating clearing to cover certain IRDs denominated in NOK, SEK and PLN were endorsed by the EC on 10th June 2016 and published in the OJ on 20th July 2016. The RTS, together with a Corrigenda to the originally published form of the RTS, can be accessed at the following links:

RTS - <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016R1178&from=EN>

Corrigenda - [http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016R1178R\(01\)&from=EN](http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016R1178R(01)&from=EN)

¹ Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories



The RTS entered into force on 9th August 2016 (20 days after publication), and similarly provide for different phase-in dates for different counterparties.

NDF

ESMA held a consultation in respect of the mandatory clearing of certain NDF currency pairs in October 2014. Following this consultation, ESMA decided in February 2015 not to propose a mandatory clearing obligation for NDF transactions. ESMA has reserved its position to revisit this in the future. ESMA's feedback statement on the NDF consultation can be accessed at the following link:
https://www.esma.europa.eu/sites/default/files/library/2015/11/2015-esma-234_-_feedback_statement_on_the_clearing_obligation_of_non_deliverable_forward.pdf

The following summary appraises the current status in respect of the four consultation / legislative processes detailed above.

Status of final RTS for mandatory clearing

<i>Scope</i>	<i>Status</i>
IRD – G4 CCYs	RTS entered into force 21 st Dec 2015
CDS – ITraxx Indices	RTS entered into force 9 th May 2016
IRD – Extension to further EEA currencies	RTS Entered into force 9 th Aug 2016
<i>NDF Products</i>	<i>Not taken forward at this time.</i>



ESMA Mandatory Clearing RTS Overview

G4 IRD Product Scope

- EUR, GBP, JPY, USD **Basis Swaps** (all 28D-50Y maturity except JPY which is 28D-30Y)
- EUR, GBP, JPY, USD **Fixed-to-Float Interest Rate Swaps** (all 28D-50Y maturity except JPY which is 28D-30Y)
- EUR, GBP, USD **Forward Rate Agreements** (all 3D-3Y maturity)
- EUR, USD, GBP **Overnight Index Swaps** (all 7D-3Y maturity)
- OTC derivatives concluded with covered bond issuers or with cover pools for covered funds are out of scope provided that the conditions that are described in the RTS are met. Please refer to the RTS for further details of these conditions.

CDS Product Scope

- CDS - iTraxx Europe Main and iTraxx Europe Crossover (Untranching, 5y tenor and series 17 onwards for both indices).

EEA IRD Product Scope

- EEA IRD - NOK, PLN, SEK **Fixed-to-Float Interest Rate Swaps** (all 28D-10Y maturity except SEK which is 28D-15Y) and NOK, PLN, SEK **Forward Rate Agreements** (all 3D-2Y maturity except SEK which is 3D-3Y)
- The EEA IRD RTS contains the same exemption regarding covered bond issuers and transactions with cover pools for covered funds, provided that the conditions that are described in the RTS are met. Please refer to the RTS for further details of these conditions.

A full list of products and further details in respect of these products can be seen in the appendix below.



Categories of Counterparties Subject to the Clearing Obligation

Category 1	Category 2	Category 3	Category 4
Existing Clearing Members of authorised EU and recognised third country CCPs in respect of relevant OTC derivatives subject to clearing obligation as at the date of entry into force of the relevant RTS	Financial Counterparties (FCs) and Alternative Investment Funds (AIFs) that are Non- Financial Counterparties (NFCs) not in Category 1 which belong to a group whose aggregate month-end average of outstanding gross notional amount of non-centrally cleared derivatives (including foreign exchange forwards, swaps and currency swaps) for January, February and March 2016 is above EUR 8 billion. This threshold generally applies at group level but see note on investment funds below	Financial Counterparties and AIFs that are NFCs not in Category 1 or Category 2.	All other NFCs who are above the Clearing Threshold (NFC+s) and are not in Category 1, Category 2 or Category 3.

