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ESMA's Consultation Paper on the Clearing Obligation under EMIR (no. 2)

Dear Sirs,

We welcome the publication of ESMA's Consultation Paper on the *Clearing Obligation under EMIR (no.2)* (the "***Consultation Paper***" or "***CP***") and we appreciate the opportunity to provide you with our comments.

Markit is a provider of financial information services to the global financial markets, offering independent data, valuations, risk analytics for internal capital models, and related services across regions, asset classes and financial instruments. Our products and services are used by numerous market participants to reduce risk, increase transparency, and improve the operational efficiency in their financial markets activities.[1]

Markit has been actively and constructively engaged in the debate about regulatory reform in financial markets, including topics such as the implementation of the G20 commitments for OTC derivatives and the design of a regulatory regime for benchmarks. Over the past years, we have submitted more than 100 comment letters to regulatory authorities around the world and have participated in numerous roundtables. We also regularly provide the relevant authorities with our insights on current market practice, for example, in relation to valuation methodologies, the provision of scenario analysis, or the use of reliable and secure means to provide daily mid-market marks. We have also advised regulatory authorities on appropriate approaches to enabling a timely and cost-effective implementation of newly established regulatory requirements, for example through the use of multi-layered phase-in or by providing market participants with a choice of means for satisfying regulatory requirements.

Comments

The most relevant of Markit's services and products in the context of this Consultation Paper are our credit default swap ("***CDS***") indices, iTraxx and CDX, as well as our derivatives processing platforms:

- Markit is a provider of various index families across regions and asset classes, including bonds, CDS and loans. We administer and publish the composition of all Markit indices and we also calculate the levels of the Markit iBoxx suite of bond indices and other third-party indices. Most relevant in the context of this CP are the Markit CDS indices in the iTraxx family, some of which ESMA proposed the clearing obligation would apply to.

[1] Please see www.markit.com for further information.

- Our derivatives processing platforms facilitate the confirmation, matching and processing of OTC derivatives across regions and asset classes, including interest rate, credit, equity and foreign exchange, and provide universal middleware connectivity for downstream processing such as clearing and reporting. Specifically, the MarkitSERV[2] platforms a) facilitate the agreement[3] between parties on the details of the transactions that they have entered into, b) provide them with connectivity to CCPs,[4] trading venues ("***TVs***") and inter-dealer brokers, trade repositories, and the whole range of counterparties, including buyside and sellside, and c) report the relevant transaction and counterparty details to trade repositories under newly established regulatory requirements.[5,6]

Based on our experience in supporting market participants with the introduction of clearing requirements for CDS indices in other jurisdictions, please find our responses to ESMA's questions below.

Question 1: Do you have any comment on the clearing obligation procedure described in Section 1?

Consistent with ESMA's statements in its Consultation Paper on the Clearing Obligation for Interest Rate Swaps ("***CP1***"),[7] we believe that a process to remove a class of derivatives from the clearing obligation should be available and ESMA should be empowered to implement such decision in a timely manner in response to, for example, exceptional market conditions. ESMA should note that a similar process has been established in other major jurisdictions.[8]

We generally believe that the decision to remove a specific class of OTC credit derivative from the clearing obligation should not depend on whether a CCP still clears the product, also because CCPs might have little incentive to remove a product once it has been listed. Instead such determination should be based on the extent to which the factors relevant for the clearing determination[9] still apply at that time as determined by ESMA, including the actual liquidity in that product. We therefore welcome ESMA's plan to raise the issue of the removal of a clearing obligation and the level of urgency potentially attached to it during the 2015 review of EMIR.[10]

Question 2: Do you consider that the proposed structure for the untranched index CDS classes enables counterparties to identify which contracts are subject to the clearing obligation as well as allows international convergence? Please explain.

