

# **Requirements for Mandatory Clearing**



**IOSCO**

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## Chapter 1 – Executive Summary

In 2009, the Leaders of the G-20 committed to ensure that all standardised OTC derivatives contracts are cleared through central counterparties (CCPs) by end-2012. The Financial Stability Board (FSB) recommended in its October 2010 Report *Implementing OTC Derivatives Market Reforms* (FSB 2010 Report)<sup>1</sup> that IOSCO, working with other authorities as appropriate, should coordinate the application of central clearing requirements on a product and participant level, and any exemptions from them as a means of minimizing the potential for regulatory arbitrage as the G-20 commitments on central clearing are implemented.

This Report outlines recommendations that authorities should follow in establishing a mandatory clearing regime within their jurisdiction. These recommendations are in relation to:

- Determination of whether a mandatory clearing obligation should apply to a product or set of products;
- Consideration of potential exemptions to the mandatory clearing obligation;
- Establishment of appropriate communication among authorities and with the public;
- Consideration of relevant cross-border issues in the application of a mandatory clearing obligation; and
- Monitoring and reviewing on an ongoing basis of the overall process and application of the mandatory clearing obligation.

This report outlines two general approaches to the determination that a product or set of products should be subject to a mandatory clearing obligation:

- The bottom-up approach considers products that a CCP proposes to or is authorised to clear; and
- The top-down approach considers products that should be assessed for a mandatory clearing obligation, but where there may be no CCP clearing or seeking to clear that product.

This report recommends that authorities implementing a mandatory clearing regime consider using these bottom-up and top-down approaches in their decision-making processes.

The FSB 2010 Report recommended that authorities should appropriately tailor any exemptions to mandatory clearing, and should not grant exemptions where doing so could create systemic risk. This Report considers some types of exemptions that may be granted (such as on a particular class of participants or on a particular class of products), and recommends steps that authorities should take to ensure appropriate communication of exemptions as well as coordination with other relevant authorities.

The G-20 Leaders<sup>2</sup> and the FSB have also emphasised the importance of mandatory clearing

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<sup>1</sup> See *Implementing OTC Derivatives Market Reforms*, Financial Stability Board, 25 October 2010, available at [http://www.financialstabilityboard.org/publications/r\\_101025.pdf](http://www.financialstabilityboard.org/publications/r_101025.pdf)

<sup>2</sup> In the 2010 G20 Seoul Summit Leaders' Declaration, it was noted that regulation and supervisions of, inter alia, OTC derivatives needs to be done in an internationally consistent and non-discriminatory manner, recognising the importance of a level-playing field. See [http://www.canadainternational.gc.ca/g20/summit-sommet/2010/g20\\_seoul\\_declaration.aspx?lang=eng&view=d](http://www.canadainternational.gc.ca/g20/summit-sommet/2010/g20_seoul_declaration.aspx?lang=eng&view=d).

obligations being applied in an internationally consistent and non-discriminatory manner. This Report outlines a framework for communication among authorities as well as between authorities and other stakeholders. The Report recommends that authorities communicate and consult with stakeholders during the decision-making process as well as once a decision on the application of a mandatory clearing obligation is reached and, where appropriate, to seek input from and communicate on an ongoing basis with other authorities.

With respect to the cross-border application of mandatory clearing obligations, this Report also considers how authorities may coordinate with each other. The Report recommends that authorities coordinate by identifying overlaps, conflicts and gaps between mandatory clearing regimes with respect to cross-border application of the clearing obligation and further recommends that authorities give due consideration to allowing the use of third-country CCPs.

The Report further outlines steps that authorities' should take to establish effective mechanisms for monitoring compliance with mandatory clearing requirements.

Finally, it is important that the authorities determining mandatory clearing obligations continue to assess the ongoing appropriateness of the relevant regimes within their own jurisdictions as derivatives markets continue to evolve.

## Chapter 2 – List of Recommendations

**Recommendation I:** Authorities implementing a mandatory clearing regime should consider using a bottom-up approach to determine products that are subject to a mandatory clearing obligation.

**Recommendation II:** A determining authority should clearly specify the information that should be contained in an eligible product notification under the bottom-up approach and whether the CCP or the supervisory authority is responsible for making the notification to the determining authority.

**Recommendation III:** A determining authority should clearly set out the criteria against which mandatory clearing obligations will be assessed in its jurisdiction.

**Recommendation IV:** In assessing a mandatory clearing obligation, a determining authority should consider information from a range of sources, including trade repositories.

**Recommendation V:** In assessing a proposal for a new clearing obligation under the bottom-up approach, a determining authority should conduct a public consultation.

**Recommendation VI:** Once a determining authority has reached a decision as to whether a product should be subject to a clearing obligation under the bottom-up approach, the determining authority should make the decision publicly available.

**Recommendation VII:** A determining authority implementing mandatory clearing should assess the timeframe over which an obligation to clear will become effective, with the objective of implementing clearing as soon as practicable so as to maximize the risk mitigation benefits provided by central clearing while ensuring the obligation is implemented in a safe and sound manner.

**Recommendation VIII:** A determining authority should consider using a top-down approach and may utilise a range of information sources in order to identify products which it considers may be suitable for mandatory clearing.

**Recommendation IX:** A determining authority should consult with stakeholders as part of its decision-making processes under the top-down approach to allow stakeholders to provide input on whether a product may be appropriate for a mandatory clearing obligation.

**Recommendation X:** A determining authority should clearly identify and disclose what steps are available to it for products identified under the top-down approach as suitable for mandatory clearing but which are not currently cleared.

**Recommendation XI:** A determining authority should seek to narrowly define exemptions and limit their number, as appropriate. A determining authority should clearly communicate the terms of any exemptions from mandatory clearing obligations, whether permanent or temporary, for both product and participant level exemptions.

**Recommendation XII:** As jurisdictions implement mandatory clearing regimes, the determining authority should, prior to implementation of the regime, provide a means through which other authorities can communicate information, including on a confidential basis, where appropriate.

**Recommendation XIII:** In order to inform other authorities, promote international consistency and

help minimise the risk of regulatory arbitrage, determining or supervising authorities, as applicable, should communicate information to other authorities regarding the mandatory clearing regimes in place - or proposed to be adopted - within their jurisdiction. The authority should attempt to include the following:

- The product(s) that is (are) subject to the mandatory clearing obligation in a way that allows relevant product(s) to be clearly identified;
- The CCP(s) that is (are) authorised to clear such product;
- the timeframes in which the mandatory clearing obligation becomes applicable; and
- Details of any exemptions from the mandatory clearing obligation (whether at the product or participant level, including the timeframes under which such exemptions become effective or remain effective).

**Recommendation XIV:** It is recommended that IOSCO explore whether to establish a central information repository such as a web portal to consolidate, in a consistent fashion, the information set out in Recommendation XIII at a global level. It is recommended that IOSCO undertake a feasibility study to determine whether there would be a net benefit provided to determining authorities and market participants from a portal along these lines, and the content that should be held on such a portal. This feasibility study should also include consultation with determining authorities as to the impact on their own systems of linking to such a portal. Such information should be made publicly available where possible with any non-public information restricted to access by determining authorities only.

**Recommendation XV:** It is recommended that determining authorities closely cooperate to identify overlaps, conflicts and gaps between regimes with respect to cross-border application of the clearing obligation. It is further recommended that determining authorities coordinate their approaches via multilateral or bilateral channels to reduce such issues, to the extent possible.

**Recommendation XVI:** In implementing mandatory clearing, a supervising authority should give due consideration to allowing the use of third country CCPs to meet mandatory clearing obligations. Where they do so, a supervising authority should comply with relevant international standards to implement a system through which participants in their markets can access these third country CCPs

**Recommendation XVII:** Authorities should consider what information they require in order to monitor compliance with mandatory clearing and should regularly reassess the ongoing suitability of mandatory clearing regimes. Any information required and any changes to the regime should be clearly communicated to the market.



## Chapter 3 – Introduction

In September 2009, the G-20 Leaders agreed to adopt policies to improve transparency, mitigate systemic risk, and protect against market abuse in over-the-counter (OTC) derivatives markets. Such policies included, among other things, measures to mitigate counterparty credit risk - a key component of systemic risk in the OTC derivatives markets – by requiring that all standardised OTC derivatives contracts be cleared through central counterparties (CCPs) by the end of 2012 (G-20 Commitments)<sup>3</sup>. The FSB 2010 Report<sup>4</sup> made a number of recommendations to authorities and global standard-setting bodies on the implementation of the G-20 Commitments, including the agreement on central clearing. In conjunction with higher capital requirements and strengthened bilateral counterparty risk management requirements for non-centrally cleared contracts, these recommendations were designed to form a complementary package that should increase the portion of the OTC derivatives markets that is centrally cleared resulting in more effective management of counterparty credit risk in these markets and serving to mitigate systemic risk.

In October 2011, the FSB released its second report assessing implementation progress, *OTC Derivatives Market Reforms - Progress report on Implementation, 11 October 2011*<sup>5</sup> (FSB 2011 2<sup>nd</sup> Progress Report), which noted that while a great deal of work had been undertaken at national, regional and international levels towards implementation of the G-20 Commitments, there were some areas of concern. Specifically, the FSB 2011 2<sup>nd</sup> Progress Report noted that few jurisdictions have a legislative or regulatory framework in place to operationalise the G-20 Commitments, including those on mandatory clearing. The FSB 2011 2<sup>nd</sup> Progress Report also noted that different approaches to central clearing requirements appeared to be emerging and that efforts focused on monitoring the consistency of central clearing requirements across different jurisdictions will be critical to achieving effective clearing regimes internationally.

The FSB 2010 Report recommended that:

*“To minimise the potential for regulatory arbitrage, IOSCO, working with other authorities as appropriate, should coordinate the application of central clearing requirements on a product and participant level, and any exemptions from them” (Recommendation 12)*

This report (Report) has been prepared by the IOSCO Task Force on OTC Derivatives Regulation (Task Force) in order to develop guidance consistent with Recommendation 12. Chapter 3 of the report provides an overview of the approach to implementing mandatory clearing regimes by authorities. Appendix I is a table summarising the current status of implementation in various jurisdictions. Chapter 5 details two possible complementary approaches to determining product eligibility for mandatory clearing, the bottom-up and top-down approaches. Chapter 6 considers exemptions to the scope of the mandatory clearing requirements that may be applied by authorities. Chapter 7 addresses the importance of communication between authorities in support of consistency of the application of mandatory clearing obligations, and Chapter 8 discusses the issue of cross-border coordination in respect of the application of clearing obligations and the use of third-country

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<sup>3</sup> See *Leaders’ Statement – the Pittsburgh Summit; September 24-25 2009*, available at <http://www.g20.org/images/stories/canal/finan/docs/uk/02pittsburgh.pdf>.

<sup>4</sup> See *Implementing OTC Derivatives Market Reforms*, Financial Stability Board, 25 October 2010, fn 1

<sup>5</sup> See *OTC Derivatives Market Reforms - Progress report on Implementation*, Financial Stability Board, 11 October 2011, available at [http://www.financialstabilityboard.org/publications/r\\_111011b.pdf](http://www.financialstabilityboard.org/publications/r_111011b.pdf)

CCPs. Lastly, Chapter 9 considers the steps that could be taken by authorities in order to monitor compliance with mandatory clearing regimes.

There are a number of stakeholders for this Report. The Report is targeted at authorities that are developing and implementing a mandatory clearing requirement pursuant to the G-20 Commitments. The Report is designed to provide guidance in a number of areas where international coordination is important and where differences in rules or requirements across jurisdictions may present concerns such as the potential for regulatory arbitrage.

