

**Template for the Responses to the Discussion Paper on the Clearing Obligation under EMIR****How to use this template**

This template is made available to stakeholders who wish to answer to ESMA's Discussion Paper on the Clearing Obligation under EMIR, reference ESMA/2013/925.

ESMA wishes to encourage stakeholders to use the template in order to facilitate the analysis of the responses to this consultation. However, ESMA will duly consider all answers irrespective of the format under which they are submitted.

When not commenting on a specific question or section, please kindly delete the corresponding references (i.e. "Question x", "Answer y", "Comments on paragraphs x to y").

The final submission of your answer in word format is preferred.

**A. Respondent**

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Country: Finland

Category:

Category	Please select
Audit/Legal/Individual	
Banking sector	X
Central Counterparty	
Commodity trading	
Government, Regulatory and Enforcement	
Insurance and Pension	X
Investment Services	X
Non-financial counterparty subject to EMIR	
Regulated markets/Exchanges/Trading Systems	
Other Financial service providers	

*Federation of Finnish Financial Services represents banks, insurers, finance houses, securities dealers, fund management companies and financial employers operating in Finland. Its membership includes employee pension, motor liability and workers compensation insurers, all three providers of statutory insurance lines that account for much of Finnish social security. The Federation has about 460 members who employ a total of 43,000 people.*

## **B. Introduction – General comments**

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Federation of Finnish Financial Services (FFI) **appreciates greatly ESMA's decision to publish a discussion paper** on the clearing obligation well in time before the actual clearing obligation consultations are set to be published. This approach will give the market participants information which in turn will help them to get prepared for the actual clearing of OTC derivatives contracts.

The implementation of Regulation 648/2012 (EMIR) has been partially suffering from tight deadlines and postponements in many aspects. With the current proposal on clearing obligation, **potential for more uncertainty for the market exists** very clearly. As a general rule without phase-ins, the scale would be from 9 to 16 months according to point 13. Any such variations are likely to put market participants in different positions in terms of preparedness. Participants with significantly more resources will be able to plan their processes more in advance whereas smaller participants will have to struggle with limited resources under this uncertainty. This applies especially to very small financial counterparties as they are obliged to clear all contracts centrally but may only have a handful of employees.

**To avoid this uncertainty and to create a level playing field, we strongly support that ESMA decides on a workable phase-in period** that will be clear to all participants from the day the central counterparties (CCPs) receive authorizations. In addition to above benefits, a clear phase-in period would also ensure that participants have more time to choose their CCP and thus also creates a level playing field for CCPs. Looking at the indicative timeline on page 10, it seems like a proper phase-in for the clearing obligation for first class of OTC derivatives might be 1<sup>st</sup> of January 2016.

**Liquidity is of great importance when clearing-eligibility** of a certain type or class of derivatives **is considered**. The general approach ESMA has taken on the classes of derivatives does not seem to recognize this as a key priority. We recommend that the approach is amended in this respect and that liquidity will be listed as one of the first key characteristics to consider.

**Administrative and operational burden on market participants and service providers should be avoided** to the extent possible. Negotiating the terms and entering into a clearing relationship with a central counterparty or general clearing member (or a client) is a major-time consumer that requires all type of resources. In most cases, this also requires changes in the IT-systems and a proper analysis of the legal documentation from both parties to the clearing relationship. Therefore any proposals on first introducing a clearing obligation for certain class and then withdrawing it should be carefully considered by ESMA. Introduction of a clearing obligation for certain class should always be accompanied with a proper cost-benefit analysis.

Furthermore, from both a systemic risk and a single competitive market perspective, **there should not be reliance on only one CCP to clear certain product**. In such a case, the clearing obligation should not be introduced in the first place or it should be dis-applied to prevent the accumulation of unmanageable and concentrated risks. As a result, we strongly recommend that at least two CCPs need to be providing services in the asset class in question before clearing obligation enters into force.

ESMA has been able to find evidence on how the markets have freely moved towards standardized and cleared products. This might be partially due to free movements but we have doubts that much of this is also due to the yet unknown European capital requirements on contracts that are not centrally cleared. Unintentionally some risks are now being hedged with centrally cleared products due to this uncertainty in the bilateral landscape. In principle, these contracts may cover the need for hedging and the risks the counterparty faces. However, it is still very likely that the product is not best suited to cover for the exact risks. More seriously, the uncertainty has in some cases meant that the risks have not been hedged at all. This trend should be avoided by all means when the clearing obligation is considered.