[2] MarkitSERV, a wholly owned subsidiary of Markit Group Limited, provides a single gateway for OTC derivatives trade processing. Please see www.markitserv.com for additional information.
[3] Depending on the asset class and the type of execution, different methods will be used to achieve such "agreement", including affirmation/confirmation or matching.
[4] Our processing platforms are currently connected to, or are planning to connect to, more than 10 CCPs around the globe and in various asset classes.
[5] For the reporting of derivatives transactions to Trade Repositories, the MarkitSERV platforms are now live in Europe, the United States, Japan, Hong Kong, Australia, and Singapore.
[6] Such services that are offered also by various other providers are widely used by participants in the global OTC derivatives markets today and are recognised as tools to increase efficiency, reduce cost, and secure legal certainty. With globally over 1,500 firms using the various MarkitSERV platforms that process, on average, 80,000 OTC derivative transaction processing events every day, our legal, operational, and technological infrastructure plays an important role in supporting the OTC derivatives markets in Europe, North America, and the Asia-Pacific region.
[7] "However, it may be more problematic that, in case a clearing obligation needs to be removed or suspended because e.g. the level of liquidity on a specific set of contracts has dried out, ESMA does not have another possibility than going through the procedure of modification of the RTS, which is the same as the procedure of issuance of a new RTS." ESMA Consultation Paper on the Clearing Obligation under EMIR (no. 1). July 11, 2014. Par. 66.
[8] Specifically, the Commodity Exchange Act ("CEA") section 2(h)(3) provides for a process to "stay" and then terminate the clearing requirement for a given swap or class of swaps. A counterparty to a swap or the Commission itself may initiate this process. The process would involve reviewing the relevant swaps under the five factors the CFTC uses to determine whether the clearing requirement is appropriate, e.g., existence of significant notional exposures, trading liquidity, etc. CEA section 2(h)(2)(D)(ii). The CFTC has 90 days to determine whether the clearing requirement should be terminated, conditionally or unconditionally, for the relevant swaps. CEA section 2(h)(3)(C).
[9] CP Chapter 3.2
[10] "Therefore, during the 2015 review of EMIR foreseen by Article 85(1), ESMA will flag that the clearing obligation process may need to be reviewed to take into account the fact that the classes that had been deemed subject to the clearing obligation in the past may no longer satisfy the necessary conditions in the future, and that the time of the procedure to amend the RTS is unsuited to the level of urgency that such a modification may require." ESMA Consultation Paper on the Clearing Obligation under EMIR (no. 1). July 11, 2014. ("CP1") Par. 67.

In the CP, ESMA performs an analysis of the relevant indicators for various European CDS indices that are administered by Markit. Specifically, it differentiates between the indices iTraxx Europe, iTraxx Crossover, iTraxx High Volatility, and iTraxx Senior Financials[11] and highlights that the relevant further characteristics that ought to be considered when identifying CDS indices for the clearing obligation are the maturity and the series of the CDS index.

We generally agree with ESMA's analysis and with the specific CDS indices it identified as appropriate candidates for the clearing obligation. We also welcome that ESMA's proposal would be generally consistent with the clearing obligations for credit derivatives that have been established in other jurisdictions.[12]

As a provider of processing and connectivity services for OTC credit derivatives we stand ready to support the straight-through processing of the categories of CDS indices that ESMA has listed to be subject to mandatory clearing. Specifically, we are connected to the CCPs that clear OTC credit derivatives and we have established the controls necessary to allow for mandatory clearing in this asset class. That said, we urge ESMA to ensure that, in all of its future clearing obligation determinations, it appropriately considers not only the standardization of operational procedures, including the fact whether a category of derivative can be electronically processed, but also the actual level of preparedness of middleware providers for the processing of such transactions.

CDS documentation standards

However, we are concerned that, in its analysis, ESMA might not have considered the major changes to the documentation of credit derivatives that are scheduled to occur later this month. Specifically, the introduction of the 2014 ISDA Credit Derivatives definitions[13] will establish new documentation standards for CDS from September 20, 2014 which will also impact the documentation of the CDS indices that are referenced in the CP.

