

Reply form to the Consultation Paper on the Clearing Obligation under EMIR (no. 2)

AMAFI's contribution

Introduction

Please make your introductory comments below:

Association française des marchés financiers (AMAFI) is the trade organisation working at national, European and international levels to represent financial market participants in France. It acts on behalf of credit institutions, investment firms and trading and post-trade infrastructures, regardless of where they operate or where their clients or counterparties are located. AMAFI has more than 120 members operating for their own account or for clients in different segments, particularly organised and over-the-counter markets for equities, fixed-income products and derivatives. Nearly one-third of its members are subsidiaries or branches of non-French institutions.

The Association has been following closely the preparation and implementation of EMIR and welcomes the opportunity to answer ESMA's Consultation on the Clearing Obligation under EMIR (no. 2), concerning credit derivatives classes.

1. The clearing obligation procedure

Q1. Do you have any comment on the clearing obligation procedure described in Section 1?

AMAFI totally agrees with ESMA's approach, which consists in grouping the analysis of the notified classes of OTC derivatives so as to minimise the set of consultation papers per asset-class (interest rate, credit, foreign-exchange, equity, etc.).

We consider this approach to be convenient and efficient.

The opposite approach, with a submission of separate draft RTS on the clearing obligation upon each CCP authorisation, would not be adapted to the stakeholders' operational and regulatory constraints nor to the applicable deadlines to be complied with.

2. Structure of the credit derivatives classes

- Q2. Do you consider that the proposed structure for the untranching index CDS classes enables counterparties to identify which contracts are subject to the clearing obligation as well as allows international convergence? Please explain.**

Yes. In AMAFI's opinion, the proposed structure for the untranching index CD classes enable counterparties to identify which contracts are subject to the clearing obligation as well as allows international convergence.

3. Determination of the classes of OTC derivatives to be subject to the clearing obligation

- Q3. In view of the criteria set in Article 5(4) of EMIR, do you consider that this set of classes addresses appropriately the systemic risk associated to credit OTC derivatives?**

Given the systemic risk associated to single name CDS, would you argue that they should be a priority for the first determination as well? Please include relevant data or information where applicable.

AMAFI considers that the prioritised set of classes appropriately addresses systemic risk associated to credit OTC derivatives. Hence, AMAFI agrees that single name CDS should not be a priority for the first determination.

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

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

- Q4. Do you have any comment on the analysis presented in Section 4.1?**

AMAFI shares the views of ESMA concerning the analysis presented in Section 4.1. In particular, we welcome the fact that ESMA imposes a clearing obligation on these asset classes on the basis of the existence of at least two CCPs available to clear the contracts belonging to such asset classes.

However, and for the same reason, we are concerned by the content of paragraph 89 of the Consultation Paper, which may imply that, in the future, ESMA would be entitled to launch a clearing obligation procedure even if the contemplated asset classes are cleared by a single CCP at the beginning of the clearing obligation procedure. Indeed, we opine that the clearing obligation of an asset class should be subject to the existence of at least two available CCPs in order to avoid any systemic risk and any monopoly situation, both being detrimental to the investors as well as to the market's efficiency and safety.

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

Q5. Do you agree with the proposal to keep the same definition of the categories of counterparties for the credit and the interest rate asset classes? Please explain why and possible alternatives.

AMAFI globally agrees with the proposal to keep the same definition of the categories of counterparties for the credit and the interest rate asset classes, since this would be beneficial not to have different definitions for each class.

Consequently, we would like to reiterate our concerns expressed in the consultation No 1 on the proposed Category 2, which is large and heterogeneous. We are of the view that this category, combined with the proposed 18 month phase-in and 6 month remaining minimum maturity, presents some important risks, which would not ensure a smooth implementation of the clearing obligation for that category. On the one hand, the long period of 18 months may push a large number of counterparties of Category 2 to wait the last minute before sorting out their clearing arrangements with the risk of putting huge pressure on CCPs and clearing members to clear 18 months worth of trades in a very short period of time. On the other hand, the 6 month remaining minimum maturity proposed for frontloading is much too short as it would impose a frontloading obligation on almost all trades for a very long period of time, therefore implying significant difficulties to price the trades due to uncertainty about future clearing terms. Such uncertainty would likely have an impact on the tradability of some products, and hence on the market liquidity.

Please see our explanations and proposals in our answers to Questions 6 & 7.

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

Q6. Do you consider that the proposed dates of application ensure a smooth implementation of the clearing obligation? Please explain why and possible alternatives.

AMAFI globally agrees with ESMA's proposals, but we wish to point out some concerns on the proposed date of application for the counterparties included in category 2.

