

**Circular to the Financial Services Industry on the European Markets
Infrastructure Regulation N° 648/2012
(‘EMIR/ the Regulation’): Clearing Obligation**

[1.0] Introduction

EMIR sets out the criteria for determining whether or not different classes of Over the Counter (‘OTC’) derivative contracts should be subject to a clearing obligation. On the basis of draft regulatory technical standards (‘RTS’) developed by the European Securities and Market Authority (‘ESMA’), the European Commission decides whether a class of OTC derivative contract is to be subject to a clearing obligation, and from when the clearing obligation takes effect.

[2.0] Clearing Obligation

The obligation to clear OTC derivatives arises from Article 4 of the Regulation and applies to a class of OTC derivatives that is subject to the clearing obligation. Furthermore, the derivative transaction has to be entered into between any combination of Financial Counterparties (‘FC’) and Non-Financial Counterparties exceeding the clearing threshold (‘NFC+’), given that one or more of the parties involved in the transaction is established in the EEA:

- Two FCs
- A FC and a NFC+
- Two NFC+s
- A FC or NFC+ and a non-EEA entity that would be subject to the clearing obligation if it would be established in the EEA

The clearing obligation procedure is set out in Article 5 of the Regulation. Under EMIR, the clearing obligation is established via Delegated Regulations based on Regulatory Technical Standards developed by ESMA. On the basis of the criteria defined in EMIR, ESMA has submitted to the European Commission three RTS covering OTC interest rate derivatives and OTC credit derivatives. Two of these RTS have already entered into force, while the third one has been adopted by the Commission and is currently under review by the European Parliament and Council.

ESMA has decided to phase in the clearing obligation depending on the categories of the counterparties.

The categories of counterparties referred to in the RTS are as follows:

Category 1: Counterparties (FCs and NFC+) that are clearing members of at least one central counterparty (CCP) within the meaning of Article 2(14) of Regulation (EU) No 648/2012, for at least one of the classes of OTC derivatives set out in the Annex to the abovementioned RTS.

Category 2: Counterparties not belonging to Category 1 which belong to a group whose aggregate month-end average of outstanding gross notional amount of non-centrally cleared derivatives for January, February and March 2016 is above EUR 8 billion and which are any of the following:

- i. Financial counterparties;
- ii. Alternative investment funds as defined in Article 4(1)(a) of Directive 2011/61/EU of the European Parliament and of the Council that are non-financial counterparties.

Category 3: Financial counterparties and Alternative Investment Funds (AIF) not included in Categories 1 and 2 with a lower level of activity in un-cleared derivatives (i.e. OTC derivative contracts with gross notional outstanding over the abovementioned 3-month period below EUR 8 billion)

Category 4: All non-financial counterparties above the clearing threshold (NFC+) not included in Categories 1, 2 or 3

[3.0] Rules on Interest Rate Derivatives

The European Commission has on 6th August 2015 adopted rules that make it mandatory for certain OTC interest rate derivative contracts to be cleared through central counterparties. The Commission's decision was taken in the form of [Commission Delegated Regulation \(EU\) 2015/2205](#) (the 'Delegated Regulation') – RTS for Interest Rate Derivatives. The RTS entered into force on 21 December 2015 and is the first RTS implementing the clearing obligation under EMIR.

The Delegated Regulation covers interest rate swaps denominated in Euro, Pounds Sterling, Japanese Yen or US Dollars that have specific features, including the index used as a reference for the derivative, its maturity, and the notional type (the nominal or face amount that is used to calculate payments made on the derivative).

The Delegated Regulation applies to the following derivative contracts:

- Fixed-to-float interest rate swaps, known as 'plain vanilla' interest rate derivatives;
- Float-to-float swaps, known as 'basis swaps';
- Forward Rate Agreements;
- Overnight Index Swaps.

[3.1] Dates from which the Clearing Obligation takes effect

The clearing obligation shall take effect as follows:

Category 1: 21 June 2016 with a frontloading application as of 21 February 2016 (4-month frontloading)

Category 2: 21 December 2016 with a frontloading¹ application as of 21 May 2016 (7-month frontloading)

Category 3: 21 June 2017 (no frontloading obligations)

Category 4: 21 December 2018 (no frontloading obligations)

[4.0] Rules on Central Clearing for certain Credit Derivative Contracts

On 1 March 2016 the Commission issued the second set of Regulatory Technical Standards, namely [Commission Delegated Regulation \(EU\) 2016/592](#) supplementing EMIR. Delegated Regulation (EU) 2016/592 sets out the classes of over the counter (OTC) derivatives that are subject to the clearing obligation; it refers in particular to certain credit default swaps that are denominated in Euro covering some European corporates. By requiring these types of credit default swaps to be cleared through CCPs, financial markets become more stable and less risky. This creates an environment that is more conducive to investment and economic growth in the EU.

[4.1] Dates from which the Clearing Obligation takes effect

In respect of contracts pertaining to a class of OTC derivatives set out in the Annex of Delegated Regulation (EU) 2016/592, the clearing obligation shall take effect as follows:

Category 1: 9 February 2017

Category 2: 9 August 2017

Category 3: 9 February 2018

Category 4: 9 May 2019

Where a contract is concluded 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 date.

[5.0] ESMA Consultation Paper on proposed Central Clearing Delay for Small Financial Counterparties

¹ Frontloading essentially is an obligation to clear OTC derivative contracts (concluded on a bilateral basis) that were entered into a certain period before the date of entry into force of the clearing obligation

On 13 July 2016 ESMA issued a [Consultation Paper](#) proposing to change the phase-in period for central clearing of OTC derivatives applicable to financial counterparties with a limited volume of derivatives activity under the European Market Infrastructure Regulation (EMIR). ESMA proposes to amend EMIR's delegated regulations on the clearing obligation to prolong, by two years, the phase-in for financial counterparties with a limited volume of derivatives activity - those ones classified in Category 3 under EMIR Delegated Regulations.

The consultation closes on 5 September 2016.

The Authority invites stakeholders to submit comments on all matters contained in the consultation paper to ESMA. 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'.

[6.0] Intragroup transactions exemption from the clearing obligation

Certain intragroup transactions may be exempt from the clearing obligation. The transactions will have to meet the definition of 'intragroup transaction' set out in EMIR and counterparties will have to notify their competent authority that they wish to rely on the exemption. The notification must be made at least 30 calendar days before the counterparties wish to use the exemption and the competent authority may object if the requirements are not met.

Contacts

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