On that basis, all series of the Markit iTraxx indices that are launched on or after 20 September 2014 ("***new CDS index series***") will trade with the 2014 CDS Definitions as standard. For CDS index series that were launched prior to September 2014 ("***legacy CDS index series***") counterparties can, by signing up to an ISDA protocol (the "***Protocol***"),[14] easily change their documentation to the new standards with the index basket following the convention of the underlying constituent single names. Depending on the nature of the index adherence to the Protocol will result in documentation for the entire index basket moving to the 2014 Definitions, for the entire basket remaining on the ISDA 2003 Definitions,[15] or in a "mixed basket.[16] However, in all three instances there will be one "standard" index contract for each legacy index transaction where both counterparties signed the protocol.

[11] CP Par. 16
[12] Specifically, we note that the CDS indices that ESMA proposed to be subject to the clearing obligation in Europe are a subset of the ones that are already cleared on a mandatory basis under rules established by the CFTC in the United States. *See* "Clearing Requirement Determination Under Section 2(h) of the CEA." 77 Fed. Reg. 74284. (December 13, 2012).
[13] *See* http://www2.isda.org/attachment/Njg4NQ==/20140821_ISDA%202014%20Credit%20Definitions%20FAQ_G_O%20(2).pdf
[14] *See* http://www2.isda.org/asset-classes/credit-derivatives/2014-isda-credit-derivatives-definitions/credit-derivatives-definitions-protocol-and-related-documents/.
[15] For example SovX Western Europe.
[16] In instances where only some constituents of the CDS index basket remain on the 2003 Definitions and others switch to the 2014 Definitions.

Table 1: Documentation standards for major iTraxx CDS indices

	Legacy CDS index series[17]		New CDS index series[18]
	Old	**New[19]**	
iTraxx Europe	2003	Mixed[20]	2014
iTraxx Crossover	2003	Mixed[21]	2014
iTraxx HiVol	2003	2014[22]	N/A[23]
iTraxx Senior Financials	2003	Mixed	2014

However, ESMA should note that counterparties to transactions in legacy index CDS are not obliged to sign the ISDA protocol and that, for a transaction to move to the new documentation standard, *both* counterparties will need to adhere to the Protocol. It is hence likely that the legacy series of the iTraxx CDS indices exist and trade in two different versions, namely with the "old" and with the "new" documentation standard respectively. Whilst market participants are free to trade different variations other than the standard contracts as set out above, these transactions would be viewed as "bespoke" by the industry. Importantly, CCPs that centrally clear the relevant iTraxx indices today have indicated[24] that they will continue to clear legacy series of the iTraxx CDS indices as long as the transaction is governed by the new documentation standard. However, CCPs will not offer clearing for any new transactions in legacy indices where counterparties did not to agree to the new documentation standard, i.e. where they enter into a "bespoke" transaction.

On that basis, we recommend ESMA reflect the aspect "documentation standard" as an additional factor in its clearing obligation determination. Specifically, any transaction in the relevant series and maturities[25] of iTraxx Europe or iTraxx Crossover should *not* be required to be cleared if it is "bespoke", i.e. not governed by the new CDS documentation standard.

Question 3: In view of the criteria set in Article 5(4) of EMIR, do you consider that this set of classes addresses appropriately the systemic risk associated to credit OTC derivatives?

Given the systemic risk associated to single name CDS, would you argue that they should be a priority for the first determination as well? Please include relevant data or information where applicable.

We generally agree with ESMA's analysis of the three specified criteria[26] and the conclusions it reaches in relation to those product categories of credit derivatives that should be cleared. Based on our involvement in processing credit derivatives transactions that are submitted to various CCPs for central clearing we believe that ESMA's determination captures the majority of the volume of transactions in credit derivatives today and would hence appropriately address systemic risk.

