EACH response to the ESMA consultation on the clearing and derivative trading obligations in view of the benchmark transition

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Introduction

The European Association of CCP Clearing Houses (EACH) represents the interests of Central Counterparties (CCPs) in Europe since 1992. CCPs are financial market infrastructures that significantly contribute to safer, more efficient and transparent global financial markets. EACH currently has 19 members from 15 different European countries. EACH is registered in the European Union Transparency Register with number 36897011311-96.

EACH appreciates the opportunity to provide feedback to the ESMA Consultation Paper on the clearing and derivative trading obligations in view of the benchmark transition[1] (hereinafter called "The consultation").

Section 2 - Introduction

Question 1: Are there any general comments you would need to raise?

EACH would like to highlight the following key points:

- EACH Members overall support the proposals included in the ESMA consultation;
- EACH Members would appreciate if there was an alignment with the implementation timing proposed by the Bank of England in its consultation "*Derivatives clearing obligation – modifications to reflect interest rate benchmark reform: Amendments to BTS 2015/2205*"[2], which suggests implementing modifications to the contract types subject to the clearing obligation by:
    - removing, on Monday 18 October 2021, the contract type referencing EONIA from the OIS class and replacing it with the contract type in the OIS class referencing €STR with an original maturity of 7 days to 3 years.
    - removing, on Monday 6 December 2021, the contract type referencing JPY Libor from the Basis Swaps and Fixed-to-float interest rate swaps classes.
    - removing, on Monday 20 December 2021, the contract type referencing GBP Libor from the Basis Swaps, Fixed-to-float interest rate swaps and Forward Rate agreements classes and replacing it with the contract type in the OIS class referencing SONIA but with an amended original maturity range of 7 days to 50 years.

  International coordination should indeed be ensured to the possible extent in light of the potential scenario where there would be a mandate to clear products that would no longer be eligible to CCPs, and whose liquidity would be significantly reduced.

[1] https://www.esma.europa.eu/sites/default/files/library/consultation_paper_on_the_co_and_dto_for_swaps_referencing_rfrs.pdf

[2] https://www.bankofengland.co.uk/paper/2021/derivatives-clearing-obligation-modifications-to-reflect-interest-rate-benchmark-reform-amendments

- EACH Members notice that SOFR is a good active liquid market and has received additional stimulus by e.g. the SOFR First initiative[3]. Nonetheless, authorities should coordinate and implement a consistent approach across jurisdictions to the extent possible.
- EACH Members encourage ESMA to further assess whether TONAR OIS (e.g., those with shorter maturities) would meet the requirements for being subject to the clearing obligation under EMIR, either at the time of the ESMA's final report or once the transition is more advanced.

Section 3 – Current status of the benchmark transition

Question 2: Are there any other aspects of the transition that need to be taken into account? Please share any data that would help qualify further the progress with the transition or any other aspects that you think should be considered.

EACH Members agree with the ESMA analysis – included in paragraph 78 of the consultation – that by the time EONIA will have ceased, the same liquidity pool should be available for €STR OIS, considering that there is a fixed relation between EONIA and €STR. Nevertheless, we would like to point out that in the past few months a build-up of €STR OIS liquidity has been observed, and this is reflected in the EONIA vs. €STR OIS monthly volume split, although this liquidity build-up should be somewhat less important than with other RFRs.

Section 4 – General approach

Question 3: Are there any other aspects that you think that ESMA should take into account or that might justify a different approach?

EACH Members appreciate that ESMA is coordinating the transition to the RFRs with other regulators and jurisdictions in order to facilitate international cooperation. However, as highlighted in our response to Question 1 and as further detailed in our response to Question 6, we believe it would be very important if ESMA could ensure an alignment with the implementation timing proposed by the Bank of England in its consultation "*Derivatives clearing obligation – modifications to reflect interest rate benchmark reform: Amendments to BTS 2015/2205*". In addition, we would caution against requiring clearing for SOFR OIS in the EU without a respective adaption of the US clearing obligation to include SOFR OIS first.