The primary stakeholders that will be affected by mandatory clearing requirements can be split into three broad categories:

1. Entities that transact in OTC derivatives and therefore may be subject to mandatory clearing requirements. This group encompasses both financial companies, such as banks, trading firms and asset managers, and non-financial companies. Another set of entities that may undertake transactions potentially subject to a mandatory clearing requirement are sovereign or other public-sector entities.
2. Entities that centrally clear OTC derivatives or act as intermediaries to those that will. This includes CCPs and also firms that act as clearing members of CCPs on behalf of customers.
3. Entities that facilitate trading or provide services to counterparties, clearing members, or CCPs in connection with trading, which may include trading platforms, trade repositories and information vendors. This category of entities may be impacted indirectly by the application of a mandatory clearing obligation. For example, these entities may need to adapt their systems for cleared products, or report information to authorities that will assist the authorities in making determinations of mandatory clearing obligations.

This report may also be of interest to public authorities and the general public to the extent that mandatory clearing is intended to reduce systemic risk which should increase the stability of the economy as a whole.

## Chapter 4 – Mandatory Clearing Regimes

In seeking to address the G-20 Commitment that “*all standardized OTC derivatives contracts should be ...cleared through central counterparties...*,” many G-20 nations have sought to introduce mandatory clearing regimes through legislation and/or regulatory rulemaking. Legislative changes and proposals to mandate central clearing are underway in a number of jurisdictions. These changes and proposals are currently in various stages of development, ranging from initial consultation and discussion periods in some jurisdictions to implemented legislation and implementing rules in others. Consequently, the range of mandatory clearing regimes in effect across the globe will continue to evolve significantly.

Responsibility for determining the exact range of OTC derivative products that should be subject to a mandatory clearing requirement should be assigned to the relevant authorities in each jurisdiction<sup>6</sup>. Except as otherwise noted, this Report will consistently refer to an authority with the power to mandate central clearing in its jurisdiction as the *determining authority*. Further, in this Report a supervisor of the CCP will be referred to as a *supervising authority*. A *supervising authority* is responsible, among other duties, for authorizing a CCP to clear a particular product, though it is recognized that in some jurisdictions the same entity may, in practice, perform both functions. Where the same entity performs the two functions simultaneously, this Report will refer to such an authority as the *supervising/determining authority*.

In a number of jurisdictions, authorities are proposing to use a combination of top-down and bottom-up approaches in order to determine mandatory clearing obligations. Both of these approaches are referenced in the FSB Report *OTC Derivatives Market Reforms - Progress report on Implementation, 15 April 2011*<sup>7</sup> and are further described in Section B of this Report.

The ongoing ability for authorities to determine mandatory clearing obligations allows for a continuing and dynamic evolution of the range of products that are required to be cleared. In this way, mandatory clearing regimes can respond to and reflect market developments. As new OTC derivative products emerge or existing products and CCP coverage of existing products change, products may be determined to be subject to a mandatory clearing obligation as deemed appropriate by the determining authority. This enables authorities to respond to developments in the OTC derivatives markets and to adapt mandatory clearing obligations accordingly. For example, there may be products that cannot be effectively risk managed by a CCP today and are therefore not subject to mandatory clearing. Over time however, the product risk characteristics could change such that the products can be risk managed and so become suitable for mandatory clearing.

An overview of the status of mandatory clearing regimes being developed in a number of jurisdictions across the globe is included as Appendix I to this Report.

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<sup>6</sup> See section 3.2.1 of *Implementing OTC Derivatives Market Reforms*, Financial Stability Board, October 2010, fn 1.

<sup>7</sup> See *OTC Derivatives Market Reforms - Progress report on Implementation*, Financial Stability Board, October 2011, fn 5.

## Chapter 5 – Determination of Products subject to a Mandatory Clearing Obligation

When determining which products should be subject to a mandatory clearing obligation, authorities may employ different approaches. The *bottom up* approach refers to a process through which products that a CCP clears or proposes to clear are made subject to a mandatory clearing requirement by the relevant authority. The *top down* approach is the process by which the relevant authority has the power to identify OTC derivatives contracts where mandatory clearing is desirable, irrespective of whether a CCP has yet proposed to clear them or not.<sup>8</sup>

Through the rest of this Report, a reference to “products eligible for a mandatory clearing obligation” should be taken to refer to:

Under the bottom-up approach:

- In jurisdictions where the supervising and determining authority are the same; 1) those products that the CCP is already authorised already to clear and that the authority is reviewing for the purpose of determining whether a mandatory clearing obligation should apply, or 2) the products where the authority is considering whether to give a CCP authorisation to clear a product<sup>9</sup> while simultaneously determining whether mandatory clearing obligation should apply; and
- In jurisdictions where the supervising and determining authorities are different; those products that the supervising authority has approved a CCP to clear, and in respect of which the determining authority is considering whether a mandatory clearing obligation should apply.

Under the top-down approach:

- Those products that the determining authority has identified should be considered for the application of a mandatory clearing obligation, irrespective of whether a CCP has yet proposed to clear them or not.

### 1. The *Bottom-Up* Approach

In the FSB 2010 Report, reference was made to the bottom-up approach to applying a mandatory clearing obligation.

As noted above, it is expected that, in some jurisdictions, a supervising authority will also be the determining authority. A CCP seeking to clear a new product may already be authorised to clear the product, or it may be seeking authorisation to clear the product whilst simultaneously notifying the authority of its intent to clear the product (which would trigger a mandatory clearing review process). In the latter case the authority may undertake both processes simultaneously.

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<sup>8</sup> Ibid.

<sup>9</sup> Authorisation to clear a product is not the subject of this Report and is referenced in this Report only to clarify the process in some jurisdictions.

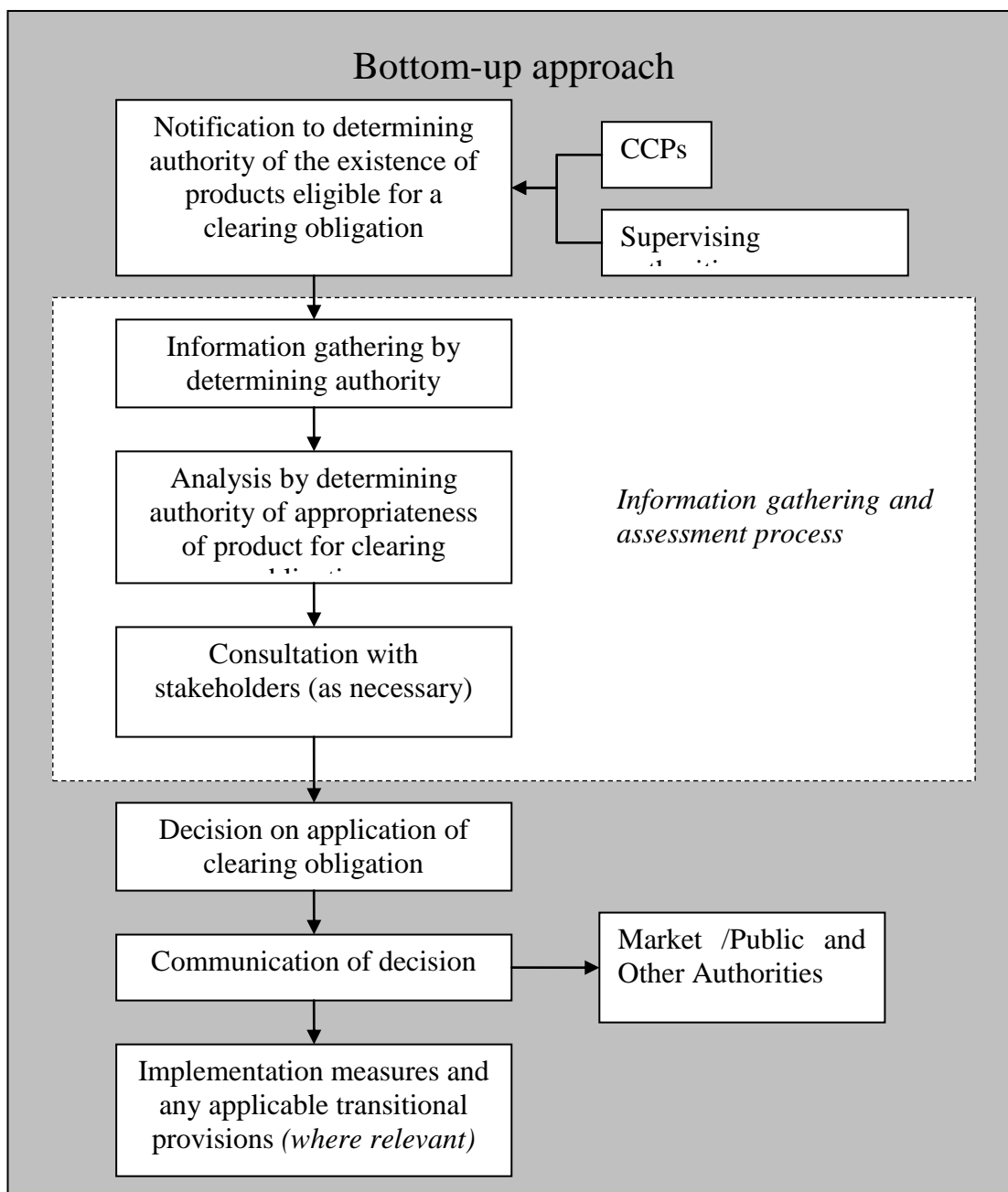
In other jurisdictions, the supervising authority may be different from the determining authority. In these jurisdictions, it would be necessary for the CCP to have received authorisation from the supervising authority prior to the consideration by the determining authority of whether mandatory clearing is required, meaning the determination process will follow the authorisation process for a particular product and CCP (although in certain circumstances, these processes may take place simultaneously).

Many of the jurisdictions that are in the process of introducing a mandatory clearing regime envisage using the bottom-up approach for determining those products that should be subject to a mandatory clearing obligation.

A bottom-up approach uses the offering of products for clearing at a CCP as the starting point. After the supervising/determining authority becomes aware of the offering of products for clearing, it may determine whether or not to apply a mandatory clearing obligation to those products. It is envisaged that CCPs will identify new products that they consider appropriate for clearing in order to expand the business they carry out and that this can form an appropriate first step, for an assessment of mandatory clearing obligations. This, in combination with the top-down approach outlined later, should help ensure that the maximum range of products is considered for mandatory clearing.

Whilst it is entirely feasible that variation in approach may exist in different jurisdictions, the following sections outline a high-level structure representing a typical process that determining authorities may follow in assessing whether a mandatory clearing obligation should be applied to a product under the bottom-up approach. The process is likely to begin with a notification to the determining authority from the CCP or supervising authority of the existence of products eligible for a mandatory clearing obligation (eligible product notification).

The following diagram illustrates the typical procedure envisaged in applying the bottom-up approach. Each step is described in more detail later in this section:



The Task Force considers the bottom-up approach to mandatory clearing an effective way for determining authorities to be made aware of products eligible for a mandatory clearing obligation in their jurisdiction, which those authorities can then assess for suitability for mandatory clearing. It is therefore recommended that all determining authorities should consider using this approach, to the extent permitted by their legislative framework.