We further agree with ESMA's view that single name CDS "are not a priority for the first [clearing] determination."[27] We believe that, given the limited liquidity, the fairly recent introduction of clearing for some of

[17] Launched before September 20, 2014
[18] Launched on or after September 20, 2014
[19] The change from "old" to "new" documentation standard for existing transactions will occur on the basis of counterparties signing up to the ISDA Protocol.
[20] For indices that contain exposures to corporates, banks, and insurance companies the new documentation standard for legacy index series will be a mixture of the 2014 and the 2003 CDS Definitions.
[21] For Series 7 to 21, whilst Series 1 to 6 will be 2014.
[22] For Series 5 to 20, whilst Series 1 to 4 will be Mixed.
[23] iTraxx HiVol will not be rolled into a new series in September 2014.
[24] Please see http://www.lchclearnet.com/documents/731485/762470/isda+2014+definitions+paper_final+format+v1.3_1.pdf/83b41645-2a84-45b3-a070-f32810a14579 and https://www.theice.com/publicdocs/futures/2014_ISDA_Definitions.pdf
[25] I.e. from Series 11 onward and with a 5 year maturity.
[26] Namely the level of standardisation, the liquidity, and the availability of reliable pricing data, for the clearing determination for OTC credit derivatives
[27] CP par. 69

the more liquid single-name CDS, and the unique risk management challenges that are related to clearing some of them it is appropriate for ESMA to reach such conclusion based on analysis of the relevant factors.[28]

Question 6: Do you consider that the proposed dates of application ensure a smooth implementation of the clearing obligation? Please explain why and possible alternatives.

ESMA proposed a phase-in schedule for the clearing obligation consisting of three phases, namely 6 months, 18 months and 3 years after entry into force of the RTS for Category 1, 2 and 3 counterparties respectively.[29]

We believe that the phased-in implementation of the clearing obligation for OTC credit derivatives as proposed by ESMA is generally reasonable. This is particularly true for Category 1 counterparties, i.e. those that are Clearing Members, as they will already centrally clear a substantial amount of their transactions in credit derivatives today. We also believe that providing Category 2 counterparties with a further 1 year phase-in is generally reasonable. However, ESMA should be cognisant of the fact that a substantial number of counterparties that are active in OTC credit derivatives today are not yet set up to centrally clear these transactions resulting in a need for a large number of firms to "onboard" ahead of a clearing obligation applying to them. Despite the proposed phase-in there is hence a significant risk of a "bottleneck situation"[30] in relation to onboarding. As experience in other jurisdictions has shown,[31] many of these firms will be naturally inclined to delay their onboarding until close to the compliance date. We believe that ESMA and National Competent Authorities could reduce this risk by ensuring that Category 2 counterparties in particular prepare for central clearing well ahead of time and/or encourage them to start centrally clearing before the actual compliance dates.

ESMA should also be aware of the operational challenges that will be created by the ongoing need for Category 3 counterparties to inform their counterparties if they have exceeded the clearing threshold and must then clear. Experience with similar requirements in other jurisdictions has shown that third party platforms can be helpful in addressing such challenges in relation to gathering the relevant information from firms and making it available to their counterparties.[32]

Implementation timing

As a general matter, we urge ESMA to be cognisant of a) the time during the year and b) the day of the week when the clearing obligation would start for the different categories of counterparties. Specifically, we recommend that:

- The start date for the clearing obligation should not fall onto the end of the year. This is because at this time of the year IT-related challenges such as general "code freezes" will make implementation much more challenging for counterparties and providers of market infrastructure alike.

- The implementation of the clearing requirement would best fall on a Monday rather than on a weekday. This is because such timing will allow CCPs, counterparties and infrastructure providers to perform final testing over the weekend when the markets are closed and there is no need to process "live" transactions.

[28] CP Pars. 65-69.
[29] CP Chapter 4.3
[30] ESMA stated that it the phase-in should be designed to "avoid[ing] "bottleneck" situations to the extent possible". CP par 133.
[31] Our view is based on the implementation and onboarding challenges associated with the start of the clearing obligation for "CAT 2" firms in the United States. Specifically, more than 400 firms requested to be onboarded to our platforms within the last couple of weeks before the compliance date.
[32] For example, Markit Counterparty Manager is a highly secure environment for trading counterparties to manage and share documentation, make regulatory representations and validate compliance with evolving business conduct rules and KYC/AML obligations. Markit and ISDA offer ISDA Amend as a joint service. With ISDA Amend, swap dealers and their customers can classify their trading entities as well as amend and share multiple ISDA master agreements using a single online tool. This helps customers ensure compliance with new requirements related to Dodd Frank and EMIR.