Category 2 Threshold Calculation

- For AIFs and UCITS, the final RTS for G4 IRD transactions, the draft RTS for CDS transactions and the draft RTS for IRD EEA transactions provide that the categorisation calculation should be completed per single fund instead of at group level. The recitals of each RTS provide that in the event of fund insolvency or bankruptcy, the funds should be distinct legal entities that are not collateralised, guaranteed or supported by other funds or the investment advisor itself.
- The threshold calculation for each RTS is based on a month end average of the outstanding gross notional amount of non-centrally cleared derivatives for the three months following the entry into force of the RTS for G4 IRD transactions and so will be based on calculations for January 2016, February 2016 and March 2016.

Implementation Dates

- The trigger for the mandatory clearing implementation date is the date on which the relevant RTS comes into force, being 20 days after publication of the RTS in the OJ.

Therefore, the start dates for the mandatory clearing obligation for G4 IRD for the different categories of counterparties are:

- Category 1 – 6 months after RTS comes into force – **21 June 2016**;
- Category 2 – 12 months after RTS comes into force – **21 December 2016**;
- Category 3 – 18 months after RTS comes into force – **21 June 2017**;
- Category 4 – 36 months after RTS comes into force – **21 December 2018**.



The start dates for the mandatory clearing obligation for CDS transactions for the different categories of counterparties are:

- Category 1 – 9 months after RTS comes into force – **9 February 2017**;
- Category 2 – 15 months after RTS comes into force – **9 August 2017**;
- Category 3 – 21 months after RTS comes into force – **9 February 2018**;
- Category 4 – 36 months after RTS comes into force – **9 May 2019**.

The start dates for the mandatory clearing obligation for EEA IRD transactions for the different categories of counterparties are:

- Category 1 – 6 months after RTS comes into force – **9 February 2017**;
- Category 2 – 12 months after RTS comes into force – **9 August 2017**;
- Category 3 – 18 months after RTS comes into force – **9 February 2018**;
- Category 4 – 36 months after RTS comes into force – **9 August 2019**.

Where a transaction is concluded between two counterparties in different categories, the clearing obligation will take effect at the later date of implementation.

Please note that Pension Scheme Arrangements may benefit from a transitional exemption from the mandatory clearing obligation. Details on this can be found in Appendix 2.

Frontloading

EMIR provides for transactions that have been entered into before the clearing obligation comes into effect to be subject to the clearing obligation when it comes into effect, where such transactions have a minimum remaining maturity above a certain threshold. The European legislative bodies have recognised the risks and challenges associated with these frontloading requirements set out in EMIR. The structure of each RTS utilises the minimum remaining maturity to minimise the impact of frontloading:

- Frontloading had a staggered start between Category 1 and Category 2 entities for the G4 IRD RTS, which allowed entities that may be Category 2 entities or Category 3 entities to determine their category classification.
- There is no frontloading requirement on trades where Category 3 or Category 4 entities are a party.
- Frontloading will not apply to trades where a NFC is a party regardless of clearing category.
- All trades with a minimum remaining maturity of less than 6 months at the date on which the clearing obligation comes into effect will be exempted from the frontloading obligation.

The start dates for the frontloading requirement for G4 IRD are:

- Category 1 – 2 months after RTS come into force – **21 February 2016**;
- Category 2 – 5 months after RTS come into force – **21 May 2016**;
- Category 3 – No frontloading requirement
- Category 4 – No frontloading requirement

Where a transaction is concluded between two counterparties in different categories, the frontloading requirement will take effect at the later date of implementation.



The relevant frontloading timelines set out in the draft CDS RTS are:

- Category 1 – 5 months after RTS come into force – **9 October 2016;**
- Category 2 – 5 months after RTS come into force – **9 October 2016;**
- Category 3 – No frontloading requirement
- Category 4 – No frontloading requirement

The difference between the G4 IRD RTS and the CDS RTS reflects the fact that Category 2 and 3 entities should know their category already so there is no need for a staggered implementation. The reason for the longer period of 5 months was due to there being only one EU CCP authorised to clear the CDS transactions that will be subject to the clearing obligation when the CDS RTS was published in the OJ.