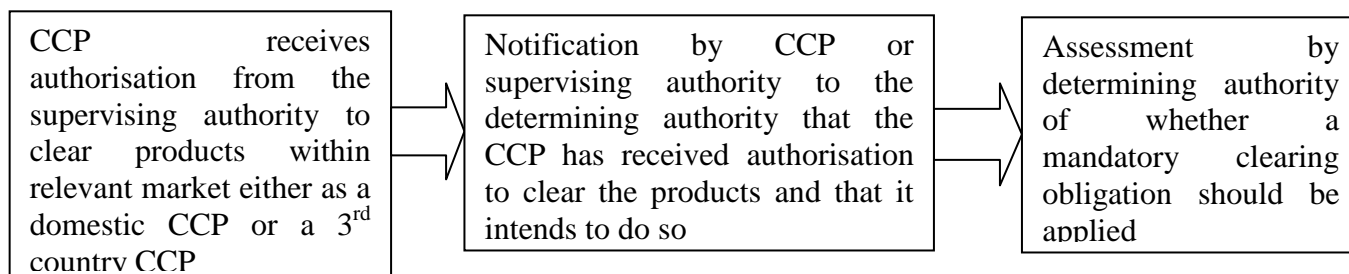
**Recommendation I: Authorities implementing a mandatory clearing regime should consider using a bottom-up approach to determine products that are subject to a mandatory clearing obligation.**

**a) Process for eligible product notification**

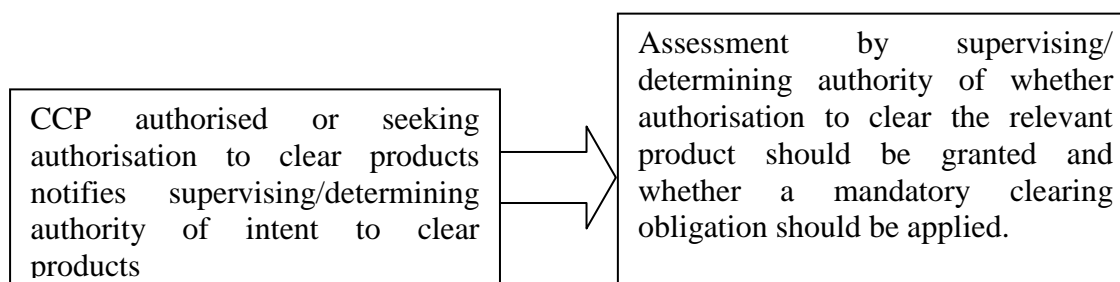
The eligible product notification could be made by either the CCP itself or the CCP’s supervising

authority. In the latter case, it will be important for the determining authority to maintain communications with the supervising authority when conducting its analysis. See Section E for further detail on the approach for CCPs located outside the jurisdiction in which the determining authority is located.

The diagram below illustrates this process in a jurisdiction where the supervising authority is distinct from the determining authority.



The following diagram illustrates this process in a jurisdiction where the supervising authority is the same as the determining authority.



One of the key elements of the bottom-up process is that a determining authority will receive notification for all products that CCPs propose to clear and can therefore consider if a mandatory clearing obligation is suitable for the complete universe of products which are or will be offered by a CCP. This, alongside the top-down approach outlined later, should help ensure that the maximum range of products is considered for mandatory clearing.

The eligible product notification should contain sufficient information to allow a determination by the determining authority as to whether those products should be subject to a mandatory clearing obligation<sup>10</sup> and may include the following:

- Details of the products for which a mandatory clearing obligation should be considered. Sufficient detail needs to be included so the product can be identified unambiguously and thus avoid clearing obligations being applied to unintended products or products that CCPs in fact do not clear;<sup>11</sup>

<sup>10</sup> As noted in footnote 6, the determination as to whether a CCP is authorised to clear a product is not the subject of this Report, and may or may not involve different criteria.

<sup>11</sup> For example a notification to clear US Dollar interest rate swaps would not provide sufficient detail for a determination because primary product attributes have not been identified. The description of the product in question would need to be sufficiently granular to avoid ambiguity or misinterpretation.

- The type of trading that takes place in the product in question i.e., on trading platforms, over-the-counter or both;
- Details of the regulatory regime to which the CCP is subject;
- The timeframe in which the CCP intends to begin clearing the product;
- Any restrictions to which the CCP may be subject, such as limits on the volume of transactions or exposure, imposed either by itself or by its supervising authority, as applicable; and
- Mandatory clearing determinations made by other regulatory authorities, if applicable.

On receipt of an eligible product notification, a determining authority should consult with stakeholders, (as necessary). Unless stipulated by local legislation, the determining authority should verify the appropriate timeframe for reaching its determination and communicate this clearly to the CCP(s) in question.

**b) Process to be followed by a determining authority to determine whether a mandatory clearing obligation should be applied**

When a determining authority receives an eligible product notification, it should follow a transparent process in assessing if the product/s may be suitable for a mandatory clearing obligation.

In general, and taking into account specific procedures that local legislation may set out for the determination process, the following three steps provide a framework for determining authorities to follow in determining whether a clearing obligation should be applied to a particular product following receipt of an eligible product notification:

- i). Information gathering by the determining authority to assess the product;
- ii). Consultation with stakeholders (including other regulatory authorities) to inform the assessment of the product, as appropriate; and
- iii). Communication of the decision to all relevant stakeholders.

These steps are described in more detail below.

i). Information gathering by the determining authority

In assessing whether a product should be subject to a mandatory clearing obligation, determining authorities will need to gather information on which to base their decision. The exact criteria for the assessment are likely to be determined by national legislation, but as outlined in the FSB 2010 Report<sup>12</sup>, determining authorities should take account of factors including:

- The degree of standardisation of a product's contractual terms and operational processes;
- The nature, depth and liquidity of the market for the product in question; and
- The availability of fair, reliable and generally accepted pricing sources.<sup>13</sup>

Many of the factors to be considered in determining whether a particular product should be subject to

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<sup>12</sup> See page 13 *Implementing OTC Derivatives Market Reforms*, Financial Stability Board, 25 October 2010, fn 1

<sup>13</sup> An assessment of whether the risk characteristics of the product can be managed by a CCP will be undertaken by the supervising authority in the course of its authorization process.



a mandatory clearing obligation are similar to those assessed in determining whether a CCP should be authorised to clear the product. Where the clearing authorisation process is separate from the mandatory clearing determination process, the determining authority responsible for assessing mandatory clearing should, as far as possible, seek to avoid duplicating any aspect of the authorisation assessment focusing instead on analysing the factors as detailed below.

(1). Degree of standardisation of a product's contractual terms and operational processes.

As part of the assessment for authorization of a CCP to clear a product, consideration will have been given to the degree of standardisation of the product including its contractual terms and supporting operational processes. Where the clearing authorisation process is separate from the mandatory clearing determination process, the Task Force recognises that consideration by the determining authority may build on, but will be distinct from, the supervising authorities' assessment of whether the CCP should receive authorization to clear that product. For example, the supervising authority may also take account of the level of product standardisation but for the purpose of assessing the CCP's ability to effectively manage the risks of clearing the product.

(2). Nature, depth and liquidity of the market for the product

In assessing whether to impose a mandatory clearing obligation, determining authorities will need to give consideration to factors over and above the assessment of liquidity undertaken by the CCP's supervising authority. They should also consider the depth of liquidity across the entire market to which such clearing obligation would apply. It may not necessarily be the case that a product that is sufficiently liquid to be cleared by a particular CCP is sufficiently liquid so that all contracts within the market can be cleared.

Factors to consider may include the following:

- The current volume and value of daily transactions for the product;
- The average size of transactions;
- The size of the bid-offer spread;
- The current number of liquidity providers and/or trading platforms for the product;
- An indication of the number of active market participants; and
- Any capacity restrictions the CCP(s) in question are subject to, such as limits on the volume of transactions or exposure.

(3). Availability of fair, reliable and generally accepted pricing sources.

The availability of adequate pricing data in the market for a product can be an indication of its level of standardisation. In relation to the assessment of the availability of fair and reliable pricing data conducted by the determining authority, consideration should therefore be given to the availability of such data to all market participants.

(4). Additional analysis by the determining authority

To ensure that the proposal for a mandatory clearing obligation is based on sound and objective criteria and supporting information, the determining authority should consider undertaking an analysis of both the information submitted by the CCP (or its supervising authority, as applicable) as well as information regarding the wider impact of the application of a mandatory clearing obligation.

When considering this wider impact, determining authorities could consider how a clearing obligation for a particular product may impact the relevant markets and the participants within those markets and the direct and indirect costs and benefits expected to be experienced by CCPs and market participants clearing the product in question<sup>14</sup>. Should a determining authority wish to make such an assessment, it should, where relevant, examine whether the implementation of a mandatory clearing obligation is consistent with the G-20 Leaders' objectives of mitigating systemic risk, as well as improving transparency and protecting against market abuse in the derivatives markets. If determining authorities have concerns that the implementation of a mandatory clearing obligation will be inconsistent with (or indeed detrimental to) one or more of these objectives, they should assess carefully whether imposing such a clearing obligation is appropriate.

Further consideration may also be given to whether an obligation to clear such product exists in another jurisdiction or whether, following an assessment under the bottom-up approach, a decision was made in another jurisdiction to not impose a clearing obligation in relation to such a product. Determining authorities should also consider whether other CCPs could be expected to clear the product in question going forward, in their domestic market or on an international basis.

The legislative framework in various jurisdictions may set out additional criteria upon which an assessment for mandatory clearing should be based. For example, under the Dodd-Frank Wall Street Reform and Consumer Protection Act<sup>15</sup> (Dodd-Frank Act), the relevant US authorities are required to consider the effect on competition and the mitigation of systemic risk resulting from the imposition of a mandatory clearing obligation. However, while acknowledging that consideration of other factors may be appropriate, for the purpose of international consistency, this Report takes the framework set out in the FSB 2010 Report<sup>16</sup>, which was endorsed in the 2010 G20 Seoul Summit Leaders' Declaration. While consideration of other factors may be appropriate, determining authorities should be mindful of possible differences in clearing obligations across jurisdictions that may result from such additional criteria.

It is envisaged that determining authorities will use a range of sources of information to support their assessment of whether a product should be subject to a mandatory clearing obligation. This could include, but is not limited to, review of the transaction records for the product within the relevant trade repository, where available. This may provide determining authorities with useful information on the market liquidity of the product.

The Task Force therefore recommends that, in order to facilitate their ability to conduct such an assessment effectively, the determining authorities should clearly set out the information that they expect to receive from a CCP and/or its supervising authority in an eligible product notification under the bottom-up approach. This will help to ensure determining authorities are provided with the information they need to conduct an assessment in a timely and effective manner.

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<sup>14</sup> In this context, direct costs are generally those associated with a particular product or service, while indirect costs are those associated with more than one product or service offering (i.e. CCP overheads).

<sup>15</sup> See *Dodd-Frank Wall Street Reform and Consumer Protection Act*, 5 January 2010, available at <http://www.sec.gov/about/laws/wallstreetreform-cpa.pdf>.

<sup>16</sup> See page 13. *Implementing OTC Derivatives Market Reforms*, Financial Stability Board, 25 October 2010, fn 1.

**Recommendation II: A determining authority should clearly specify the information that should be contained in an eligible product notification under the bottom-up approach and whether the CCP or the supervisory authority is responsible for making the notification to the determining authority.**

Furthermore, in order to facilitate consistency in the application of mandatory clearing obligations and provide clarity to the market as to how decisions will be made regarding which products will be subject to mandatory clearing, it is important for the determining authorities to clearly set out the criteria they will use when making their assessments. Such disclosure could be made via the standard legislative or rulemaking process, or via the determining authority's website.

**Recommendation III: A determining authority should clearly set out the criteria against which mandatory clearing obligations will be assessed in its jurisdiction.**

It is likely that a determining authority will not be able to solely rely on information provided in the eligible product notification from either the CCP or its supervising authority, as applicable. A range of information may be available from sources such as other market infrastructures, for example, trading venues, confirmation platforms, compression providers and trade repositories, publicly available sources, and other market participants. A determining authority should therefore seek to access information it believes will be relevant in assessing the product against the applicable criteria. The Task Force specifically notes that data held in trade repositories is likely to be a useful source for information regarding executed OTC derivatives. It is envisaged that trade repositories will be an extensive data source for the determining authorities covering the existing population of trades in a product and will therefore be a valuable resource in assessing factors such as standardisation and liquidity.

