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EMIR MANDATORY CLEARING – CDS CLEARING OBLIGATION LAUNCHED

On 19 April 2016 the European Commission published the clearing obligation regulatory technical standards (RTS) for Credit Derivative Swaps (CDS) in the Official Journal (see [CDS Clearing Obligation RTS](#)). The RTS will enter into force on 9 May 2016. It confirms the phase-in period for CDS clearing to start, restates the classes of derivative to be cleared and sets out the frontloading requirements for CDS. It follows a very similar framework to the phase-in of IRS (see IRS clearing note here), with the same categorisation, though different start dates.

WHEN WILL CDS CLEARING BECOME MANDATORY?

In respect of the classes of CDS set out below, the clearing obligation will take effect on:

- ◆ **9 February 2017** for Category 1 counterparties

These are FCs and NFC+s *who are clearing members* of a recognised or authorised CCP listed on ESMA's Public Register, authorised to clear at least one of those classes of CDS set out in the Annex of the RTS.

- ◆ **9 August 2017** for Category 2 counterparties

These are FCs and Alternative Investment Funds (AIFs) under the Alternative Investment Fund Managers Directive (AIFMD) that are NFC+, that do not fall within Category 1, but whose aggregate month-end average notional value of all uncleared derivatives for January to March 2016 exceeds €8bn.

- ◆ **9 February 2018** for Category 3 counterparties

These are FCs and AIFs that are NFC+ but are not in categories 1 or 2 above.

- ◆ **9 May 2019** for Category 4 counterparties

These are NFC+s which do not fall into categories 1, 2 or 3 above.

- ◆ **9 May 2019** for certain Category 1, 2 or 3 counterparties where the transaction is intra-group, with a non-EU entity

If however a cross-border equivalence agreement has been entered into with the relevant third party, then 60 days after the start date should be specified in such agreement.

Where a CDS is entered into between entities in different categories, the later start date will apply. Note also, that as the clearing obligation covers trades between an FC and an entity established in a third country that would be subject to the clearing obligation if it were established in the EU, the above timings should be considered to apply to third country entities clearing in Europe with FCs, with each non-EU entity deeming itself in one of the four categories above.

WHICH CDS TRADES ARE COVERED?

The Annex of the RTS requires the clearing of the following credit derivative swap categories:

European untranchet Index CDS classes with the following parameters:

Type	Sub-type	Reference Index	Settlement Currency	Series	Tenor
Index CDS	Untranchet Index	iTraxx Europe Main	EUR	17 onwards	5 yrs
Index CDS	Untranchet Index	iTraxx Europe Crossover	EUR	17 onwards	5 yrs

FRONTLOADING – WHAT IS IT?

Frontloading is the clearing of earlier trades – those entered into (or novated) within a set period prior to mandatory clearing commencing. This means that if you are caught by the requirement, when clearing commences for you will have to clear certain trades already entered into, as well as trades entered into from that point. It only covers FCs.

The frontloading period for CDS will take effect from 9 October 2016 for Category 1 and 2 FCs.

WHAT TRADES WILL IT APPLY TO?

For Category 1 FCs and Category 2 FCs

- ◆ Untranchet Index CDS classes referencing the iTraxx Europe Main and iTraxx Europe Crossover entered into or novated on or after 9 October 2016 with a minimum remaining maturity as at the clearing start date of six months.
- ◆ Given that to be subject to mandatory clearing the CDS must have a tenor of five years, and the relevant clearing start dates for Category 1 and 2 FCs are less than a year after the frontloading period starts, the minimum remaining maturity requirement of six months at the clearing start date should invariably be satisfied.

In effect, this means that all CDS of a type that will be subject to mandatory clearing that are entered into between Category 1 and 2 FCs on or after 9 October 2016 will be subject to frontloading.

CONTACT DETAILS

If you would like further information or specific advice please contact:

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FINALLY, A RECAP OF THE TYPES OF COUNTERPARTY CATEGORIES

- ◆ FCs means financial counterparties, such as MiFID firms (e.g. EU broker-dealers), banks, pension funds, UCITS funds, alternative investment funds whose manager is authorised under AIFMD.
- ◆ NFCs means non-financial counterparties and further sub-divides into NFC+ and NFC- entities established within the EU who are not FCs, such as non-UCITS funds managed by a manager which is not yet authorised under AIFMD. NFC+ are NFCs whose clearing thresholds are within or exceed the prescribed limits set by the European Commission Delegated Regulation No 149/2013. NFC- are NFCs whose clearing thresholds fall below the clearing threshold.

For more detail on general obligations under EMIR, please see our earlier notes [here](#).

APRIL 2016

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