The relevant frontloading timelines set out in the EEA IRD RTS are:

- Category 1 – 2 months after RTS come into force – **9 October 2016;**
- Category 2 – 2 months after RTS come into force – **9 October 2016;**
- Category 3 – No frontloading requirement
- Category 4 – No frontloading requirement

Intra-group transactions

Transactions between two counterparties that are in the same group that would otherwise be subject to a clearing obligation may be exempt from the clearing obligation if certain requirements are met. Such requirements are set out in full in EMIR and include notifications to relevant national competent authorities.

One of the requirements for intragroup transactions concluded between a counterparty established in the EU and a counterparty established elsewhere is that the EC has adopted an equivalence decision under Article 13 EMIR in respect of the jurisdiction of the counterparty established outside of the EU. So far, no such equivalence decisions have been adopted. As a result, each RTS contains derogation from the general clearing obligation so that:

- Transactions between counterparties which are part of the same group where one of the entities is established outside of the EU and the other entity is established in the EU are subject to a general exemption from the clearing obligation for a period of three years from the date the RTS enters into force, provided that no relevant equivalence decision has been made under Article 13 EMIR.
- If a relevant equivalence decision is made within this three year period, the imposition of the clearing obligation will take place on the later of the dates that the clearing obligation comes into effect or 60 days after the equivalence adoption is made.

In order to qualify the counterparties must also meet certain conditions, as more fully set out in the RTS, and which, for the EU counterparty, includes a notification to its national competent authority.



Appendix 1: Products subject to the Clearing Obligation

Confirmed G4 IRD Product Scope:

Interest rate OTC derivatives classes subject to the clearing obligation

Table 1

Basis swaps classes

id	Type	Reference Index	Settlement Currency	Maturity	Settlement Currency Type	Optionality	Notional Type
A.1.1	Basis	Euribor	EUR	28D-50Y	Single currency	No	Constant or variable
A.1.2	Basis	LIBOR	GBP	28D-50Y	Single currency	No	Constant or variable
A.1.3	Basis	LIBOR	JPY	28D-30Y	Single currency	No	Constant or variable
A.1.4	Basis	LIBOR	USD	28D-50Y	Single currency	No	Constant or variable

Table 2

Fixed-to-float interest rate swaps classes

id	Type	Reference Index	Settlement Currency	Maturity	Settlement Currency Type	Optionality	Notional Type
A.2.1	Fixed-to-float	Euribor	EUR	28D-50Y	Single currency	No	Constant or variable
A.2.2	Fixed-to-float	LIBOR	GBP	28D-50Y	Single currency	No	Constant or variable
A.2.3	Fixed-to-float	LIBOR	JPY	28D-30Y	Single currency	No	Constant or variable
A.2.4	Fixed-to-float	LIBOR	USD	28D-50Y	Single currency	No	Constant or variable



Table 3

Forward rate agreement classes

id	Type	Reference Index	Settlement Currency	Maturity	Settlement Currency Type	Optionality	Notional Type
A.3.1	FRA	Euribor	EUR	3D-3Y	Single currency	No	Constant or variable
A.3.2	FRA	LIBOR	GBP	3D-3Y	Single currency	No	Constant or variable
A.3.3	FRA	LIBOR	USD	3D-3Y	Single currency	No	Constant or variable

Table 4

Overnight index swaps classes

id	Type	Reference Index	Settlement Currency	Maturity	Settlement Currency Type	Optionality	Notional Type
A.4.1	OIS	EONIA	EUR	7D-3Y	Single currency	No	Constant or variable
A.4.2	OIS	FedFunds	USD	7D-3Y	Single currency	No	Constant or variable
A.4.3	OIS	SONIA	GBP	7D-3Y	Single currency	No	Constant or variable



Confirmed CDS product scope:

Credit Default OTC derivatives classes subject to the clearing obligation

European untranched Index CDS Classes

id	Type	Sub-type	Geographical Zone	Reference Index	Settlement Currency	Series	Tenor
B.1.1	Index CDS	Untranched Index	Europe	iTraxx Europe Main	EUR	17 onwards	5Y
B.1.2	Index CDS	Untranched Index	Europe	iTraxx Europe Crossover	EUR	17 onwards	5Y