Finally, as a detailed linguistic comment, derivatives markets are often described using great amount of abbreviations. In this discussion paper ESMA has introduced yet another abbreviation when Clearing Obligation is referred to as CO. As abbreviations make the text sometimes harder to understand, we recommend that obligations derived from binding regulations are never shortened in ESMA communications.

### **C. Comments on the discussion paper and answers to questions**

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#### **Question 3 (Index CDS):**

*Do you have preliminary views on the specific items within those classes which would be the best candidates for the clearing obligation, taking into consideration the overarching aim of reducing systemic risk and the criteria defined in Article 5(4) of EMIR?*

#### **Answer 3:**

We believe that in the current market most common CDS indices could be clearing eligible. However, options on them cannot be centrally cleared.

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#### **Question 5 (Single name CDS):**

*Please indicate your preference between the options presented. Under Option C, which criteria do you believe are relevant and how should they be calibrated?*

#### **Answer 5:**

In many cases of the discussion paper where different options are presented, all of these have their advantages and disadvantages. In our opinion this implies that the market is not yet standardized enough and thus not ready for mandatory clearing. Therefore we recommend ESMA to look for more input and provide more details in the following consultation paper. In addition, a proper and clear phase-in period needs to be introduced to overcome these difficulties and increase standardization.

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**Question 7 (Single name CDS):**

*Do you have preliminary views on the specific items within those classes which would be the best candidates for the clearing obligation, taking into consideration the overarching aim of reducing systemic risk and the criteria defined in Article 5(4) of EMIR?*

**Answer 7:**

We believe that sufficiently liquid and standardized CDS single names are best candidates for central clearing. Any other CDS are not yet even close to be suitable.

**2.2 Interest rate derivatives**

**Question 8 (Interest rate derivatives):**

*Do you consider that the main characteristics of the interest rate derivatives are adequately captured by the proposed structure? Are there any other variables which you consider as relevant in the context of the clearing obligation?*

**Answer 8:**

The main characteristics of interest rate derivatives are adequately captured by the proposed structure. Naturally, liquidity is of great importance in context of clearing obligation. Therefore we urge ESMA to give priority only to the most liquid segment and where at least two CCPs are already offering clearing services.

**Question 9 (Interest rate derivatives):**

*Do you have preliminary views on the specific items within those classes which would be the best candidates for the clearing obligation, taking into consideration the overarching aim of reducing systemic risk and the criteria defined in Article 5(4) of EMIR?*

**Answer 9:**

Introducing the same scope of products between different jurisdictions is very important in the global financial markets as it will create a consistent and fair market for all counterparties regardless of jurisdiction.

As a detailed comment from a European and Nordic perspective, Interest Rate Swaps in all major currencies are clearable and also IRS in Nordic currencies up to 10 years. On the contrary, non-linear products e.g. Caps/Floors / Swaptions are not yet eligible for mandatory clearing, neither CPI nor more exotic product types. This is due to high dimensionality (strike/"moneyness", option maturity, underlying asset / swap tenor, conventions) which all add to illiquidity, non-uniqueness and complexity in pricing for most products.

### 2.3. Equity derivatives

#### **Question 10 (Equity derivatives):**

*Please indicate your preference between the options presented. Under Option D, which criteria do you believe are relevant and how should they be calibrated?*

#### **Answer 10:**

The easiest option of the ones presented to categorize single name derivatives is to look at what Index the underlying stock is a member to (Option B). One main Index per country should be used to avoid overlaps. In a case where such overlap still exists (a stock is part of several indexes), detailed rules need to be in place to determine which Index is prevailing. In addition it is crucial to very regularly follow the updated composition of an index instead of outdated, for example yearly compositions.

#### **Question 11 (Equity derivatives):**

*Please indicate your preference between the options presented.*

*In relation to Option B, which geographical zones would you define, i.e. how could the currencies be grouped in geographical zones? What is the standard market practise in this respect?*

#### **Answer 11:**

As already stated above, all of the options still require more information and may not be perfectly suitable as such. In any case settlement currency should be used as an indicator instead of geographical region (Option A). From a system and sourcing perspective currency is an easier way to categorize a trade than to list markets where the underlying stocks are traded.