Indirect client clearing

We note that ESMA mentions "indirect client clearing" in the CP[33] without being more specific about the current status of this offering. We agree with ESMA's conclusion in CP1 that an offering for indirect clearing is currently "only at a very early stage"[34] and market infrastructure to support the workflows for such transactions that are cleared indirectly is currently not available. Based on our experience, we believe that a period of 3 years might not suffice to establish the relevant infrastructure to support indirect clearing. To avoid creating any unnecessary operational risk we therefore recommend for ESMA to retain the ability to extend the deadline for indirect clearing depending on the status of the infrastructure at that time.

The relevance of connectivity to CCPs

We believe that ESMA's proposed classes of OTC credit derivatives that are suitable for clearing and phase-in of the clearing obligation for three broad categories of counterparties are generally appropriate and would provide the right conditions for a smooth implementation of the clearing obligation in Europe.

That said, we note that ESMA acknowledges the relevance of confirmation/processing and connectivity platforms in several sections of the CP:

- As part of its analysis of the standardisation of operational processes for OTC credit derivatives[35] ESMA found that the level of electronic trade processing "stood consistently at 98% in both 2010 and 2012",[36] that affirmation services were used in addition, and that the two CCPs "are connected to these market utilities in order to receive trades from counterparties, pass on clearing confirmation messages back or handle credit events".[37] ESMA thus concluded that the factor of "standardisation of operational processes" is satisfied.

- When analysing the level of preparedness of different categories of counterparties and proposing a phased-in implementation for the clearing obligation for those ESMA refers to its analysis in relation to interest rate derivatives as contained in CP1.[38] In CP1 ESMA repeatedly argues that certain types of market participants should not be included in Category 1 given that "they have no direct connection" to the relevant CCPs.[39]

These examples highlight the importance that ESMA assigns to market participants' ability to use neutral connectivity mechanisms with CCPs for the introduction of the clearing obligation. Indeed, platform-neutral connectors such as MarkitSERV are also widely recognized by market participants as tools that enhance the efficiency, reduce cost and risk of a horizontal model in the OTC derivatives markets and foster competition on the levels of execution and clearing.[40] Importantly in the context of this CP, ESMA should note that experience in other jurisdictions has shown that market participants' ability to *continue* to rely on such platform-neutral

[33] CP Par. 98 and Table 18
[34] CP1 Par. 214, also Par. 156: "indirect client clearing activity remains undeveloped".
[35] Criteria 1(b): Standardisation of the operational processes. CP Pars. 41-46.
[36] CP Par. 42
[37] CP Par. 46
[38] Chapter 4.3 Determination of the dates from which the clearing obligation takes effect. CP p.52.
[39] See, for example, CP Par. 169 and 180. Also Par. 210 where ESMA points out that within Category 1, some participants "will need to establish connections with other CCPs for some Class+, or with CCPs to which they are already connected but in different asset classes".
[40] As we stated in our response to ESMA's MiFID II/ MiFIR Discussion Paper, available at we are generally supportive of the access requirements introduced in Articles 35 to 37 of MiFIR as means to increase competition in European financial markets. Recital 40 of MiFIR asserts that "access to licences is critical to facilitate access between trading venues and CCPs under Articles 35 and 36 of MiFIR as otherwise licensing arrangements could still prevent access between trading venues and CCPs that they have requested access to. The removal of barriers and discriminatory practices is intended to increase competition for clearing and trading of financial instruments in order to lower investment and borrowing costs, eliminate inefficiencies and foster innovation in Union markets". *See* http://www.esma.europa.eu/system/files/esma_mifid2_dp_markit_replyform.doc.

connectivity services to connect to CCPs in a timely and efficient manner represents a key condition required to achieve the desired smooth implementation of the clearing obligation.