Confirmed Additional EEA CCY IRD scope:

Table 1

Fixed-to-float interest rate swaps classes

id	Type	Reference Index	Settlement Currency	Maturity	Settlement Currency Type	Optionality	Notional Type
C.1.1	Fixed-to-float	NIBOR	NOK	28D-10Y	Single currency	No	Constant or variable
C.1.2	Fixed-to-float	WIBOR	PLN	28D-10Y	Single currency	No	Constant or variable
C.1.3	Fixed-to-float	STIBOR	SEK	28D-15Y	Single currency	No	Constant or variable

Table 2

Forward rate agreement classes

id	Type	Reference Index	Settlement Currency	Maturity	Settlement Currency Type	Optionality	Notional Type
C.2.1	FRA	NIBOR	NOK	3D-2Y	Single currency	No	Constant or variable
C.2.2	FRA	WIBOR	PLN	3D-2Y	Single currency	No	Constant or variable
C.2.3	FRA	STIBOR	SEK	3D-3Y	Single currency	No	Constant or variable



Appendix 2: Briefing on the Clearing Exemption for Pension Scheme Arrangements

Why is there an exemption?

- Pension schemes typically minimize their allocation of cash to maximize the efficiency and the return for their policyholders.
- At present CCPs are only able to accept variation margin in cash.
- Forcing pension schemes to centrally clear would force them to increase their allocation of cash as a proportion of their assets to cover variation margin.
- To avoid the negative impact of reducing absolute returns on the retirement impact of pensioners, it has been decided to not oblige pension schemes to clear until there is a technical solution for the transfer of non-cash collateral to cover variation margin provided by the CCPs.

Timeframes of the Exemption

- Certain Pension Scheme Arrangements, as defined in Article 2(10) EMIR, had an initial exemption from the EMIR Clearing Obligation until the 16th August 2015.
- The EC has now extended this exemption by a further 2 years to 16th August 2017.

Scope of the Exemption

- The exemption **ONLY** applies to trades that are objectively measurable as reducing investment risks directly relating to the financial solvency of the pension scheme.
- Any trades entered into by a pension scheme arrangement that are not reducing investment risks are still required to be centrally cleared when the clearing obligation applies.
- The obligation for ensuring that the trades are subject to the mandatory clearing obligation exemption lies with the pension scheme or fund/pension manager as they are the only party able to confirm whether the trade qualifies.

Impact of the Exemption on Frontloading

- Qualifying transactions entered into by qualifying Pension Scheme Arrangements will not be subject to frontloading during the exemption period.
- As per the guidance in the ESMA Q&A, only contracts entered into after the exemption expires will have to be cleared, assuming that the relevant contracts fall within the Scope of the Exemption noted above.

Qualification for Exemptions

- The clearing obligation exemption will **ONLY** apply to Pension Scheme Arrangements in the EU and will not apply to pension scheme arrangements established in a third country.
- Each pension fund will need to assess whether it is a qualifying Pension Scheme Arrangement² under EMIR.



- In certain cases approvals will need to be granted by the relevant National Competent Authority (NCA) for the Pension Scheme Arrangement to be able to make use of the exemption.
- In other cases, the exemption will be automatic for Pension Scheme Arrangements for contracts that fall within the Scope of the Exemption noted above.