**Recommendation IV: In assessing a mandatory clearing obligation, a determining authority should consider information from a range of sources, including trade repositories.**

ii). Consultation by a determining authority with stakeholders

As part of its information gathering or once a determining authority has completed its information gathering, the determining authority should engage in a transparent consultation with stakeholders. These could include:

- Relevant domestic and third country authorities;
- Market participants; and
- The general public.

The purpose of the consultation should be to inform the determining authority of the views of stakeholders as to whether the mandatory clearing obligation should be applied.

Where permitted by law or regulation, if, after the information gathering exercise but prior to a wider consultation, a determining authority concludes that imposing a mandatory clearing obligation upon a particular product is clearly unnecessary or inappropriate for readily apparent reasons, the determining authority may proceed to make its determination without conducting a public consultation. The basis for this is that if a clear reason not to require mandatory clearing is evident at the outset of the review, a requirement to undertake a full public consultation may place an unnecessary burden on both the determining authority and on market participants in submitting

responses to a public consultation. If a determining authority determines not to impose a mandatory clearing obligation upon a particular product in such circumstances, and does not conduct a public consultation, the Task Force considers that any such decision should be communicated publicly in order to afford market participants transparency and certainty over their obligations.

(1). Consultation with other authorities

When determining whether to apply a mandatory clearing obligation, the determining authority should liaise with authorities in other jurisdictions where this will aid assessment. Where other authorities have implemented a clearing obligation for a similar product, or found it to be unsuitable for mandatory clearing following due consideration, a determining authority may gain useful insight into the suitability of that product for mandatory clearing from the analysis conducted by the other authority.

Engagement with other authorities may also be useful where there is a pertinent nexus between the product being considered and the domestic market of the other authority. In these circumstances determining authorities may benefit through engagement with other authorities by obtaining an understanding of the potential impact on market activity beyond their own jurisdiction.

Determining authorities should determine the most effective and appropriate means of engaging with one another on these matters.

(2). Consultation with market participants and the general public

The Task Force believes that consultation with market participants and the general public will be an important part of the determining authority's assessment of a mandatory clearing obligation. In particular, a determining authority should seek views from market participants that would be subject to the clearing obligation, as well as views from operators of platforms offering the product for trading purposes. A determining authority should also seek the views of the CCP submitting the product for the mandatory clearing determination, and CCPs who may wish to consider clearing the same product in the future, as well as likely liquidity providers of the product. Such consultation may be part of public consultation.

Such a consultation process should enable a determining authority to better understand the likely impact of introducing a new obligation to clear.

Unless already prescribed by applicable law, a determining authority should determine the period for consultation. This time period should reflect an appropriate time for stakeholders to respond to the consultation, but it is recognised that there may be instances when it is beneficial for the determining authority to take swifter action, such as through a shortened consultation period.

**Recommendation V: In assessing a proposal for a new clearing obligation under the bottom-up approach, a determining authority should conduct a public consultation.**

iii). Communication of the decision to all relevant stakeholders

Once a determining authority has reached a decision as to whether the clearing obligation should be applied, the decision should be made publicly available in a timely manner, for example on its website. Such communication will be essential for all market participants and other relevant

authorities to be aware of the requirement to clear and take the necessary steps to ensure compliance with the requirements.

In order to support international consistency in the area of mandatory clearing, a determining authority should consider introducing a central mechanism for publishing new clearing obligations and any changes to these obligations on an on-going basis. See section F for further discussion on this point.

Determining authorities should provide sufficient information so that participants have full clarity of their obligations, and when such obligations will be effective. The public notification should include at least the following:

- Details of the product that will be subject to the clearing obligation in sufficient detail so that the product can be unambiguously identified;
- Any exemptions granted to the clearing obligation and the reasons for the exemptions. (See section C for further consideration on the use of exemptions);
- The date, or dates, from which the clearing obligation will take effect (and types of market participants to which it will apply); and
- The approach to be taken for any historical contracts executed before the clearing obligation enters into force, if not already provided for under legislation.

The Task Force believes that the public should be informed, on an ongoing basis, of which CCPs currently clear products that are subject to a clearing obligation so as to allow participants clarity over where they can satisfy their obligations. This information could be made available by the CCPs themselves.

If a determining authority reaches a decision that a new clearing obligation should not be imposed upon a particular product, that decision should also be communicated to market participants and to fellow authorities, if applicable. The determining authority may also wish to provide an explanation of the reasons for not applying the clearing obligation in the communication. Similar to positive decisions to apply an obligation to clear a particular product, these negative determinations should be made freely and publicly available so as to offer as much clarity as possible as to whether a clearing obligation does or does not apply. Furthermore, a determining authority should seek to keep this information current as developments, such as a new CCP receiving authorisation to clear the same product, occur.

**Recommendation VI: Once a determining authority has reached a decision as to whether a product should be subject to a clearing obligation under the bottom-up approach, the determining authority should make the decision publicly available.**

**c) Factors to consider when determining the timeframe for implementation**

Once a determining authority reaches a decision to impose a new clearing obligation, consideration should be given to the appropriate timeframe for implementation. The objective of such a consideration should be to balance implementing each obligation at the earliest practicable date, so as to maximize the risk mitigation provided by central clearing, while ensuring the obligation is implemented in a safe and sound manner. In reaching this decision it is recommended that determining authorities take the following factors into consideration:

i). The timeframe for readiness of the CCP to clear a product

A determining authority should consider whether the CCPs intending to or currently clearing the product are ready to clear any anticipated increase in volumes that could arise from a clearing obligation applying across an entire market. This will need to be determined in cooperation with the supervising authority, where such authorities are distinct. Considerations may include: the size of the market in question, whether the clearing obligation would apply across a number of jurisdictions, such as in the EU, or to the extent the clearing obligation will apply to existing contracts, whether there is a large outstanding volume of executed trades of that product that are not already cleared. In some instances, it may therefore be appropriate for a defined delayed or staggered implementation schedule to allow the CCPs to make necessary adjustments to their systems and risk management frameworks.

ii). The timeframe for readiness of market participants to begin clearing the product

In determining the appropriate timeframe for implementation it is recommended that a determining authority give due regard to the time that market participants will need to give effect to the clearing obligation, in particular the time needed to make any necessary operational or technical changes and the time needed to establish the relevant links with the CCP in question. The steps that need to be taken are likely to vary by market participant. For example, in general, derivatives dealers and other large financial entities may need less time to prepare for the introduction of a clearing obligation as compared to smaller participants, as such smaller participants may not have links established with the CCP or its general clearing members and may not have the operational infrastructure in place to begin clearing immediately. Therefore, it may be appropriate for a determining authority to consider different implementation dates for different types of market participants, provided that the differing market participants can be defined clearly and such an approach does not allow regulatory arbitrage or for firms to seek to avoid mandatory clearing on either a temporary or permanent basis. Such flexibility could, for example, allow larger market participants to begin clearing transactions between one another without being delayed by any distinct needs of smaller market participants or of their own clients.

iii). The feasibility of other CCPs offering the same product

The assessment of whether to apply a mandatory clearing obligation should not be dependent on whether multiple CCPs are in a position to offer the same product for clearing, and clearing should commence as soon as appropriate. However, in assessing the appropriate timeframe for implementation, a determining authority may wish to give due regard to the existence or likelihood of other CCPs regulated or exempted by the relevant supervising authority offering to clear the product and the likely timeframe for such offerings.

The availability of more than one CCP to clear a product could have risk reducing benefits, as market share will be divided between the various CCPs, thereby avoiding the concentration of counterparty risk in one CCP. In addition, if a significant problem occurs at one CCP which poses systemic implications, outstanding positions can potentially be transferred to another CCP, providing such functionality is available. Consideration should therefore be given to the likelihood of other CCPs regulated or exempted by the supervising authority offering the same product. Accordingly, a determining authority may deem it appropriate to either delay the timeframe for implementation or introduce transitional periods for implementation to allow other CCPs the ability to offer the same

product for clearing, having given due consideration to the associated risks and benefits. However, a determining authority should also consider the potential disadvantages to multiple CCPs clearing the product versus a single CCP in this respect. These include the fact that, where two counterparties hold existing relationships with two different CCPs, either one counterparty must establish legal and operational relationships with a new CCP (either directly or through a member of the new CCP) in order to clear or alternatively the two CCPs will need to establish links (if feasible) between one another. Further, delaying the implementation of a mandatory clearing obligation in order to allow time for other CCPs to prepare to clear the product delays the risk-reduction benefits associated with clearing and reduces incentives for CCPs to commence the clearing of products.

### **Approach for historical contracts**

In addition to setting the appropriate future point in time at which a mandatory clearing obligation will take effect, consideration should be given to whether historical contracts should be moved to central clearing.

The FSB 2010 Report<sup>17</sup> highlights this issue. In general, a determining authority will need to consider the legal and practical implications of requiring historical contracts to be cleared. This could include assessing the ability of the relevant CCPs to effectively manage the anticipated increase in cleared volumes. The consideration of how to treat historical contracts should not prevent a determining authority from ensuring that all new contracts are cleared from the time the clearing obligation takes effect. However, a determining authority may determine that other existing contracts also need to be cleared, and in such a case, a determining authority will need to consider whether a fixed date in time should be applied for the loading of historical contracts or whether the market should clear these contracts on an incremental basis, with eventual full clearing across the market at a certain defined point in time.

**Recommendation VII: A determining authority implementing mandatory clearing should assess the timeframe over which an obligation to clear will become effective, with the objective of implementing clearing as soon as practicable so as to maximize the risk mitigation benefits provided by central clearing while ensuring the obligation is implemented in a safe and sound manner.**

### **Approach for third country CCPs**

It is envisaged that the process outlined above for considering a clearing obligation and the details contained within a clearing obligation notification would be similar for products cleared by a CCP located in the jurisdiction of the determining authority as well as those cleared by a CCP located outside of the determining authorities' jurisdiction but operating within markets in its jurisdiction (third country CCP). In such cases, communication between the relevant domestic and foreign determining authorities will be extremely important to ensure mandatory clearing is assessed and implemented appropriately for all parties.