More precisely:

- AMAFI supports ESMA's proposal for category 1, that is an entry into force of the clearing obligation 6 months upon the entry into force of the RTS on the clearing obligation. Indeed, this rather short time-period is justified by the status of clearing member and by the fact that a large number of counterparties of this category already clear on a voluntary basis. We even consider that some of these clearing members may be in a position to clear all classes' right as from the entry into force of the RTS. Accordingly, some French financial intermediaries may decide to extend voluntary clearing before the expiration of the 6 month phase-in period;
- AMAFI agrees with ESMA's proposal for category 3 (i.e. an entry into force of the clearing obligation 3 years upon the entry into force of the RTS on the clearing obligation). Indeed, we are of the view that this long time-period granted to non-financial counterparties does not raise any operational / regulatory risks for their counterparties (notably French financial intermediaries) given the fact that OTC derivative contracts entered into with such category 3 entities will never be subject to frontloading (pursuant to ESMA's proposal in the Consultation Paper);

- On category 2, AMAFI is of the view that ESMA's proposal, that is an entry into force of the clearing obligation 18 months upon the entry into force of the RTS on the clearing obligation, is questionable. We consider that category 2 counterparties should be encouraged to set-up clearing arrangements in a shorter timeframe. We recommend **reducing it to 12 months**. Such shorter time-period is justified notably by the fact that some entities belonging to this category 2 already have access to clearing, sometimes clear already, or in any case, should be in a position to secure access to clearing in such a timeframe (please refer to our [answer to Question 7](#) hereinabove).

5. Remaining maturity and frontloading

Q7. Do you consider that the proposed approach on frontloading ensures that the uncertainty related to this requirement is sufficiently mitigated, while allowing a meaningful set of contracts to be captured? Please explain why and possible alternatives compatible with EMIR.

Not completely. Even though AMAFI generally agrees with ESMA's proposals, we have concerns with issues linked to (i) the applicability of the proposed frontloading requirements to OTC derivative transactions entered into with category 2 counterparties and to (ii) the determination of the duration of the "remaining maturity" for OTC derivative contracts entered into during Period B.

More specifically:

- On the proposal not to apply frontloading requirements to OTC derivative contracts that are entered into with non-financial counterparties subject to the clearing obligation, AMAFI supports ESMA. Indeed, such proposal ensures that the long phase-in period granted to such counterparties (3 years) will not create any operational risk to financial counterparties entering into OTC derivative contracts with them (as we remind that frontloading requirements may create pricing uncertainty, consequently bid-offer spreads widening and, eventually, market instability).
- AMAFI also welcomes ESMA's proposal to divide the frontloading period into two different timeframes (Period A and Period B) and to ensure that no OTC derivative contracts entered into during Period A will be subject to frontloading requirements. Indeed, such proposal will address any uncertainties and negative impacts of frontloading. This is crucial for market participants as uncertainties and negative impacts linked to the frontloading are more significant during Period A than during Period B (as noticed by ESMA in the Consultation Paper).
- Nevertheless, AMAFI considers that ESMA should also propose not to apply any frontloading requirements to OTC derivative transactions entered into between and with category 2 counterparties during Period B, by proposing to mirror the minimum remaining maturity duration of 4 years and 6 months of Period A. Indeed, as mentioned above, frontloading requirements may create pricing uncertainty, consequently bid-offer spreads widening and, eventually, wide market instability due to the broad scope of that category. Today, there are no accepted techniques for determining how to price a derivative which becomes clearable at a future date (or for agreeing terms for future clearing). Therefore counterparties that are not clearing members will face uncertainties as to whether they will be able to find a clearing member and the terms of clearing at the time the clearing obligation becomes effective. Such uncertainty has an impact on the pricing of the trades. The large number of counterparties in this category and the long proposed phase-in period would exacerbate the risks on market liquidity and stability.

Hence, we recommend the following approach on frontloading:

- (i) For category 3 counterparties, no frontloading obligation at all (as proposed by ESMA);
- (ii) For category 1 counterparties, 4 years and 6 months of minimum remaining maturity during Period A and 6 months of minimum remaining maturity duration during Period B (as proposed by ESMA);
- (iii) For category 2 counterparties, granting a minimum maturity of 4 years and 6 months for both periods which would result, in practice, in a non-application of frontloading.

Annex I - Commission mandate to develop technical standards

Annex II - Draft Regulatory Technical Standards on the Clearing Obligation

Q8. *Please indicate your comments on the draft RTS other than those already made in the previous questions.*

No additional comments.

Annex III - Impact assessment

Q9. *Please indicate your comments on the Impact Assessment.*

AMAFI does not have any specific comment to provide on the Impact Assessment.

