European Commission - Press release

Financial stability: new Commission rules on central clearing for interest rate derivatives

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The European Commission has today adopted new rules that make it mandatory for certain over-the-counter (OTC) interest rate derivative contracts to be cleared through central counterparties. Mandatory central clearing is a vital part of the response to the financial crisis; it follows commitments made by world leaders at the G-20 Pittsburgh Summit in 2009, to improve transparency and mitigate risks.

Jonathan Hill, EU Commissioner for Financial Stability, Financial Services and Capital Markets Union, said: *"Today we take a significant step to implement our G20 commitments, strengthen financial stability and boost market confidence. This is also part of our move towards markets that are fair, open and transparent*."

Today's decision takes the form of a Delegated Regulation—the first such to implement the clearing obligation under the European Market Infrastructure Regulation ('EMIR'). It 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 (i.e. the nominal or face amount that is used to calculate payments made on the derivative).

These contracts are:

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

Recent statistics show that interest rate derivatives constitute the largest segment of all OTC derivative products, making up around 80% of all global derivatives as of December 2014. The estimated daily turnover in the EU of OTC interest rate derivative contracts denominated in G4 currencies was over €1.5 trillion as of April 2013.

The clearing obligations will enter into force subject to scrutiny by the European Parliament and Council of the EU and will be phased in over three years to allow additional time for smaller market participants to begin complying.

Background

A "central counterparty" (CCP) clears a transaction between two parties, helping to manage the risk that can arise if one party defaults on its payments. By making it necessary for some classes of interest rate derivative contracts, or 'interest rate swaps', to be cleared through CCPs, financial markets become more stable and less risky. This creates an environment more conducive to investment and economic growth in the EU.

In 2009, G20 leaders agreed that standardised OTC derivative contracts should be centrally cleared through CCPs.

The EU co-legislators enshrined these commitments in Regulation (EU) No 648/2012 on OTC Derivatives, Central Counterparties and Trade Repositories (EMIR). According to Article 5 of EMIR, the European Commission, on the basis of a proposal from the European Securities Markets Authority (ESMA), should determine the types of OTC contracts that should be subject to mandatory clearing by a central counterparty (CCP). On the basis of this mandate, the European Commission is adopting a delegated Regulation introducing a clearing obligation for OTC interest rate swaps.

EMIR mandates the European Securities and Markets Authority (ESMA) to review clearing eligible contracts and, with the overarching aim of reducing systemic risk, to propose clearing requirements for products meeting certain criteria.

This is the first clearing obligation that has been proposed by ESMA and it is expected that ESMA will propose obligations for other types of OTC derivative contracts in the near future.

While mandatory clearance through CCPs brings many benefits, it also increases the systemic importance of those CCPs within the financial system, and the consequences if a CCP were to fail. The Commission 2015 Work Programme includes a commitment to legislate for a European framework for the recovery and resolution of CCPs.

For more information on the regulation of derivatives: http://ec.europa.eu/finance/financial-markets/derivatives/index_en.htm

G20 Pittsburgh statement:http://ec.europa.eu/archives/commission_2010-2014/president/pdf/statement_20090826_en_2.pdf

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