## **2. The Top-Down Approach**

The top-down approach for determining what products may be suitable for a mandatory clearing obligation is initiated by a determining authority where the authority is aware that there are products

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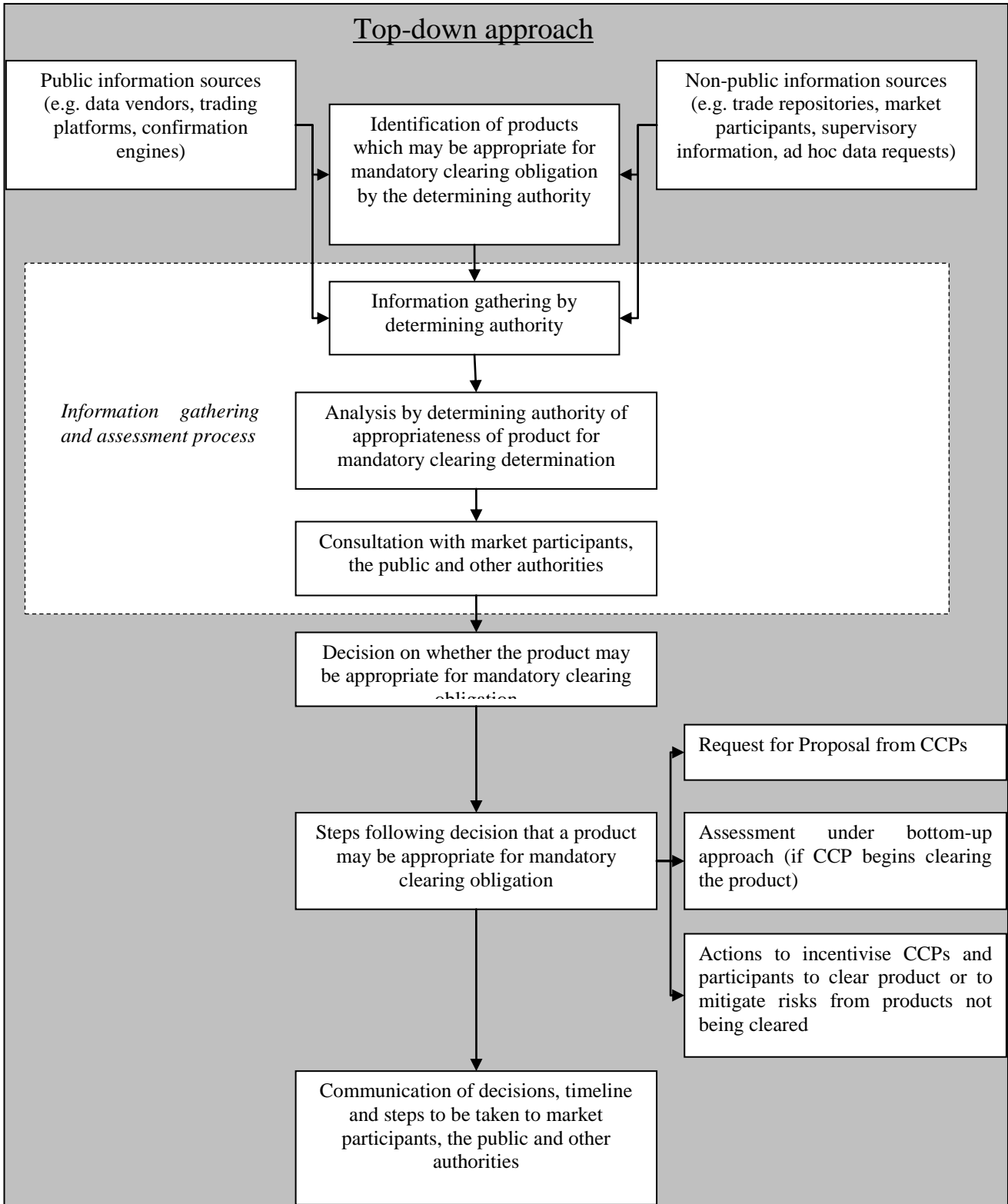
<sup>17</sup> See page 28 *Implementing OTC Derivatives Market Reforms*, Financial Stability Board, 25 October 2010, fn 1.

that may be appropriate for a mandatory clearing obligation. For clarity, the top-down approach will not create a list of products which will automatically be subject to a clearing obligation once a CCP offers to clear such product. Instead it is a list of potential products designed to encourage market developments. Any product offered to be cleared by a CCP would need to be considered under a procedure which incorporates the process and criteria outlined in the bottom-up approach.

Under the top-down approach, a determining authority identifies products that it deems may be suitable for mandatory clearing based on the criteria within its jurisdiction even though there may be no CCP clearing or seeking to clear that particular product. This determination may then result in further work being done by the determining authority to consider what steps should be taken to promote the clearing of those products.

The below diagram illustrates the procedure involved in applying the top-down approach, with detail of each aspect addressed later in this section.





**a) Facilitating the identification of a product for the top-down approach**

There are a number of potential information sources available to a determining authority for assessing which products may be appropriate for a mandatory clearing obligation.

Trade repositories are expected to be useful for this approach, as they will contain data on broad segments of the OTC derivatives market. While we expect trade repositories will provide a valuable source of information, it should be noted that until reporting obligations come into force in different jurisdictions and trade repositories are more fully developed, they may only provide a limited amount of useful information about the products, including liquidity and price transparency. A determining authority may therefore need to consider other sources of information that may be useful.

A determining authority may have access to other forms of non-public information that could be useful in informing them about products. One example of this kind of information that may be available to some determining authorities is data provided to certain supervisors as part of the *2011 Strategic roadmap of industry initiatives and commitments to the Supervisors of the OTC Derivatives Supervisors Group*<sup>18</sup>. As part of this roadmap, G-14 dealers committed to increasing transparency to their respective supervisors of the processes related to expanding central clearing offerings. This roadmap includes commitments from the dealers to provide information to supervisors on methodologies and data employed by CCPs to evaluate the suitability of a given product for central clearing and to provide regularly updated plans and schedules for the roll-out of potential new products and features.

A determining authority may have direct access to information about market participants and the trades they facilitate or to which they are a counterparty which may also be useful for determining authorities. This may involve both the collection of data from market participants on an ad hoc or on an ongoing basis and through discussions with market participants to understand their trading and investment operations. Where the determining authority is not the supervisor of all market participants, it should consider coordinating with the relevant supervising authority for the market participants in order to collect the relevant information.

Access may also be available to detailed trading information from market infrastructure that a determining authority supervises. This may comprise trading data from trading platforms, confirmation platforms, and data vendors. Where a determining authority has access to this kind of data, it should consider whether the data would be useful to it in helping to determine whether the product poses systemic risk or is sufficiently standardised to justify a mandatory clearing obligation being applied to it. A determining authority should however be mindful to ensure that they do not put an undue burden on market participants or infrastructures to provide data that could more easily be obtained from other sources.

A determining authority should also look to use public sources of information. This may include information available publicly from firms, trading venues, CCPs and confirmation platforms. One example of this type of information is the standardisation matrices developed by the G-14 dealers for the OTC Derivatives Supervisors Group<sup>19</sup>. In addition, derivatives industry groups can be a useful source of information through information they publish in relation to standardised derivatives across many different asset classes.

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<sup>18</sup> See G-14 Letter <http://newyorkfed.org/newsevents/news/markets/2011/SCL0331.pdf>.

<sup>19</sup> These are available at <http://www2.isda.org/functional-areas/market-infrastructure/G20-objectives/>. The matrices can be used by authorities in estimating the population of standardized OTC derivatives contracts, although they do not contain all the information that determining authorities may need.

See *OTC Derivatives Market Reforms - Progress report on Implementation*, Financial Stability Board, October 2011, fn 5, which provides a detailed overview of the standardization matrices in particular page 6 as well as Appendix III on page 27.

These sources of information are likely to be particularly useful for understanding the level of standardisation of different types of derivatives and the comparable volumes between types of derivatives that are not cleared versus those that are cleared.

Where possible, a determining authority could consider having a process or mechanism that allows the public to notify the determining authority of products members of the public think should be subject to mandatory clearing, and the rationale behind their assertion.

To effectively implement a top-down approach, a determining authority should continue to monitor information sources to ensure that they capture and identify instances of new products or product developments which may be suitable for mandatory clearing.

**Recommendation VIII: A determining authority should consider using a top-down approach and may utilise a range of information sources in order to identify products which it considers may be suitable for mandatory clearing.**

**b) Assessment of a product that may be eligible for mandatory clearing under the top-down approach**

i). Process to be followed by a determining authority under the top-down approach

Once information about a product that may be appropriate for a clearing obligation has been collected and reviewed, a determining authority may determine it wishes to undertake further investigation to make a determination whether a mandatory clearing obligation should be applied. The set of products to be investigated may be large and it may be necessary to assign priorities to the investigations. Such prioritisation could consider, among other things, whether the product is designed as a deliberate attempt to avoid an existing clearing obligation, whether the product is already under a clearing obligation in another jurisdiction and the relative systemic importance of the products.

To make this determination, it is appropriate for a determining authority to follow a similar process of detailed information gathering as would be undertaken for the assessment of a product for a mandatory clearing obligation under the bottom-up approach. It should, however, be recognised that a different process may be appropriate where the product being reviewed is substantially similar to a product for which an assessment has already been made by the determining authority to apply a mandatory clearing obligation. In these circumstances, the determining authority may decide to undertake a shortened process.

As outlined on page 18 at b) i) (*Information gathering exercise by the determining authority*) under the bottom-up approach, a determining authority should assess:

- The degree of standardisation of a product's contractual terms and operational processes;
- The nature, depth and liquidity of the market for the product in question; and
- The availability of fair, reliable and generally accepted pricing sources.

As a next step and distinct from the process undertaken under the bottom-up approach, a determining authority should consider whether there is a CCP available to clear the product or a similar product. The determining authority should consult with the supervising authority (if not the

same authority) regarding whether any CCP is in the process of seeking authorisation to clear the product.

The determining authority should consult with the supervising authority (if not the same authority) to consider whether there are any reasons specific to the particular jurisdiction that may prevent or impede a CCP from clearing the product. A determining authority may also find it helpful to consider whether a clearing obligation has been applied to these (or similar) products in other jurisdictions, and whether the lack of a clearing obligation would provide an incentive for participants to avoid a clearing obligation by trading in that authority's jurisdiction. To the extent permissible under applicable law, if a CCP is in the process of seeking authorisation to clear the product, this should be communicated by the supervising authority to the determining authority. Transparency among authorities concerning the authorisation process would be beneficial for the determining authority in its assessment of products for mandatory clearing.

A determining authority could also consider factors unique to its own jurisdiction. For example, it could consider whether there are any features of its domestic market that make clearing of a product by a CCP particularly burdensome or counter-conducive to reducing systemic risk. This may include legal impediments, settlement processes or market practice. A determining authority also needs to consider the size of its market in order to help ensure that the application of a clearing obligation would not result in undue risk being assumed by market infrastructures.

A determining authority could consider the impact on the market of the application of a mandatory clearing obligation. It should consider the main users and uses of the particular product, and whether there would be an overall achievement of the objectives of the G-20 Commitments. When considering the users impacted by the application of a mandatory clearing obligation, a determining authority may wish to consider the impact on end-users who may fall under an exemption from the mandatory clearing obligation, but who may be indirectly impacted by other users being subject to the clearing obligation, for example through higher hedging costs or a reduced range of dealers in the market.

Finally, in considering the timeline for the implementation of a clearing obligation under the top-down approach, there may be scenarios where a determining authority believes that the time in which the mandatory clearing obligation takes effect should be shortened. Circumstances where this could arise are where a new product is developed with the aim of avoiding a mandatory clearing obligation, or where there is a risk of market participants transacting in a set of products not subject to the clearing obligation before the clearing obligation is set to take effect. In these circumstances, it may be appropriate to expedite the process, although a determining authority should attempt to ensure that the full process is still followed (including a period of public consultation) and that the impact of the expedited process is considered as part of the assessment process.

- ii). Communication and consultation with stakeholders regarding the decision that a product may be appropriate for a mandatory clearing obligation under the top-down approach

Communication and consultation with stakeholders will be important in the process of determining whether a product may be appropriate for a mandatory clearing obligation and should take place throughout the process of each determining authority.

In common with the process outlined at.b) ii) on page 21. (*Consultation by a determining authority with stakeholders*) under the bottom-up approach, a determining authority should undertake

appropriate consultation with relevant stakeholders before making a determination under the top-down process that a product may be appropriate for a mandatory clearing obligation. Also as outlined under the bottom-up approach, this consultation should include consulting with relevant domestic and third country authorities, market participants and the general public.

All relevant stakeholders should be given the opportunity to contribute to this consultation, and a determining authority should take stakeholder views into account before making a final decision. This consultation should be done in an open and transparent manner and all stakeholders have the ability to make their responses available to the public if desired.

**Recommendation IX: A determining authority should consult with stakeholders as part of its decision-making processes under the top-down approach to allow stakeholders to provide input on whether a product may be appropriate for a mandatory clearing obligation.**

**c) Decision to be made following completion of analysis by determining authorities**

Following an investigation by a determining authority, if a determination is made that the product may be suitable for a mandatory clearing obligation and the product is not currently cleared, the determining authority needs to carefully consider what further action should be taken in order to encourage and facilitate the development of a clearing solution by a clearing house and, ultimately, the imposition of a mandatory clearing obligation. This section will seek to outline some actions authorities may consider taking following the determining authority's decision that a mandatory clearing obligation may be appropriate for the product that is not then listed for clearing.