To enable a smooth implementation of the clearing obligation for CDS Indices in Europe and to ensure that ESMA's analysis of the criteria underlying the clearing determination remains valid market participants must be able to continue to use established connectivity to CCPs once the clearing obligation is implemented. However, in this context, we note that neither Article 35 of MiFIR nor ESMA's related DP acknowledged the vital role of third party connectivity providers with the discussion evolving solely around "access of Trading Venues to CCPs". We believe that failure to recognize the role of third party connectivity providers in ESMA's implementing measures would increase the risk of CCPs abusing their market power by potentially refusing access to third parties that want connect to them on behalf of counterparties and/or TVs. This risk will be particularly pronounced where CCPs operate their own processing platforms as they could, by requiring TVs and/or counterparties to only use those for establishing connectivity to them, directly foster the development of their own vertical silo or in asset classes where central clearing is only provided by a small number of CCPs, or even just one. By undermining market participants' level of preparedness for the introduction of the clearing obligation such behaviour would also question the validity of ESMA's analysis of the criteria underlying the clearing determination, in addition to standing in direct conflict with the spirit of Article 35 of MiFIR.

ESMA should note that under the United States' Dodd-Frank Act some CCPs have interpreted "open access" requirements to encompass third party connectivity providers[41] while others explicitly allow third party connectivity providers open access under their rules.[42] To prevent the occurrence of competition-restricting practices in this respect in Europe, we recommend that ESMA reflect established market practices and workflows also in its various implementing measures. Specifically, ESMA should clarify that the requirement for CCPs to provide open, non-discriminatory access to TVs equally applies for the provision of access to *third party providers that act (and establish connectivity) on behalf of TVs or counterparties*. In addition, in asset classes where the number of CCPs providing central clearing is small or just one, we encourage ESMA to reflect the elevated risks that this might create for the implementation process in its clearing determination.[43]

We further believe that ESMA should consider establishing procedural safeguards to ensure non-discriminatory access to clearing for all classes of counterparties, including those using third-party connectivity providers. In this context, ESMA should clarify, for example, that CCPs should submit new rules and rule amendments relevant in relation to access to their competent authority for their review.[44, 45]

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[41] "ICE Clear Credit shall ensure that, consistent with the requirements of [Commodity Exchange Act] Section 2(h)(1)(B) and Securities Exchange Act Section 3C(a)(2), there shall be open access to the clearing system operated by ICE Clear Credit pursuant to these Rules for all execution venues (including, without limitation, designated contract markets, national securities exchanges, swap execution facilities and security-based swap execution facilities) and trade processing platforms…" ICC Rulebook, Rule 314, available at https://www.theice.com/publicdocs/clear_credit/ICE_Clear_Credit_Rules.pdf (last revised Nov. 18, 2013). Commodity Exchange Act section 2(h)(1)(B)(ii)(B)'s (as amended by Dodd–Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") section 723) open access requirement states that DCOs must "provide for non-discriminatory clearing of a swap (but not a contract of sale of a commodity for future delivery or option on such contract) executed bilaterally or on or through the rules of an unaffiliated designated contract market or swap execution facility."

[42] "See CME Rulebook Rule 8H17, available at http://www.cmegroup.com/rulebook/CME/I/8H/8H.pdf ("CME shall provide open access to its CDS Contract clearing services for any execution venue or trade processing or confirmation service that desires to facilitate the submission of CDS Product transactions to the Clearing House for clearing, subject to the Clearing House's normal operational requirements applied to all such third-party services[.]"). See also LCH Rulebook, available at http://www.lchclearnet.com/Images/Voluntary%20Submission%20of%20Rulebook%20and%20Supporting%20Materials_tcm6-62205.pdf (Definition of "Approved Trade Source System" as "a system or facility, such as an exchange, a clearing house, a swap execution facility, a designated contract market or other similar venue, approved by the Clearing House for executing Transactions and/or presenting such Transactions to the Clearing House."). LCH Rule 2A.3.3 provides that "Currently the Approved Trade Source Systems designated by the Clearing House for SwapClear are MarkitWire, Bloomberg and Tradeweb. Where the Clearing House approves additional Approved Trade Source Systems, it will notify Clearing Members via a member circular."

