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European Securities and Markets Authority
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By online submission: https://www.esma.europa.eu/

2 September 2021

RE: Consultation Paper on the Clearing and Derivative Trading Obligations in View of the Benchmark Transition

Dear Sir or Madam,

The Alternative Investment Management Association[1] ("AIMA") welcomes the opportunity to respond to the European Securities and Markets Authority ("ESMA") regarding its consultation on modifications to the Derivatives Clearing Obligation ("DCO") and Derivatives Trading Obligation ("DTO") to reflect interest rate benchmark reform (the "consultation")[2].

AIMA supports the objectives that underlie the clearing and trading obligations for Over-The-Counter ("OTC") derivatives under the European Market Infrastructure Regulation ("EMIR") and Markets in Financial Instruments Regulation ("MiFIR"), respectively. We welcome moves to facilitate the access of buy-side market participants to central clearing and greater use of regulated trading venues. As such, we strongly support ESMA's proposals to modify the scope of the DCO and DTO, in light of interest rate benchmark reform.

[1] AIMA is the global representative of the alternative investment industry, with more than 1,900 corporate members in over 60 countries. AIMA's fund manager members collectively manage more than $2 trillion in assets. AIMA draws upon the expertise and diversity of its membership to provide leadership in industry initiatives such as advocacy, policy and regulatory engagement, educational programs and sound practice guides. AIMA works to raise media and public awareness of the value of the industry. AIMA set up the Alternative Credit Council ("ACC") to help firms focused in the private credit and direct lending space. The ACC currently represents over 100 members that manage $350 billion of private credit assets globally. AIMA is committed to developing skills and education standards and is a co-founder of the Chartered Alternative Investment Analyst designation (CAIA) – the first and only specialized educational standard for alternative investment specialists. AIMA is governed by its Council (Board of Directors).
[2] Available at https://www.esma.europa.eu/press-news/consultations/public-consultation-clearing-and-derivative-trading-obligations-in-view

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We believe that in removing from the DCO and DTO contracts which reference benchmarks that are being discontinued, the obligations will remain relevant as the volume of trade and liquidity in these contracts decreases. Similarly, we believe that including contracts which reference risk-free rates ("RFRs") removes the possibility that a large proportion of OTC derivatives activity will no longer be cleared centrally and traded on regulated trading venues.

While AIMA is pleased with ESMA's policy choices for its proposed modifications, we do not find ESMA's data and liquidity assessment to be satisfactory, particularly in respect of where the DTO should apply. We believe that ESMA should focus on daily/ongoing trading activity, for example. We also note that ESMA applies a different approach to evaluating Overnight Indexed Swaps ("OIS") referencing the Sterling Overnight Index Average ("SONIA") and the Euro short-term rate ("€STR") as compared to USD London Interbank Offered Rate ("LIBOR") and OIS referencing Secured Overnight Financing Rate ("SOFR"). In its assessment of trading activity for OIS referencing SONIA and €STR, ESMA looks only at current liquidity. However, in assessing trading activity for USD LIBOR and OIS referencing SOFR, ESMA takes a broader stance and considers the "expected situation by end of this year". We believe that ESMA should take a forward-looking approach to all classes of derivatives impacted or likely to be impacted by interest rate benchmark reform.

We have provided detailed comments on a number of the consultation questions in an annex to this letter.

In summary, we:

- Support proposals to remove the contract type referencing GBP from the DCO and replace it with the contract type referencing SONIA in the OIS class but with an amended original maturity range of "7 days to 50 years".

- Encourage ESMA to amend also the maturity range for the contract type referencing €STR in the OIS class to ""7 days to 50 years".

- Encourage ESMA to include OIS refencing SOFR within the scope of the DCO before end-2021.

- Believe that the dates on which the modifications to the DCO come into force should coincide with key dates associated with the broader RFR transition.

- Believe that OIS referencing SONIA is currently sufficiently liquid to impose a DTO.

- Encourage ESMA to include OIS referencing €STR within the scope of the DTO before end-2021.

- Encourage ESMA to include OIS referencing SOFR within the scope of the DTO before end-2021.

- Believe that Interest Rate Swaps ("IRS") referencing USD LIBOR should continue to be subject to the DCO and DTO until SOFR swaps are brought into scope.