It should be noted however that the steps available to authorities will differ in each jurisdiction based on the provisions of primary legislation and other relevant legal provisions. In addition, the steps that will most effectively encourage the development of a clearing solution, following the decision that the product may be appropriate for a mandatory clearing obligation, are likely to differ in each market based on the structure of each market.

It is possible that, during the period in which a determining authority is considering products under a top-down approach, a CCP may receive approval to begin clearing the particular product (although communication between determining and supervising authorities should ensure that the determining authority is aware of this at an early stage). In this case, it may be appropriate to consider the product under the bottom-up approach. The work that a determining authority has previously done in connection with the top-down approach may be utilised for the authority to make a determination under the bottom-up approach as to whether the mandatory clearing obligation applies.

In the event a determining authority makes a determination that a product may be appropriate for a mandatory clearing obligation pursuant a top-down approach, but there is no CCP currently clearing the product in its jurisdiction, the determining authority should investigate the relevant facts and circumstances and consider actions that will encourage the development of a clearing solution by one or more CCPs. Determining authorities may consult with CCPs and market participants to better understand why there is no CCP available to clear the product, and whether there are any regulatory actions that could be taken to encourage a CCP to begin clearing the product. The determining authority may also consider (as outlined in Section E) whether there are any third-country CCPs that have, or are able to obtain, the relevant authorisation or recognition to clear the product with that jurisdiction.

After a determination is made that a product may be appropriate for a clearing obligation following a top-down approach, there may be no CCP available to clear the product. In this situation, there are a number of options available to determining authorities. One option would be after making public its determination that the product would be appropriate for a mandatory clearing obligation, the authority may choose to take no action for a specified period of time. This would provide the industry with a period of time to develop a clearing solution for the product, and to overcome obstacles that may have previously prevented CCPs from accepting a product for clearing previously.

In the absence of market developments, authorities may also consider issuing a Request for Proposal for a CCP to clear that product in the jurisdiction. This would provide CCPs and market participants with information about the products, and would provide a formal view from the authority that it sees the product as being appropriate for a mandatory clearing obligation. The determining authority may consider actions that would support the development of a clearing solution by incentivising trading counterparties to encourage a CCP to offer to clear the product (in conjunction with the supervisor of the counterparties, where different from the determining authority). This could be achieved by measures such as increasing risk-proportionate capital requirements for trades in these products, increasing the collateral requirements or, restricting trading in that product, all depending on the powers available to the authorities.

A determining authority should, however, analyse the impact of undertaking these steps. Specifically, it should be cognizant of whether these actions will have an impact on the users of the product in question which may be disproportionate or undesirable, or result in increased transactions in products that are less standardised, which could have an overall negative impact on the outcomes that authorities are seeking to achieve in line with the G-20 Commitments.

**Recommendation X: A determining authority should clearly identify and disclose what steps are available to it for products identified under the top-down approach as suitable for mandatory clearing but which are not currently cleared.**

## Chapter 6 – Scope of Mandatory Clearing

In accordance with the G-20 Commitments, determining authorities should be seeking to substantially increase the proportion of the market that is standardised, and ensure that, in order to mitigate systemic risk, all standardised derivatives should be cleared through central counterparties. The FSB 2010 Report stated that the use of central clearing should be expanded through increasing standardisation, in combination with higher capital requirements for non-centrally cleared contracts. However, as noted by the FSB 2010 Report, determining authorities may appropriately tailor exemptions from mandatory clearing obligation where the exemption would not create systemic risk, and these exemptions should be monitored and reviewed on a regular basis.

In considering a mandatory clearing regime, exemptions could take the form of *product*, *participant* or *fixed period* exemptions:

- *Product*  
Absolute exemptions may be applied upfront for classes of derivatives products for which determining authorities are concerned that the product is not appropriate for clearing or that will not benefit from the risk mitigation that clearing is designed to provide. This may be the case where the primary risk associated with a certain product is not one that a clearing model is able to mitigate. For example, certain foreign exchange derivatives are under consideration for product exemptions in some jurisdictions. This can be distinguished from the ongoing determination of eligibility products for clearing via the top-down or bottom-up approach.
- *Participant*  
Exemptions may be applied for certain types of market participants. The most likely basis for a participant exemption will be the limited level of risk posed by such participants, meaning that the proportionally greater burdens that may be experienced by such participants if they are required to comply with a mandatory clearing obligation would not be outweighed by a material reduction in systemic risk. For example, this could include participants with very low derivatives exposures, both in absolute terms and relative to the size of the market in that class of derivatives, along with those who engage in hedging commercial activity and who may not be able to continue to reduce risk through hedging if they need to comply with a clearing mandate.
- *Fixed Period*  
Exemptions may be applied to certain products or participants to provide temporary relief from the clearing requirement. Such exemptions may be adopted where legislators or authorities conclude that further time is needed to develop or implement appropriate mandatory clearing regimes. The temporary exemption periods should have fixed end-dates which have been clearly communicated to market participants. For example, some jurisdictions are considering pension schemes for such an exemption.

It is important for market participants to note that exemptions to mandatory clearing do not prohibit them from clearing transactions otherwise subject to an exemption. For example, an exempted market participant may nonetheless choose to clear its transactions where it has access (directly or indirectly) to a CCP authorised to clear the relevant product class.

Specific examples of exemptions and potential exemptions in the regimes of various jurisdictions are included as Appendix II to this report.

## 1. Global Coordination

As has been noted elsewhere in this Report, determining authorities should generally seek to coordinate with each other in developing and implementing a mandatory clearing obligation in order to ensure consistency of approach wherever possible. This is also true in the context of exemptions, where disparity in the scope of exemptions across jurisdictions could enable certain counterparties to avoid the requirements of one jurisdiction by transacting in another and, in that way, avoid clearing its transactions altogether where exemptions are based upon the location of transactions. Further detail on this is provided in Section D (*Communication between jurisdictions*).

## 2. Common Exemptions for Consideration

The Task Force has noted two specific participant exemptions which are being considered in some form in several jurisdictions, and therefore merit consideration by determining authorities.

### a) Intragroup/Interaffiliate Transactions

Transactions undertaken between counterparties belonging to the same corporate group ('intragroup' transactions) are under consideration for exemption from mandatory clearing obligations in some jurisdictions. This can be attributed to the view that intragroup transactions may facilitate beneficial risk management practices, such as centralised risk management. There is, however, a risk that counterparties could exploit such an exemption to avoid clearing by transferring positions to affiliates in jurisdictions where clearing requirements do not apply. Therefore, careful construction of any intragroup exemptions will be important in order to ensure that genuine non-intragroup counterparty risk exposure is subject to clearing requirements and the risk is mitigated. This could include consideration of factors such as the definition of a group or affiliate as well as the purpose of the trade.

### b) Small Financial Firms and Non-Financial Firms

Transactions undertaken by financial firms that are relatively small in size and firms whose principal business is non-financial in nature are not subject to clearing requirements in most jurisdictions<sup>20</sup>. This is attributable to the view of the relevant authorities that such firms do not impose significant systemic risk in the particular domestic market, given the relatively low volume of derivatives exposure they hold. In respect of non-financial firms it is also attributed to the view that, the derivatives contracts they enter into are typically for the purposes of mitigating the risks encountered in the ordinary course of their business, as opposed to being 'speculative' in nature. For example, non-financial firms may use OTC derivatives to hedge against currency, commodity and interest rate fluctuations which could pose a risk to their business.<sup>21</sup> Authorities may wish to limit the application of any clearing exemption for non-financial firms to transactions that are entered into for such purposes.

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<sup>20</sup> Some jurisdictions may provide exemption to hedging transactions of non-financial firms rather than to non-financial firms in general.

<sup>21</sup> In spite of such exemptions, and as noted in section B, small and non-financial firms may nonetheless encounter higher hedging costs or a reduced range of dealers in the market owing to the higher costs that their financial counterparties are subject to as a result of a mandatory clearing obligation.



Determining authorities and legislators may adopt the use of defined thresholds to ensure that the level of uncleared trading activity by these counterparties does not increase to levels that could pose systemic risk. Transactions that breach those thresholds would become subject to the clearing obligation.

### **3. Communication of Exemptions**

It is essential that a determining authority communicate the scope of any exemptions from mandatory clearing in a clear and comprehensive manner, and ensure that such communications are accessible to all affected parties. For example, this communication could be undertaken via prompt publication on the relevant authority's website. Communications should be kept up-to-date at all times and should contain a level of detail sufficient to clearly identify the products and/or participants that are within the scope of the exemption, using terminology that is understandable by all market participants. Particular care must be taken to address any potential scope for uncertainty or misinterpretation. This is integral to removing opportunities for participants to avoid mandatory clearing by exploiting exemptions that they do not in fact fall within, as well as reducing the potential for genuine misunderstanding as to whether an exemption applies. A determining authority should promptly respond to any reasonable requests for clarification on the scope of an exemption.

**Recommendation XI: A determining authority should seek to narrowly define exemptions and limit their number, as appropriate. A determining authority should clearly communicate the terms of any exemptions from mandatory clearing obligations, whether permanent or temporary, for both product and participant level exemptions.**

## Chapter 7 – Communication among Authorities

In order for jurisdictions to meet the G-20 Commitments, and to do so in “an internationally consistent and non-discriminatory manner”<sup>22</sup>, it will be important for determining authorities to communicate with one another regarding the implementation of mandatory clearing within their own jurisdictions.

Undertaking effective communication between determining authorities will help to ensure that, there is as much consistency as is possible between authorities in the implementation of clearing obligations across jurisdictions. Challenges to achieving this consistency are discussed in Section E below.

Strong communication channels would be beneficial in defining areas such as:

- The products subject to a mandatory clearing obligation;
- The participants subject to a mandatory clearing obligation; and
- The timeframes in which a mandatory clearing obligation is implemented.

It is therefore important that the relevant authorities have in place effective means to communicate with other determining authorities both during the process of considering whether to implement mandatory clearing for a particular product, or particular class of participants (by removing an exemption for those participants) and also for the current obligations with respect to mandatory clearing on an ongoing basis.

### 1. Input by Other Authorities

Effective communication between authorities will provide a mechanism to highlight any potential input that an authority in one jurisdiction may have regarding the implementation of a mandatory clearing obligation by a determining authority in another jurisdiction and the impact those obligations may have on market efficiency or financial stability in the jurisdiction of the other authority. Effective communication will allow such concerns to be raised to determining authorities so that they may be taken into consideration prior to implementing mandatory clearing obligations. It is important to note, however, that such concerns should only relate to either the impact of the clearing obligation would have in the jurisdiction of the other authority or to issues related to the G-20 Commitment on clearing with respect to derivatives, but not the factors considered by the determining authority in making its assessment.

The valuable practice of consultation and communication during the process of considering and implementing a mandatory clearing obligation has been covered during earlier sections of this report and will not be repeated here. It is reasonable to expect that other authorities could, and would, contribute their thoughts and opinions to a determining authority considering mandatory clearing during these consultation periods. This will be especially pertinent where the implications of a mandatory clearing obligation in one jurisdiction may be felt in another, and determining authorities should coordinate via appropriate fora in order to enable the sharing of information appropriately.

Existing mechanisms such as bilateral or multilateral memoranda of understanding could provide a

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<sup>22</sup> See *G20 Leaders Seoul Declaration*, November 2010, fn 2.

means via which information can be shared between authorities and determining authorities, including on a confidential basis. The range of authorities who may want, and need, to provide input regarding mandatory clearing obligations in other jurisdictions could be broad and include, among others, financial stability, securities and prudential regulators as well as resolution authorities and relevant central banks.