[43] We note ESMA's view that, even if "the existence of a single CCP to clear the class does not lead to an automatic exclusion of the that class from the scope of the clearing obligation determination" it "should not be understood as meaning that the number of CCPs clearing the same class is irrelevant for the purpose of determining the classes." See CP Par. 89. We believe that introducing a clearing obligation in an asset class with only a small number of CCPs creates significant systemic risk issues and the number of CCPs should hence play an important role in ESMA's clearing determination.

[44] Regulation (EU) No 648/2012 at (51)

Question 7: Do you consider that the proposed approach on frontloading ensures that the uncertainty related to this requirement is sufficiently mitigated, while allowing a meaningful set of contracts to be captured? Please explain why and possible alternatives compatible with EMIR.

We support ESMA's general approach to frontloading, including the differentiation between Period A and B and the setting of the backloading minimum remaining maturity for period A to "ensure that no contract is subject to frontloading".[46] However, we believe that ESMA will need to make several changes to its proposals in order to ensure its objectives are achieved.

Specifically, for credit derivative contracts that are concluded in Period A, ESMA proposed to set the minimum remaining maturity at 4 years and 6 months, based on its assumption that the maximum maturity of the contracts falling under the European untranched index CDS class is "5 years".[47] However, ESMA should be aware of the fact that, when a new series of the iTraxx indices is launched in March or September,[48] it will carry a maturity of 5 years *and 3 months*.[49] To achieve its objective that "the minimum remaining maturity is set at a level which ensures that no contract is subject to frontloading" ESMA should therefore set the cutoff maturity at 4 years and 9 months, i.e. 5 years and 3 months minus 6 months.

For transactions in the relevant CDS indices that are concluded in Period B, ESMA proposed a 6 month minimum maturity to determine which CDS index transactions must be frontloaded.[50] We believe that it would be more appropriate for ESMA to use a longer period. This is because we believe that the cost created by requiring the central clearing of index CDS transactions with such short remaining maturity is likely to exceed the benefits from a systemic risk perspective. We therefore recommend for ESMA to set a minimum maturity of at least 12 months. This would also be consistent with the feedback that ESMA received in response to its discussion paper.[51]

Finally, ESMA should consider industry concerns about the legal status of derivatives transactions that are subject to the frontloading requirement and the potential need to flag them as subject to such requirement as part of the legal confirmation process to ensure that parties to the transaction are bound to suitable language regarding the requirement to frontload or terminate the transaction at a later stage. When considering the timing of frontloading ESMA should be cognisant of the fact that discussions are not at an advanced stage.[52] Also, even once any decision had been taken to add a frontloading flag to the confirmation process, the relevant middleware providers such as MarkitSERV would require a sufficient amount of time to implement it.

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[45] Moreover, the relevant new policy changes should be required to be subjected to competent authority review, i.e. any change in policy, practice, or interpretation affecting in any material respect the CCP's operations should be deemed to be a proposed rule change. See e.g., SEC Rule 19b-4(c) (17 CFR 240.9b-4), available at http://www.law.cornell.edu/cfr/text/17/240.19b-4.

[46] CP Par. 117.

[47] CP Par. 118

[48] This routinely happens twice a year, in March and in September. See http://www.markit.com/en/products/data/indices/credit-and-loan-indices/index-annexes/annexes.page? for details.

[49] This slightly longer maturity is used to ensure that, during their 6 months lifetime as on-the-run series, these indices are always fairly close to the 5 year maturity point which is the most liquid.

[50] CP Par. 121.

[51] "Among those few responses, the median answer was found to be 12 months". CP Par. 248

[52] Specifically, ISDA had suggested language to be added to the confirmations to address situations where a counterparty would not clear the transaction despite the fact that it was traded as "to be frontloaded". However, this effort was discontinued sometime last year, also because concern about its relevance as part of the legal confirmation.

We hope that our above comments are helpful to ESMA. We would be more than happy to elaborate or further discuss any of the points addressed above in more detail. In the event you may have any questions, please do not hesitate to contact us.

Yours sincerely,

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