

EMIR ALERT: CLEARING OBLIGATION FOR IRS

FINANCIAL SERVICES

Following the publication on 11 July 2014 of its [consultation paper](#) on the clearing obligation for some interest rate OTC derivative classes, ESMA published yesterday its [final draft regulatory technical standards \(RTS\) for the central clearing of Interest Rate Swaps \(IRS\)](#). As and when adopted by the European Commission, regulatory technical standards are binding standards that implement the technical detail of certain European legislation. These RTS define the types of IRS contracts which will have to be centrally cleared; the types of counterparties covered by the obligation; and the dates by which central clearing of IRS will become mandatory for them.

ESMA's draft IRS RTS require the following four classes of IRS to be subject to central clearing:

- ♦ basis swaps denominated in Euro, Pounds sterling, Japanese Yen or US Dollars;
- ♦ fixed-to-floating swaps denominated in Euro, Pounds sterling, Japanese Yen or US Dollars;
- ♦ forward rate agreements denominated in Euro, Pounds sterling, or US Dollars; and
- ♦ overnight index swaps denominated in Euro, Pounds sterling, or US Dollars.

ESMA's draft RTS also set out the implementation schedule for market participants for whom central clearing will become mandatory. These participants have been split into four categories (previously three – category two is now divided into two), to start central clearing of IRS after the entry-into-force of ESMA's RTS as follows:

- ♦ **Category 1:** clearing members of a recognised or authorised CCP listed on the Public Register - six months after the RTS enter into force (estimated to be August 2015).
- ♦ **Category 2:** financial counterparties (FCs) and alternative investment funds (AIFs) that are non-financial counterparties above the clearing threshold (NFCs+), which are not included in Category 1, and which belong to a group for which the aggregate month-end average notional amount of non-centrally cleared derivatives for (assuming the RTS enter into force in February 2015) November 2014, December 2014 and January 2015 is above €8bn - 12 months after the RTS enter into force (estimated to be February 2016).

- ♦ **Category 3:** FCs and other NFC+ AIFs that have a low level of activity in uncleared derivatives and which are not included in Category 1 or 2 - 18 months after the RTS enter into force (estimated to be August 2016).
- ♦ **Category 4:** non-financial counterparties (NFCs) - three years after the RTS enter into force (estimated to be February 2018).

Where a contract is entered into between two counterparties included in different categories of counterparties, the date from which the clearing obligation takes effect for that contract shall be the later of the two.

Frontloading - the requirement to retrospectively clear existing trades once the clearing obligation begins - applies to Categories 1-3. For Category 3, however, ESMA has, since its initial consultations, increased the minimum remaining maturity (one of the factors establishing whether frontloading is required) to 50 years for basis swaps and fixed-to-float IRS classes and three years for forward rate agreements and overnight index swap classes, to ensure that the number of contracts caught is kept to a minimum.

The minimum remaining maturity for Categories 1 and 2 counterparties are the same: for contracts entered into or novated before the date of publication of the RTS in the Official Journal (OJ), 49.5 years for basis swaps and fixed-to-float IRS contracts, and 2.5 years for forward rate agreements and overnight index swap classes. Contracts entered into or novated on or after publication of the RTS are subject to a 6 month minimum remaining maturity.

NFCs falling within Category 4 are **not** subject to frontloading.

ESMA has submitted this final draft IRS RTS to the European Commission which has up to three months to endorse them. Following this, the IRS RTS will be passed to the European Parliament and Council. They will enter into force 20 days after their publication in the OJ; ESMA currently expects this to be in February 2015.

CONTACT DETAILS

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

WILL SYKES
DD: +44 (0)20 7849 2294
will.sykes@macfarlanes.com

MICHELLE KIRSCHNER
DD: +44 (0)20 7849 2227
michelle.kirschner@macfarlanes.com

YVONNE CLAPHAM
DD: +44 (0)20 7849 2869
yvonne.clapham@macfarlanes.com

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MACFARLANES LLP

20 CURSITOR STREET LONDON EC4A 1LT

T: +44 (0)20 7831 9222 F: +44 (0)20 7831 9607 DX 138 Chancery Lane www.macfarlanes.com

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