AIMA encourages ESMA to monitor trading and liquidity in all relevant classes of derivatives regularly so that appropriate and timely modifications can be made to the derivatives trading and clearing obligations. A well-calibrated DCO and DTO would help to promote an orderly transition to RFRs while minimising systemic risk and supporting market integrity.

If you would like to discuss any aspect of this submission further, please contact Aniqah Rao (arao@aima.org) and Adam Jacobs-Dean (ajacobs-dean@aima.org).

Yours truly,

/s/ Adam Jacobs-Dean

Adam Jacobs-Dean
Head of Markets, Governance and Innovation
Alternative Investment Management Association

ANNEX

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.**

AIMA broadly agrees with ESMA's proposed classes for inclusion in the DCO. We support aims to ease benchmark transition and keep the level of OTC derivatives activity that is currently covered by the DCO broadly the same once transition is complete.

AIMA welcomes ESMA's proposals to remove the contract type referencing GBP and replace it with the contract type referencing SONIA in the OIS class but with an amended original maturity range of "7 days to 50 years"; to remove the contract type referencing Euro Overnight Index Average ("EONIA"); and to exclude the contract type referencing the Tokyo Overnight Average rate from the DCO until the class holds an appropriate level of liquidity.

However, we encourage ESMA to amend the maturity range for the contract type referencing €STR in the OIS class in the same way as that for OIS referencing SONIA, in order to capture relevant trading volumes during the transition away from EONIA to €STR. With €STR, like SONIA, trading more at long-dated tenors, we believe that ESMA should remove the contract type referencing EONIA from the OIS class and replace it with the contract type in the OIS class referencing €STR but with an amended original maturity range of "7 days to 50 years".

We believe that such an amendment would enable ESMA to satisfy more suitably its requirement under Article 5(4) of EMIR to consider the volume and liquidity of relevant classes of OTC derivatives when developing technical standards and ensure a smooth transition of markets from EONIA to €STR.

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?**

AIMA believes that in no event should IRS referencing USD LIBOR be removed from the DCO until SOFR swaps are brought into scope and a harmonised approach is agreed with the US Commodity Futures Trading Commission's ("CFTC"). We believe that there will be sufficient liquidity to introduce OIS referencing SOFR to the DCO before end-2021.

With, for example, supervisory guidance from US authorities stating that use of USD LIBOR in new contracts should stop by end-2021 and the CFTC's intention to revise clearing mandates for interest rate swaps soon[3], AIMA expects liquidity in OIS referencing SOFR to increase quickly as we near the end of the year.

We encourage ESMA to foster international harmonisation and take a forward-looking approach to modifications to the DCO, with consideration for the length of time required for amendments to take effect.

[3] See Statement of Commissioner Dawn D. Stump before the Market Risk Advisory Committee

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

   AIMA agrees that there is no need to introduce an additional phase-in for changes to the DCO as clearing derivatives referencing the new RFRs is part of a larger preparation to transition to new benchmarks.

   We believe that the dates on which the modifications to the DCO come into force should coincide with key dates associated with broader RFR transition, specifically with the contractual conversion of contracts referencing benchmarks that are soon to be discontinued by central counterparties ("CCPs"). With this activity due to take place on different dates depending on the reference benchmark, we believe that modifications to the scope of the DCO should come into force on the different dates that correspond to the CCP's transition activities.

7. **Do you agree with the proposal to not include OIS referencing €STR, SONIA nor SOFR to the DTO at this point in time? In case you disagree with ESMA's proposal, please justify and support your assessment with qualitative and quantitative data.**

   AIMA does not agree with ESMA's proposal to not include OIS referencing SONIA at this point in time and believes that OIS referencing €STR and SOFR should be included within the scope of the DTO before end-2021.

   As mentioned in our cover letter, AIMA does not find ESMA's data and liquidity analysis to be satisfactory. We do not find ESMA's focus on "notional volume" and for the period "November 2020 to February 2021" to present an accurate reflection of current trading activity. We believe that ESMA should evaluate Markets in Financial Instruments Directive II data and ongoing trading activity, such as the flow of volume on a day-to-day basis, which is particularly important for instruments that trade at short-dated tenors.