[3] https://www.cftc.gov/PressRoom/PressReleases/8409-21#:~:text=SOFR%20First%20is%20a%20phased,the%20sponsor%20of%20the%20MRAC.

Section 5 – Clearing obligation

Question 4: Do you agree with the assessment of the EMIR criteria and with the proposed classes (except for USD which is dealt with in a dedicated Question 5)? If not please detail how the assessment could differ and please also provide data and information to justify a different assessment.

We agree with ESMA's proposals to adapt the clearing obligation by replacing EONIA with €STR as the reference index for EUR OIS. We are also in favour of the extension of the maturity of OIS referencing SONIA from 3 to 50 years, as the expansion of maturity is required to replace the GBP LIBOR IRS currently subject to the clearing obligation. EACH is of the opinion that the adaption of the clearing obligation to the new rates will help avoiding that new business will shift back from central clearing to the bilateral space.

Question 5: Will the transition regarding USD have made sufficient progress by this Autumn to decide on whether to maintain or remove USD LIBOR classes. Will there be sufficient liquidity to introduce SOFR OIS to the CO and for which maturity range? Please provide the relevant data and information to explain your assessment, in accordance with the EMIR framework.

Generally, EACH cautions against a removal of the USD LIBOR from the clearing obligation as long as a decision has not been made on the treatment of SOFR, and as long as the US has not decided on a removal and subsequent replacement.

In addition, we suggest not requiring clearing for SOFR OIS in the EU without a respective adaption of the US clearing obligation to include SOFR OIS first. EACH Members understand that ESMA is aware of the CFTC's statement on the "SOFR First initiative" for increasing liquidity in derivatives referencing SOFR and welcome ESMA's approach to closely monitor the further build-up of liquidity and the approach taken by US regulators before taking a decision on the EU clearing obligation to include SOFR OIS.

Question 6: Do you agree with the proposed implementation of the changes? if not please provide details that could justify a different implementation.

As mentioned in our answers to Questions 1 and 3, EACH Members would like to point out the importance of aligning with the implementation timeline proposed by the Bank of England in its consultation paper. In this regard, we would like to highlight that EU CCPs have aligned on a switch for EONIA legacy trades to €STR on 15 October 2021 and plan for a conversion of GBP and the JPY LIBOR legacy trades to RFR OIS trades in early and mid-December 2021. The Bank of England indicates in its consultation on adapting the UK clearing obligation that it plans to implement the respective changes in line with the dates when CCPs are making the switches. As ESMA is aiming at an implementation as of 3 January 2022, in the EU there may be a gap at the end of December where the GBP and JPY LIBORs will be subject to the clearing obligation without a CCP clearing them as well as new business under the replacement rates which will not yet be subject to the clearing obligation; this is also true with EONIA from mid-October until the end of the year. We could therefore not exclude the possibility that some market participants would have to do some targeted GBP/JPY LIBOR or EONIA transactions which would be done in the bilateral space. It is our opinion that an alignment in this context would protect the integrity of central clearing and avoid a move back to the bilateral space.

In addition, EACH Members have notice that JPY RFR liquidity has evolved since the publication on this consultation on 9 July 2021. As TONAR is the recommended alternative to JPY LIBOR and in light of the "TONA First"[4] initiative implemented as from 30 July 2021, TONAR volumes are expected to increase in the coming months. As a result, while EACH does not object to what ESMA is proposing, consideration should be given to the implementation timing of a mandate for JPY RFR since a clearing obligation will at some point be appropriate. As such, we would encourage ESMA to further assess whether TONAR OIS (e.g., those with shorter maturities) would meet the requirements for being subject to the clearing obligation under EMIR, either at the time of the ESMA's final report or once the transition is more advanced.

[4] https://www.boj.or.jp/en/paym/market/jpy_cmte/data/cmt210726b.pdf