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#### **Question 13 (Equity derivatives):**

*Do you have preliminary views on the specific items within those classes which would be the best candidates for the clearing obligation, taking into consideration the overarching aim of reducing systemic risk and the criteria defined in Article 5(4) of EMIR?*

#### **Answer 13:**

In the equity derivatives markets, we consider that only “Vanilla” products with Index or Single names as underlying and which have a maturity up to 6 month are best candidates for clearing. Total return swaps will not be eligible at this stage. Bearing in mind the aim of the regulators to reduce systemic risk in the derivatives market, this scope would cover a large part of the OTC market at the same time as the input parameters remain limited.

### 2.4. Foreign Exchange derivatives

#### **Question 14 (FX derivatives):**

*Do you consider that the main characteristics of the FX derivatives are adequately captured by the proposed structure? Are there any other variables which you consider as relevant in the context of the clearing obligation?*

**Answer 14:**

There is an exemption in the US market for clearing of currency-related instruments and these can be cleared bilaterally. In this respect EU firms should not be put in a competitive disadvantage in comparison to US firms. It is very crucial to harmonise the scope of the clearing obligation as much as possible and to introduce similar requirements to those in other markets. This harmonization will help to avoid detrimental effect on EU firms and ensure a level playing field on a global level.

**Question 15 (FX derivatives):**

*Do you have preliminary views on the specific items of the presented class which would be the best candidates for the clearing obligation, in view of the criteria to be assessed by ESMA, taking into consideration the overarching aim of reducing systemic risk and the criteria defined in Article 5(4) of EMIR?*

**Answer 15:**

FX product types that are in scope for EMIR but which are exempted from mandatory clearing under the Dodd-Frank Act should be exempt from the clearing obligation under EMIR as well. Such are for example physically settled FX forwards and FX swaps. This should be a full exemption without for example tenor restrictions. In addition to the point of alignment across jurisdictions, the risk characteristics of these products make them unsuitable for clearing (as raised in question 33 about settlement risk). This exemption is also supported by the recent BCBS-IOSCO recommendations on margin requirements which exempt these types of transactions from margining requirements.

In addition there are such FX options that are not appropriate for clearing. Firstly, all non-vanilla options are outside of the scope of the clearing obligation due to large variety of product types and challenges in liquidity. Secondly, the range of currency pairs needs to be restricted as liquidity issues are often available with non-major currency pairs. We would advocate that the currency pairs would have to include two of the following currencies; EUR, USD, JPY, GBP, AUD, CHF and CAD. According to the BIS only the listed currencies achieve a minimum 5% daily share of the global foreign exchange market turnover and are thus a crucial factor in defining the scope of clearing obligation.

**2.5. Commodity derivatives**

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**Question 17 (Commodity derivatives):**

*Do you consider that the main characteristics of the Commodity derivatives are adequately captured by the proposed structure? Are there any other variables which you consider as relevant in the context of the clearing obligation?*

**Answer 17:**

As in the case of equity derivatives, classification of commodity derivatives will be extremely challenging in view of the specific nature of the market. We strongly recommend that ESMA works further with the industry to examine characteristics for clearing based on product location, delivery method and tenor to ensure that mandatory clearing is fully aligned with the availability of suitable instruments in the market.

**Question 18 (Commodity derivatives):**

*Do you have preliminary views on the specific items within those classes which would be the best candidates for the clearing obligation, taking into consideration the overarching aim of reducing systemic risk and the criteria defined in Article 5(4) of EMIR?*

**Answer 18:**

We refer firstly to our comments to Q17.

In addition, it is clear that some of the proposed commodity classes are not suitable for clearing due to liquidity constraints. These are at least commodity class 11: Energy – Petrochemicals and commodity class 12: Energy – Refined Products. The non-liquid Refined Oil Product qualities that are not clearable at the moment will not probably become eligible for clearing in the future either. In general, only commodities denominated in USD or EUR (sometimes probably in GBP) can be cleared whereas this is practically impossible for commodities in other currencies. Finally, regardless of their currency, none of the option instruments can be cleared.

**3. Preliminary analysis of the readiness of asset classes vis-à-vis the clearing obligation**

**Question 19 (readiness of the classes):**

*Do you agree with this analysis?*

**Answer 19:**

In our opinion, ESMA has made a justified analysis that interest rate swaps and index CDS appear to be better suited for the introduction of a clearing obligation than other types of OTC derivatives. However this only applies to the extent the scope of clearing obligation is defined in all instances with sufficient clarity and does not inadvertently capture types of transactions which are not suited for clearing for example due to liquidity reasons.