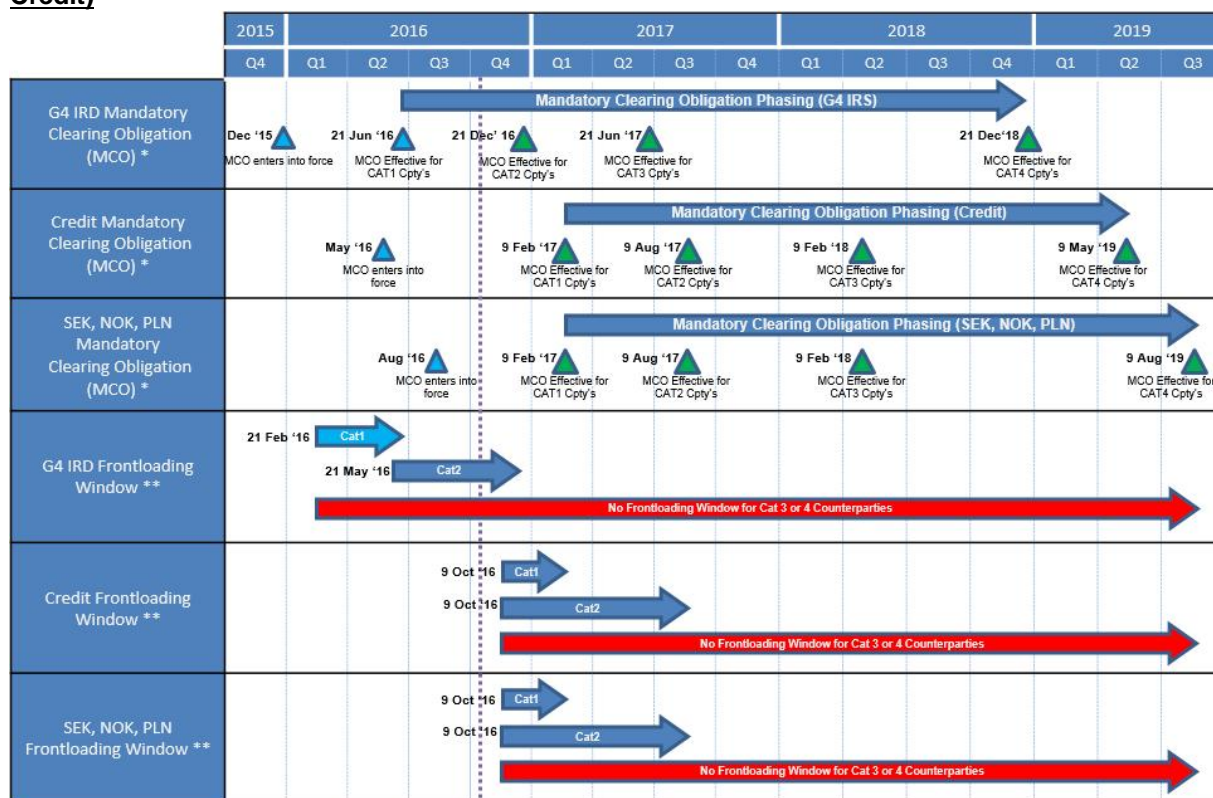
You should consult your legal counsel for guidance on the applicability of the Pension Scheme Exemption, if relevant.

² EMIR Level 1 text - 'pension scheme arrangement' means:

- (a) institutions for occupational retirement provision within the meaning of Article 6(a) of Directive 2003/41/EC, including any authorised entity responsible for managing such an institution and acting on its behalf as referred to in Article 2(1) of that Directive as well as any legal entity set up for the purpose of investment of such institutions, acting solely and exclusively in their interest;
- (b) occupational retirement provision businesses of institutions referred to in Article 3 of Directive 2003/41/EC;
- (c) occupational retirement provision businesses of life insurance undertakings covered by Directive 2002/83/EC, provided that all assets and liabilities corresponding to the business are ring-fenced, managed and organized separately from the other activities of the insurance undertaking, without any possibility of transfer; and
- (d) any other authorised and supervised entities, or arrangements, operating on a national basis, provided that: (i) they are recognized under national law; and (ii) their primary purpose is to provide retirement benefits.



Appendix 3: Mandatory Clearing & Front Loading Timeline (G4 IRD, Additional EEA CCYs & Credit)



* Cat 1 – Clearing Members / Cat 2 – FC's & AIFs (>€8bn) / Cat 3 – FC's & AIFs (<€8bn) / Cat 4 – All other NFC+

** All trades with a Minimum Remaining Maturity of less than 6 months on the date the mandatory clearing obligation applies are not subject to Frontloading



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