

August 18, 2015

European Commission Publishes Delegated Regulation on Mandatory Clearing for OTC Interest Rate Derivatives

On August 6, 2015, the European Commission (EC) adopted new rules in the form of a [delegated regulation](#) (Delegated Regulation) requiring the mandatory clearing of certain over-the-counter (OTC) interest rate derivatives contracts (IRDs) through central counterparties (CCPs) pursuant to the European Market Infrastructure Regulation (EMIR).

The Delegated Regulation covers the following classes of IRDs that must settle in a single settlement currency in either EUR, GBP or USD, which is detailed in [Annex 1 to the Delegated Regulation](#):

- fixed-to-float (IRS), referencing either EURIBOR or LIBOR, with a maturity of 28 days to 50 years (this category also includes IRS settling in JPY);
- float-to-float swaps (basis swaps), referencing either EURIBOR or LIBOR, with a maturity of 28 days to 50 years (this category also includes IRS settling in JPY);
- forward rate agreements (FRAs), referencing either EURIBOR or LIBOR, with a maturity of three days to three years; and
- overnight index swaps (OIS), referencing the Euro OverNight Index Average, FedFunds or the Sterling OverNight Index Average, with a maturity of seven days to three years (collectively, Covered IRDs).

Article 1 of the Delegated Regulation provides an exemption from the mandatory clearing obligation for those Covered IRDs that are concluded with covered bond issuers or with cover pools for covered bonds, which satisfy all of the following conditions:

- they are used only to hedge the interest rate or currency mismatches of the cover pool in relation with the covered bond;
- they are registered or recorded in the cover pool of the covered bond in accordance with national covered bond legislation;
- they are not terminated in case of resolution or insolvency of the covered bond issuer or the cover pool;
- the counterparty to the OTC derivative concluded with covered bond issuers or with cover pools for covered bonds ranks at least pari-passu with the covered bond holders, except where such counterparty is the defaulting or the affected party, or waives the pari-passu rank; and
- the covered bond meets the requirements of Article 129 of Regulation (EU) No 575/2013 and is subject to a regulatory collateralisation requirement of at least 102 percent.

Articles 2 and 3 of the Delegated Regulation specify which types of counterparties are subject to the mandatory clearing obligation and the applicable timing. These four categories and applicable compliance dates are:

- Category 1 – clearing members of a recognized or authorized CCP of at least one of the classes of Covered IRDs—six months after the Delegated Regulation is entered into force;

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- Category 2 – financial counterparties (FCs) (as defined under EMIR) and alternative investment funds (AIFs) (as defined under the Alternative Investment Fund Managers Directive) that are non-financial counterparties (NFCs), which belong to a group whose aggregate month-end average of outstanding gross notional amount of non-centrally cleared derivatives is above EUR 8 billion (Threshold)—12 months after the Delegated Regulation is entered into force;
- Category 3 – FCs and AIFs whose aggregate month-end average of outstanding gross notional amount of non-centrally cleared derivatives is below the EUR 8 billion Threshold—18 months after the Delegated Regulation is entered into force; and
- Category 4 – all remaining NFCs—three years after the Delegated Regulation is entered into force.

For purposes of determining the Threshold, all of a group's non-centrally cleared derivatives, including foreign exchange forwards, swaps and currency swaps, must be included. When an applicable counterparty is either an AIF or an undertaking for collective investment in transferable securities as defined in Article 1(2) of Directive 2009/65/EC (UCITS), the Threshold applies individually at the fund level. To calculate the Threshold, the EC has proposed a three-month period following the publication of the Delegated Regulation in the *Official Journal of the European Union*—excluding the month of the publication. Additionally, when a Covered IRD is transacted between counterparties in different categories, the date from which the clearing obligation takes effect for that contract will be the later date.

The Delegated Regulation, subject to certain conditions, provides time-limited relief for the clearing of intra-group Covered IRDs, which is dependent upon whether or not an equivalence decision has been adopted for the third country pursuant to EMIR (Equivalence Decision) in which the EU group counterparty is established. If an Equivalence Decision has not been determined, clearing will be required three years after the Delegated Regulation is entered into force. If an Equivalence Decision has been determined, clearing will be required from the later of 60 days after an Equivalence Decision has been made and the applicable timing for Categories 1, 2 and 3.

EMIR requires any OTC derivative contract concluded between the first authorization of a CCP under EMIR, which took place on March 18, 2012, and the later date on which the clearing obligation actually takes effect to also be subject to mandatory clearing unless such derivative has a remaining maturity lower than the minimum maturities as specified in the applicable regulatory technical standards (the frontloading requirement). The frontloading requirement only applies to Category 1 and Category 2 entities. Article 4 of the Delegated Regulation specifies such minimum maturities in accordance with whether a counterparty is an FC or NFC, which Category such counterparty falls within and whether the Covered IRD is an IRS, basis swap, FRA or OIS. The minimum maturities range from six months to 50 years. The frontloading period is proposed to commence two months after the Delegated Regulation is entered into force for Category 1 entities, and five months after the Delegated Regulation is entered into force for Category 2 entities.

Before the Delegated Regulation can be entered into force, it must be reviewed by the European Parliament and the European Council, which can take up to three months. Once the Delegated Regulation is published in the *Official Journal*, it will enter into force 20 days after such publication. Because the review period for the European Parliament will not commence until after the summer recess has ended in September 2015, the earliest the Draft Regulation could be entered into force would be October 2015, with mandatory clearing of the Covered IRDs commencing in April 2016 for Category 1 counterparties; October 2016 for Category 2 counterparties; April 2017 for Category 3 counterparties; and October 2018 for Category 4 counterparties.

The Delegated Regulation has been issued following a process that commenced on July 11, 2014, with the publication by the European Securities and Markets Authority (ESMA) of a consultation paper proposing mandatory clearing for certain IRDs and draft regulatory technical standards (Draft RTS). On October 1, 2014, ESMA submitted to the EC its final report on the clearing obligations for IRDs and Draft RTS, which had been amended to take into account certain of the comments received by ESMA. In December 2014, the EC informed ESMA that it intended to adopt the Draft RTS subject to certain amendments.

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