The number or percentage of transactions which are processed electronically via confirmation matching platforms could be used as one of the first indicators to start considering the eligibility of a certain type of transaction for the clearing obligation.

Whatever the final decisions will be, we would highly appreciate that ESMA provides an indicative timing of each asset class to facilitate preparation for the introduction of clearing obligations. As already stated, entering into clearing requires a massive amount of work and sufficient time to control the risks therein and thus an indicative timeline is of utmost importance.

**4. Determination of the phase in, and the categories of counterparties to which the CO would apply**

**4.1. Dates, phase in, categories of counterparties**

**Question 20 (dates, phase in):**

*What would you consider to be the shortest delay to impose a clearing obligation to a class of OTC derivatives when there are several CCPs available? And when there is only one CCP available?*

*Please specify in your answer whether the cause of delay is due to operational issues (e.g. time for CCP/counterparties to be ready for the CO) and/or to market issues (e.g. time for a CCP to add a new product to its offering).*

**Answer 20:**

We repeat the fact that practical implementation of clearing processes will pose significant challenges to all market participants (CCPs, clearing members, clients of clearing members etc.) The operational, legal and technical preparations will be costly and time consuming. A sufficient phase-in period and advance notice before the start of clearing obligations are therefore crucial.

It is indeed difficult to estimate the time such preparations will generally take as this depends on many factors, including the scope of the relevant clearing obligation, the readiness of the markets and the market structure. In this case two existing CCPs clearing the class in question would be very useful as competitive landscape will ensure that clearing members and their clients receive better and faster services. However, even the existence of multiple CCPs does not necessarily reduce the time required to negotiate terms and legal frameworks which are need to build a risk resilient offering.

In any case, the minimum period for the necessary preparations by the market participants should not be less than 12 months. The period would need to be significantly longer if only one CCP is authorised or recognised for the specific class of derivatives.

**Question 21 (dates, phase in):**

*What would you consider to be a reasonable delay to allow CCPs which clear the same asset class or a similar Class+ to clear a new Class+?*

**Answer 21:**

The timeline requested in Q20 should be used as a minimum regardless of the asset class. The existence of clearing facility for one asset class does not reduce the time needed to introduce another class. With introduction of clearing obligation for a new asset class it is likely that new clients will need to set up clearing arrangements. This will take the same amount of time as any other introduction of a clearing obligation.

**Question 22 (dates, phase in):**

*What should be the assumption regarding market share which the CCP would have to be able to assume? Should it be requested that each CCP be able to handle the whole volume to tackle the worst case scenario?*

**Answer 22:**

The suitability of a CCP to start clearing a new asset class should be carefully considered together with the CCP, its supervisory authorities and the market participants. In many cases, the current market structure may play a significant role in this analysis and therefore any general requirements may not be suitable here.



**Question 23 (dates, phase in):**

*What should be the elements (e.g. number of transactions, increase in risks, number of active counterparties, new jurisdiction involved) for ESMA to investigate, after consulting the NCAs responsible for CCPs authorisation, on the ability of the relevant CCPs to handle the expected volume and to manage the risk arising from the clearing of the relevant class of OTC derivatives?*

**Answer 23:**

Please see above (Q22).

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**Question 25 (categories of counterparties):**

*Please indicate your preference between the options presented. Would you rather use an option that is not detailed here? Under Options B and C, do you agree to base the clearing access approach on the asset class to which the counterparties have access? What should be the date on which clearing access/threshold calculation should be assessed?*

**Answer 25:**

As explained above in the general comments, there are major differences in the readiness of financial counterparties to enter into clearing. Some financial counterparties under EMIR might be investment firms, banks or asset managers that have very scarce resources and practically no possibility to enter into clearing relationships directly with CCPs or not even with clearing members. For these reasons and to consider the systemic importance of an FC, we have a preliminary preference for option C, volume based categorization.

We believe volume would be a good proxy for clearing preparedness (the main benefit of option B), while being easier to measure and use to categorize counterparties. Volume based categorization may also be less likely to impact the behaviour of market participants and ensure proper time management with clearing implementation as project would not need to be postponed due to the fact that participants with small volumes have not been able to find a suitable clearing solution.