   We also believe that ESMA should take a forward-looking approach to all classes of derivatives impacted or likely to be impacted by interest rate benchmark reform and consider the length of time required for amendments to take effect. As markets move to RFRs, we believe that ESMA should consider what could be done to foster liquidity and encourage trading on regulated trading venues.

   Our detailed comments on ESMA's proposals with respect to OIS referencing SONIA, €STR and SOFR can be found below.

   <u>OIS referencing SONIA</u>
   AIMA believes that OIS referencing SONIA as a class of OTC derivatives is currently sufficiently liquid to impose a DTO and believes that it should be included within the scope of the DTO as derivatives referencing GBP LIBOR are removed.

   OIS referencing SONIA will be the appropriate market convention for most GBP LIBOR contracts, particularly those maturing after 2021. SONIA derivatives are traded on a frequent and regular basis by a large number of market participants and benefit from the support of liquidity providers. The Bank of England's Working Group on Sterling Risk-Free Reference Rates' recent June 2021 milestone for standard trading conventions in exchange-traded derivatives to be changed to a SONIA basis and successes such as the change to the interdealer quoting convention for linear sterling swaps in 2020 have supported a substantial move in trading volumes from GBP LIBOR to SONIA, accelerating SONIA as a primary source of liquidity.

<u>OIS referencing €STR</u>

While AIMA agrees that liquidity in OIS referencing €STR is not currently sufficient to include within the scope of the DTO, we believe that ESMA should be forward-looking in its approach to modifying the DTO and include OIS referencing €STR within the scope of the DTO before end-2021.

AIMA believes that liquidity in OIS referencing €STR has been developing and will pick-up quickly in the coming months to a sufficient level as relevant transition deadlines and milestones draw closer.

In particular, we note the upcoming CCP transition from EONIA to €STR in mid-October; the €STR First Initiative, which recommends that interdealer brokers change RFR swap trading conventions from EONIA to €STR from 18 October; and the Cross-Currency Swaps Initiative, which sets 21 September as a common start date to switch quoting conventions in the interdealer market for cross-currency swaps involving non-Euro currencies[4], as milestones which will further develop liquidity in OIS referencing €STR.

<u>OIS referencing SOFR</u>

While AIMA agrees that liquidity in OIS referencing SOFR is not currently sufficient to include within the scope of the DTO, we believe that ESMA should be forward-looking in its approach to modifying the DTO and include OIS referencing SOFR within the scope of the DTO before end-2021.

As with OIS referencing €STR, AIMA believes that liquidity in OIS referencing SOFR has been developing and will pick-up quickly in the coming months to a sufficient level as relevant transition deadlines and milestones draw closer.

For example, the CFTC's recently adopted SOFR First initiative and current recommendation of trading in USD LIBOR swaps to be replaced with trading in SOFR swaps[5] is helping to facilitate a switch in trading conventions for the interdealer market and deepen SOFR-linked liquidity.

8. Do you consider that IRS referencing USD LIBOR should continue to be subject to the DTO? Please explain.

AIMA believes that IRS referencing USD LIBOR should continue to be subject to the DTO for now as the class remains sufficiently liquid with high levels of trading activity.

IRS referencing USD LIBOR should continue to be subject to the DTO while OIS referencing SOFR remains out of scope - in no event should USD LIBOR be removed until SOFR swaps are subject to the DTO and a harmonised approach is agreed with the CFTC.

[4] See Recommendations from the Working Group on Euro Risk-Free Rates on the switch to RFRs in the interdealer market.
[5] See CFTC Market Risk Advisory Committee Adopts SOFR First Recommendation at Public Meeting.

9. **Are there other elements that should be taken into account and that would impact the outcome of the cost-benefit analysis? Please provide quantitative and qualitative details.**

   As noted above, AIMA strongly supports the regulatory objectives underlying the DCO and DTO. Following the implementation of these regulatory reforms, buy-side market participants have benefited from greater market transparency, competition and liquidity in OTC derivatives. These observed benefits strongly support ESMA updating the DCO and DTO to reflect interest rate benchmark reform, as these updates will improve liquidity conditions in RFRs and support the market's transition.