It is therefore recommended that authorities work to ensure they have a means through which other authorities can provide input, including where appropriate in a confidential manner, upon a jurisdiction's initial consideration and ongoing review of a mandatory clearing regime.

**Recommendation XII: As jurisdictions implement mandatory clearing regimes, the determining authority should, prior to implementation of the regime, provide a means through which other authorities can communicate information, including on a confidential basis, where appropriate.**

## **2. Communication regarding products cleared and existing mandatory clearing obligations.**

Once clearing, and mandatory clearing, has been implemented within a jurisdiction, it will be important that determining authorities in other jurisdictions are able to access information as to what products are being cleared in the jurisdiction and what clearing obligations exist in the jurisdiction at any point in time. This will help facilitate the promotion of consistency and also the adherence of obligations by participants within an authority's own jurisdiction.

Such information could cover a range of areas, but it is suggested that determining authorities focus on developing transparency among authorities in the following three areas:

### a) Notification of products cleared in jurisdictions

The publication of information regarding the products cleared within a jurisdiction along with the identity of the CCPs offering to clear those products by supervising and/or determining authorities could assist the determining authorities in other jurisdictions with assessing mandatory clearing obligations within their own jurisdictions. For example, this information will allow other determining authorities to consider mandatory clearing obligations for products that are not cleared by a CCP within their own jurisdictions but can be cleared via a third country CCP.

This, in turn, would assist with the G-20 Leaders' objective of mitigating systemic risk via central clearing provided that the other authorities could, in coordination with the relevant CCP supervisor/overseer, gain the necessary assurances regarding the third country CCP in question and be comfortable implementing a mandatory clearing obligation that requires the use of such third country CCP.

Furthermore, information regarding the products cleared in other jurisdictions may be of assistance in allowing determining authorities to assess, via the top-down approach, which products may be suitable for clearing. To facilitate this process and avoid confusion, it will be important that determining authorities communicate clearly with one another and use a sufficient level of detail to enable accurate identification of the products and CCPs in question.

b) Notification of mandatory clearing obligations in force in jurisdictions

When a determining authority clearly communicates the mandatory clearing obligations that are in place within a jurisdiction and the CCPs that can be used to satisfy those obligations, it will assist the efforts of other determining authorities who will be better placed to assess mandatory clearing within their own jurisdiction. This should assist in coordinating implementation of mandatory clearing obligations, where possible, as determining authorities could clearly identify the products in question, and the timeframes over which mandatory clearing obligations come into force and any applicable variations, such as a ‘phase-in’ at either the product or participant level.

c) Notification of exemptions in jurisdictions

As noted above, the mandatory clearing regimes may include exemptions for both products (e.g. foreign exchange derivatives) and participants (e.g. non-financial firms that use OTC derivatives for hedging commercial risks). Such exemptions may take the form of permanent exemptions (as is the case with end-user exemptions in several jurisdictions) or temporary exemptions. In either scenario, an opportunity for regulatory arbitrage exists if exemptions are not coordinated, because market participants may seek to switch the location or form in which they conduct their derivatives transactions solely to avoid a mandatory clearing obligation.

Whilst information on the exemptions that are in place within a jurisdiction should be readily available within that jurisdiction, it should also be easily accessible to authorities in other jurisdictions. By informing authorities in other jurisdictions, those determining authorities can seek to produce convergent approaches where appropriate and the risk of regulatory arbitrage can be minimised. Therefore, determining authorities should make readily available to other authorities the details of any exemptions from mandatory clearing within their jurisdictions. This should apply to exemptions at both the product and participant level and include all necessary details such as whether an exemption is temporary or permanent and, if relevant, the timeframes to which the exemption becomes effective.

**Recommendation XIII: In order to inform other authorities, promote international consistency and help minimise the risk of regulatory arbitrage, determining or supervising authorities, as applicable, should communicate information to other authorities regarding the mandatory clearing regimes in place - or proposed to be adopted - within their jurisdiction. The authority should attempt to include the following:**

- **The product(s) that is (are) subject to the mandatory clearing obligation in a way that allows relevant product(s) to be clearly identified;**
- **The CCP(s) that is (are) authorised to clear such product;**
- **the timeframes in which the mandatory clearing obligation becomes applicable; and**
- **Details of any exemptions from the mandatory clearing obligation (whether at the product or participant level, including the timeframes under which such exemptions become effective or remain effective.**

### **3. Consolidation of Disclosures Regarding Mandatory Clearing**

The section above makes recommendations regarding the information that should be made available by determining authorities to inform other jurisdictions and authorities. It is anticipated that much, if not all, of this information will also be made publicly available within the authority’s domestic

jurisdiction in order to inform resident market participants of their regulatory obligations.

However, as outlined in Section A, implementation of the G-20 Commitments across the globe will require the implementation of mandatory clearing regimes across many jurisdictions. This likely implies that for any determining authority to gain a truly global picture of mandatory clearing, it will need to piece together information from a range of sources. The same issue will also affect market participants, especially those with global operations, as they try to assess the clearing obligations to which they are subject.

If such information is available in a consistent format at an international level then it should serve to reduce the search costs of authorities and participants alike and help ensure clarity as to mandatory clearing obligations in force. This will not only promote compliance with mandatory clearing, but potentially increase consistency in the implementation of obligations and allow bodies such as the FSB to more easily assess the implementation of the G-20 objectives for the clearing of standardised OTC derivatives. IOSCO should evaluate whether the collation of such information could be achieved via the website portal of an international body at reasonable cost. Accomplishment of such a goal would be in line with the intent of Recommendation 12 of the FSB 2010 Report.

Whilst it is not envisaged that much, if any, of the information to be made available would be non-public, the use of a confidential area available to determining authorities could be utilised for any such confidential information.

**Recommendation XIV: It is recommended that IOSCO explore whether to establish a central information repository such as a web portal to consolidate, in a consistent fashion, the information set out in Recommendation XIII at a global level. It is recommended that IOSCO undertake a feasibility study to determine whether there would be a net benefit provided to determining authorities and market participants from a portal along these lines, and the content that should be held on such a portal. This feasibility study should also include consultation with determining authorities as to the impact on their own systems of linking to such a portal. Such information should be made publicly available where possible with any non-public information restricted to access by determining authorities only.**

## **Chapter 8 – Issues Associated With the Cross-Border Coordination Of Mandatory Clearing Regimes**

International consistency between mandatory clearing regimes is desirable as it reduces the risk of gaps and inconsistencies between regimes and/or opportunities for regulatory arbitrage which could lead to potential market instability.

Inconsistencies between mandatory clearing regimes may be significant, given that the global nature of the derivatives market results in a significant portion of the OTC derivatives transactions being cross-border, such that two counterparties to a transaction are located in different jurisdictions, and would therefore be subject to different regimes for a particular transaction. In addition, some of the new proposed clearing obligation regimes will impact non-domestic participants e.g. a non-European firm may find itself subject to the European regime as well as their home regime, due to entering into a transaction subject to a clearing obligation under the European regime.

In both of these circumstances, it is vital that the authorities communicate with one another to better identify areas where there may be gaps or inconsistencies between the two clearing obligations to which a counterparty finds itself subject. Reaching a mutually acceptable position between the determining authorities on how such counterparties or transactions should be treated with regards to a clearing obligation should be a priority for the determining authorities in order to provide certainty and clarity for the market participants and authorities.

Communication between authorities by way of multilateral or bilateral means will be an important step to help minimise the opportunities for market participants to avoid the substance and intent of the G-20 Commitment pertaining to clearing by leveraging opportunities for regulatory arbitrage and transacting business in locations or forms that allow them to avoid clearing for derivatives transactions that would otherwise be subject to mandatory clearing obligations.

**Recommendation XV: It is recommended that determining authorities closely cooperate to identify overlaps, conflicts and gaps between regimes with respect to cross-border application of the clearing obligation. It is further recommended that determining authorities coordinate their approaches via multilateral or bilateral channels to reduce such issues, to the extent possible.**

### **1. Use of Third Country CCPs**

Advantages of allowing the use of third country CCPs to satisfy mandatory clearing are that it could allow mandatory clearing obligations to apply to a wider range of products or currencies than is available within any individual jurisdiction as well as increasing consistency between regimes and reducing the potential for regulatory arbitrage. Utilising such CCPs in mandatory clearing regimes would allow authorities to decrease counterparty risk via utilisation of central clearing over and above the use of domestic CCPs. The ability of third country CCPs to provide clearing services under overseas mandatory clearing regimes may also incentivise domestic CCPs to expand the range of products they offer in order to protect and expand their market share. The Committee on the Global Financial System has recently noted that the increased use of existing global CCPs and the construction of links between CCPs are possible ways to provide market participants with access to central clearing and thus meet the G-20 leaders commitment to centrally clear all standardised OTC

derivatives by end-2012<sup>23</sup>.

While the benefits of greater innovation in the products cleared may aid counterparty risk reduction, reduce the potential for regulatory arbitrage and reduce costs for market participants, it also increases the number of authorities who have an interest in the supervision of the third country CCPs in question. Many jurisdictions already have regimes that permit such CCPs to operate in their jurisdiction, typically either through a distinct form of authorisation or through some form of recognition of the third country regulatory regime. However this is not universal.

Where third country CCPs are used, a domestic authority may have limited oversight and ability to intervene if necessary in respect of the operations of the third country CCP. In such circumstances, where such a third country CCP clears a product which is systemically important to a jurisdiction, this limitation on the domestic authorities' power could be a source of concern for that jurisdiction, if a third country CCP is used to satisfy mandatory clearing. The determining authority may wish to consider, alongside the advantages discussed above, whether there is an overall reduction in systemic risk when considering allowing the use of third country CCPs to satisfy the mandatory clearing obligation.

A possible mitigation to this concern may be if the third country CCPs' supervisors ensure that the risk management of such products is carried out in line with appropriate regulatory standards, such as the CPSS-IOSCO *Principles for Financial Market Infrastructures* (Principles) and alongside cooperative oversight arrangements. Please see the section below regarding "Coordination between Authorities" for further proposals in this area.

Another area which could be considered by authorities is allowing links, i.e. contractual and operational arrangements, between two or more CCPs that connect the CCPs directly or indirectly. While this is currently under consideration in other regulatory fora (notably CPSS-IOSCO and the Committee on the Global Financial System), it is not anticipated that any such links will be implemented on a broad basis prior to the 2012 deadline set by the G-20.

## **2. Coordination between Authorities**

It should be recognised that the implementation of a mandatory clearing regime may increase a supervising authority's need to cooperate with other supervising authorities. This will be particularly important for mandatory clearing regimes which permit the use of third country CCPs so that the supervising authority can help ensure that the use of third country CCPs will not increase risk inappropriately in their jurisdiction.

In the FSB October 2011 note to the G-20 leaders on "*Progress of Financial Regulatory Reforms*"<sup>24</sup>, the FSB recognised that a robust global policy framework has not yet been established to support, *inter alia*, "appropriate safeguards, including cooperative regulatory oversight and access to information on a cross-border basis, and robust standards for the stability and resiliency of the resulting global network of central counterparties". The FSB therefore recommended (and the G-20

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<sup>23</sup> See *The macrofinancial implications of alternative configurations for access to central counterparties in OTC derivatives markets*, Committee on Global Financial Systems, Publication No. 46, November 2011, available at <http://www.bis.org/publ/cgfs46.pdf>.

<sup>24</sup> See *Progress of Financial Regulatory Reforms*, Chairman Financial Stability Board, 31 October 2011, available at [http://www.financialstabilityboard.org/publications/r\\_111104ff.pdf](http://www.financialstabilityboard.org/publications/r_111104ff.pdf).