The volume thresholds should be set carefully, considering the need for all small and medium sized financial counterparties to have a proper time to prepare for the clearing obligation. The fact that even clearing brokers choose their clients based on high volumes needs to be considered as a factor that makes it even more difficult for some financial and non-financial counterparties to enter into clearing relationship. Should the timetable be too tight for these counterparties, a valid risk of market disruption exists, in addition to the risk that smaller counterparties are left out from the OTC derivatives market.

**Question 26 (categories of counterparties):**

*What would in your view be the appropriate timeframe for counterparties with / without access to clearing in the relevant asset class?*

**Answer 26:**

Access to clearing is a crucial factor in this respect. As explained above, the type of access (direct or indirect access via clearing member) needs to be considered as well. We would propose a timeline of at least 12 months after the start of the first clearing obligation in each asset class for counterparties with direct access and at least 18 months for counterparties with indirect access or without any access. This set up would allow additional time for clearing members to take on new clients in a prudent manner.

**Question 27 (categories of counterparties):**

*Do you agree that a key factor to take into account when defining the phase in for the counterparties to comply with the clearing obligation will be the number of clearing members offering client clearing services? Is the client clearing capacity of the CCP also a relevant factor? What could be the other criteria?*

**Answer 27:**

Yes this is one of the key factors, see also our responses above.

**4.2. Minimum remaining maturity of the OTC derivative contracts referred to in EMIR Article 4(1)(b)(ii)**

**Question 28 (remaining maturity):**

*What are your views regarding the calibration of the remaining maturity of the contracts to be subject to the CO? What criteria should ESMA take into account when defining it?*

**Answer 28:**

Back loading of trades requires a huge amount of work and if the remaining maturity is limited, central clearing would not have the needed positive impact on the risks of the contract. Therefore we first suggest that no trades entered into before the clearing obligation start date should be back loaded. Secondly, if considered necessary, the minimum remaining maturity should be as long as possible both for operational and cost reasons. There is a valid risk that clients are requested to cover the costs (most probably fixed) of back loading for all trades regardless of the remaining maturity.

**5. The clearing obligation in specific cases**

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**5.2. Foreign exchange OTC derivatives**

**Question 33 (FX derivatives):**

*Within the foreign exchange asset class, for which type of contracts do you consider that settlement risk is the predominant risk, and what criteria or characteristics should be used by ESMA to identify those contracts?*

**Answer 33:**

The settlement risk is the central risk in case of FX swaps and forwards. This is also reflected in the decision of BCBS-IOSCO to exempt such transactions from margining requirements. Therefore, and since there is no clearing obligation for FX derivatives in major third countries, the EU should follow the BCBS-IOSCO recommendation and exempt all these instruments from the clearing obligation regardless of their characteristics.

### 5.3. Interaction of portfolio compression and the clearing obligation

#### **Question 34 (Portfolio compression):**

*Are there ways in which the imposition of the clearing obligation in the EU could hamper the effectiveness of compression services? If so, please provide evidence of the potential impact. Are there ways in which exclusions to the clearing obligation could be defined which alleviate the problem without creating opportunities for avoidance?*

#### **Answer 34:**

We repeat the request to follow those jurisdictions that have already made their decisions in this respect to ensure a globally level playing field between market participants.

### 5.4. How to withdraw a clearing obligation on a class or subset of it?

#### **Question 35 (Modification of a Class+):**

*For which reason (other than the fact that a CCP does not clear it any longer) do you believe that the clearing obligation of a class - or subset of it - would need to be removed? Please focus on the risks which could stem from a clearing obligation on contracts which would no longer be appropriate for mandatory clearing and provide concrete examples.*

#### **Answer 35:**

Liquidity is the key factor in defining whether an asset class is eligible for clearing or not. Hence reduced liquidity would be the most obvious reason to remove the clearing obligation. Removals based on other factors are possible but these should be carefully considered to avoid impacts on market prices and margining.

#### **Question 36 (Modification of a Class+):**

*In case a clearing obligation would need to be reviewed, how crucial would be the time needed to dis-apply the clearing obligation?*

#### **Answer 36:**

The obligation to clear should be dis-applied immediately as any uncertainty related to the timeline to dis-apply the clearing obligation may generate significant market uncertainty. Any decision to cancel the clearing obligation should be taken rapidly and a delay of for example several months should be avoided. The best way forward seems to set the criteria for mandatory clearing on a sufficiently high level and adjust the criteria in a way that the decision to dis-apply the obligation can be taken and informed of fast, i.e. by removal from the Public Register.