Leaders in the Cannes Declaration supported) the establishment of “a senior-level coordination group to prioritise initiatives, (*sic*) expedite implementation and support ongoing multilateral work to address these issues”. As a result, the FSB announced in January 2012 that it had established the OTC Derivatives Coordination Group<sup>25</sup>.

The determining authority should, when establishing a mandatory clearing obligation which may include the use of one or more third country CCPs, take into account, to the extent possible within the scope of laws within each jurisdiction, the degree of compliance with these *Principles* with regards to the third country CCP in question.

**Recommendation XVI: In implementing mandatory clearing, a supervising authority should give due consideration to allowing the use of third country CCPs to meet mandatory clearing obligations. Where they do so, a supervising authority should comply with relevant international standards to implement a system through which participants in their markets can access these third country CCPs**

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<sup>25</sup> See *Meeting of the Financial Stability Board in Basel on 10 January*, Press Release, Financial Stability Board, 10 January 2012, available at [http://www.financialstabilityboard.org/press/pr\\_100112.pdf](http://www.financialstabilityboard.org/press/pr_100112.pdf).



## **Chapter 9 – Monitoring of Mandatory Clearing**

Once a jurisdiction has implemented a mandatory clearing regime, a determining authority and the authorities responsible for oversight of market participants should establish effective mechanisms for monitoring compliance with mandatory clearing requirements, in order to ensure adherence with the relevant requirements and to impose sanctions for non-compliance in a timely manner, where appropriate. Additionally, it is important that the determining authority continue to assess the ongoing suitability of the mandatory clearing regimes within their own jurisdictions as derivatives markets continue to evolve.

### **1. Monitoring Mandatory Clearing Requirements**

When a mandatory clearing regime is being implemented within a jurisdiction, the relevant authorities will need to consider how to determine whether the associated obligations are being adhered to by market participants. Without an effective monitoring regime in place, market participants who do not comply with the relevant clearing obligations, whether accidentally or otherwise, will not be incentivised to meet their requirements. Therefore, in constructing a mandatory clearing regime, authorities should give due regard to the information they will require to monitor compliance. This is likely to include a combination of:

- Information from trade repositories – regarding executed trades, whether they have been centrally cleared and whether they are subject to central clearing or not.
- Information from firms – as part of their ongoing regulatory reporting regarding any use of exemptions from mandatory clearing;
- Information from other infrastructures – such as clearing houses and compression service providers on the range of outstanding trades they are processing; and
- Information from other authorities – regarding the compliance of firms they supervise with mandatory clearing regimes either in the jurisdiction in question or other jurisdictions.

In addition to these sources of information, authorities should consider any further sources of information they can use to enforce compliance with mandatory clearing obligations. Where this requires specific periodic, or ad hoc, reporting to the authority, it should be clearly communicated to the firms and market participants in question.

### **2. Monitoring Exemptions to Mandatory Clearing Requirements**

The Task Force also recommends that the relevant authorities establish mechanisms to effectively monitor the use of clearing exemptions. Authorities should be able to detect any transactions and/or participants that do not fall within the scope of an exemption, but that seek to utilise one. It is recommended that authorities put in place mechanisms to receive the necessary information from trade repositories in particular, which can be cross-checked or supplemented by information from the firms themselves, to enable them to undertake such monitoring. In respect of certain exemptions, participants may be required to flag individual transactions and provide authorities with detail of the exemption on which they are seeking to rely and the basis on which they qualify for that exemption.

### **3. Monitoring the Suitability of Mandatory Clearing Regimes**

It is also considered important by the Task Force that authorities continue to assess the suitability of mandatory clearing regimes on an ongoing basis. Authorities should consider all aspects of the

mandatory clearing regimes in their jurisdictions, including continuing suitability of a product for mandatory clearing requirements and suitability of exemptions to those requirements, as well as the procedures for determining suitability of new products for clearing. This will ensure that any effects on mandatory clearing regimes caused by changes to market conditions or applicable laws are detected and appropriate measures taken. For example, a product that has previously been determined as subject to a mandatory clearing requirement may have become illiquid and no longer able to be effectively risk-managed by the relevant CCPs. In such a case, it may be appropriate for an authority to revoke or alter the mandatory clearing obligation with respect to that product. To do this, an authority may consider putting in place a consultation or notification process whereby market participants can notify it of any issues concerning mandatory clearing. Such issues could include whether developments have occurred which may advise toward a particular obligation or exemption being extended or modified or, conversely, that its ongoing appropriateness should be reviewed.

Any revocations or alterations of mandatory clearing requirements, exemptions or related procedures should be undertaken following consultation with relevant stakeholders such as CCPs and market participants, and due consideration should be given to the impact that such changes will have on outstanding transactions. Revocations or alterations must be clearly communicated to all affected parties.

**Recommendation XVII: Authorities should consider what information they require in order to monitor compliance with mandatory clearing and should regularly reassess the ongoing suitability of mandatory clearing regimes. Any information required and any changes to the regime should be clearly communicated to the market.**

## Appendix I - Mandatory Clearing Regimes

Jurisdiction	Mandatory Clearing Regime	Status
<b>Australia</b>	In response to the G-20 Commitments, Australia's Council of Financial Regulators has initiated a consultation exercise to consider the adoption of mandatory clearing requirements in its jurisdiction.	Appropriate recommendations will be made to the Australian Government in due course.
<b>Brazil</b>	In Brazil only centrally clearing of exchange traded derivatives are mandatory. For OTC derivatives there is not a provision for mandatory clearing.	Current.
<b>Canada</b>	In Canada, provincial legislation to address the G-20 Commitments is planned, and mandatory clearing requirements are expected to be covered in the scope of this legislation.	Legislation anticipated by the end of 2012.
<b>China</b>	No regulatory reform is anticipated in China. However the People's Bank of China is in discussions with the recently-launched Shanghai Clearing House to encourage the development of a detailed structure for clearing OTC derivatives.	In progress.
<b>European Union</b>	European Regulation on OTC Derivatives, Central Counterparties and Trade Repositories (EMIR) has been proposed by the European Commission and is under consideration by the European Parliament and European Council. EMIR will mandate central clearing for all classes of OTC derivative transactions determined by ESMA as being subject to a clearing obligation. The Regulation, along with any technical standards developed by ESMA, will be legally binding in all European Union <sup>26</sup> Member States.	EMIR expected to enter into force early 2012. Following entry into force, implementation of EMIR will require a process of rulemaking to be undertaken by the European Securities and Markets Authority (ESMA) and the European Commission.
<b>Hong Kong</b>	Regulators to issue legislative and	A consultation paper on the

<sup>26</sup> The Regulation will be directly binding on all European Union member states, and is likely to be adopted by all countries in the European Economic Area.

<b>Jurisdiction</b>	<b>Mandatory Clearing Regime</b>	<b>Status</b>
	regulatory proposals on mandatory clearing.	concept of the proposed regulatory regime for the Hong Kong OTC derivatives market was issued in October 2011. It contains proposals on mandatory clearing. The consultation period has ended and a new consultation paper on detailed proposals will be issued in the new year.
<b>Japan</b>	Amended legislation (the Financial Instruments and Exchange Act) in conjunction with a pending amendment to the Japanese Cabinet Ordinance will mandate clearing for trades that are considered to be systemically significant in terms of volume and settlement risk in Japan.	Legislation amended May 2010. Cabinet Ordinance review in progress, which will include public consultation.
<b>Mexico</b>	Clearing regulations in progress.	General framework to be developed during 2011.
<b>Republic of Korea</b>	Revised legislation (Financial Investment Services and Capital Markets Act) to be submitted to the National Assembly. To be followed by enforcement ordinances and supervisory regulations, as well as establishment and pilot testing of a domestic CCP.	Revised legislation to be submitted by the end of 2011.
<b>Russia</b>	Laws in place to serve basis for regulation on central clearing, implementing regulation yet to be adopted.	In progress.
<b>Singapore</b>	A public consultation is to be issued by early 2012, with a view to legislation being proposed shortly thereafter.	Legislation to be introduced by end-2012.
<b>South Africa</b>	Financial Markets Bill (FMB) submitted to the National Treasury for Cabinet and Parliamentary approval	FMB and subordinate legislation expected to be promulgated during 2011
<b>Switzerland</b>	Under review.	Review to be concluded by end of 2011.
<b>United States</b>	The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) requires entities not eligible for	Dodd-Frank was enacted in July 2010. The rules defining how a clearing determination

Jurisdiction	Mandatory Clearing Regime	Status
	<p>an end-user exception (available to non-financial entities using swaps to hedge or mitigate commercial risk and potentially some small banks, savings associations, farm credit systems, credit unions, as well as captive finance) to submit for clearing to a registered or exempt clearing house any swap or security-based swap that is required to be cleared as determined by the Commodity Futures Trading Commission (CFTC) or the Securities and Exchange Commission (SEC), as applicable.</p>	<p>will be made are in various stages of proposal and finalization by the CFTC and SEC.</p>

## Appendix II - Exemptions to Mandatory Clearing

### A – Participant Exemptions

Jurisdiction	Smaller Participants	Pension Schemes	Corporate End-Users	Other
<b>Brazil</b>	There are no exemptions for exchange traded derivatives regarding mandatory clearing.			
<b>Canada</b>	Exemptions are yet to be determined, but are anticipated for end-users and transactions hedging commercial risks.			
<b>European Union</b>	N/A	Pension scheme entities/arrangements may receive a fixed period exemption to provide development time for a clearing model that avoids the negative impact of CCP cash margin requirements on pension fund yields.	Transactions by non-financial entities undertaken with the purpose of hedging commercial risk are exempt (subject to a threshold likely to be determined by ESMA).	EMIR will not apply to: <ul style="list-style-type: none"> <li>- the members of the European System of Central Banks (and similar entities)</li> <li>- multilateral development banks,</li> <li>- the Bank for International Settlements;</li> <li>- public sector entities owned by central governments (that have central government guarantee arrangements);</li> <li>- European Financial Stability Facility</li> <li>- the European Stability Mechanism;</li> <li>- European Company for the Financing of Railroad Rolling Stock.</li> </ul>
<b>Japan</b>	Mandatory clearing is applicable to Financial Instruments Business Operators (FIBOs), as defined in the Financial Instruments and Exchanges Act, which, in the initial stage will include main securities companies and banks.			
<b>United States</b>	By law, the CFTC and SEC may consider an exemption for small banks, savings associations,	Positions held by employee benefit plans are excluded from the calculation of the de minimis threshold for purposes of determining whether they are major swap	An exception is available to certain non-financial entities that are using derivatives for hedging or mitigating	Captive finance entities, whose purpose is to provide financing to affiliates within the same corporate group and whose use of OTC derivatives is restricted to hedging

<b>Jurisdiction</b>	<b>Smaller Participants</b>	<b>Pension Schemes</b>	<b>Corporate End-Users</b>	<b>Other</b>
	farm credit systems and credit unions. Rule-makers are considering whether to exempt small banks, savings associations, farm credit system institutions, and credit unions. Both Commissions are currently considering such exemptions.	participants subject to regulation.	commercial risks and who report how they generally meet their financial obligations associated with non-cleared derivatives.	or mitigating risks associated with that financing, are exempt.

## **B – Transaction Exemptions**

<b>Jurisdiction</b>	<b>FX Transactions</b>	<b>Intragroup Transactions</b>
<b>Brazil</b>	There are no exemptions for exchange traded derivatives regarding mandatory clearing.	There are no exemptions for exchange traded derivatives regarding mandatory clearing.
<b>European Union</b>	N/A	Transactions between both financial and non-financial entities belonging to the same corporate group are exempt.
<b>United States</b>	FX Spot and Forward are likely to be exempt from clearing by the rule-makers, as the principal associated risk (settlement risk) is considered by U.S Treasury to be effectively managed by existing infrastructure.	