

**ISDA response to the Bank of England consultation
Derivatives clearing obligation – introduction of contracts referencing TONA: Amendment
to BTS 2015/2205**

Executive Summary

ISDA members are very supportive of the Bank of England’s (BoE) consultation on adapting the UK EMIR derivatives clearing obligation (CO) in the context of interest rate benchmark reform. We also welcome that this supplementary consultation on TONA swaps allows us to feed into the process again.

ISDA members acknowledge the benefits of central clearing, as demonstrated by the current clearing rates for risk free reference rate (RFR) swaps. We believe that introducing a CO for these products could be a helpful tool for avoiding liquidity fragmentation.

Not only for TONA swaps, but for all new RFR swap clearing obligations, we would ask BoE for sufficient time to enact all changes to systems (internal and external) and control frameworks. We would welcome a confirmation that the BoE or other UK authorities will not use their supervisory power if insufficient notice is provided between the BoE final policy statement and the effective date of the rule.

We believe that transactions stemming from Post Trade Risk Reduction (PTRR) exercises should be exempt from the CO, to enable market participants to manage the risk in their uncleared portfolios.

This response should be read in conjunction with our response to the consultation “Derivatives clearing obligation – modifications to reflect interest rate benchmark reform: Amendments to BTS 2015/2205” and we will not repeat all points made in this response.

Consultation Questions

1. Do you agree with the proposed modification to the scope of the clearing obligation? If not, please provide your rationale.

We do not object to the additional clearing obligation for TONA swaps based on regulatory action by Japanese regulators, including the consultation on a local clearing mandate.

2. Do you agree with the proposed date for when this modification will come into force? If not, please provide your rationale.

We do not object to the proposed date in principle.

Not just in relation to TONA swaps, but for all RFR clearing obligations, we would like to point out that, generally speaking, our members require sufficient notice to implement any new clearing obligation. Many preparations can only be done once the final rules are available. Such actions include for example:

- Adapting the control framework to make sure all transactions that fall under the new clearing obligation will be cleared
- Adapting middleware, which can include liaising with external suppliers that might impose their own notice periods
- Changes to reporting systems: for instance, EMIR reporting which requires adjustments in term of mandatory clearing instrument eligibility.

All these preparations take time, and our members require a sufficient notice period between final rules and effective date of the clearing obligation. We would welcome a confirmation that the BoE or other UK authorities will not use their supervisory power if insufficient notice is provided between the BoE final policy statement and the effective date of the rule.

Ideally, we would ask for an implementation date of end Q1 2022. We believe there is no particular urgency for enacting these new clearing mandates, as we do not think a significant build-up of uncleared swaps would happen if the new TONA clearing obligation would not be enacted right away, particularly if there was only a short gap between the switch-off of JPY LIBOR and the additional of TONA. Counterparties set up to clear would be incentivised to continue to do so even absent a CO, not least due to the EMIR margin rules. Hence, we request a moderate delay of the go live beyond what the Bank proposes in order to avoid firms unnecessarily being in temporary technical breach of the EMIR CO or EMIR reporting rules. This would also avoid firms focusing resources unnecessarily on tactical or temporary fixes during the crucial year end period in order to hit the deadline, given the lack of time to plan.

We also note that we appreciate the intention to align with the outcome in Japan, where the JFSA is consulting, but the scope of counterparties impacted by a UK EMIR CO is broader than the local JFSA scope and requires slightly more involved client preparations.

3. Do you have any other comments on the proposal set out in this consultation?

As already mentioned in the response to your previous consultation on clearing obligations in relation to benchmark reform, we ask the BoE to contemplate an exemption from the clearing mandate applying to RFR swaps in the case of trades resulting from PTRR exercises (such as multilateral risk rebalancing cycles, which reduce uncleared counterparty credit risk and/or shift existing risk from the uncleared space to CCPs). With the extension of the clearing obligations to RFR swaps, such risk management practices, currently undertaken by many large dealer banks, could be impaired, as OIS as a tradeable instrument for both cleared and uncleared interest rate risk would no longer be available.

Reducing risk in uncleared portfolios is very beneficial in volatile markets such as those experienced in March 2020. Large market moves will cause large liquidity requirements for market participants if they are not able to manage the risk in their bilateral portfolios.

Trade Association Contacts

Ulrich Karl, head of clearing (ukarl@isda.org)

Roger Cogan, head of European public policy (rcogan@isda.org)

About ISDA

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 960 member institutions from 78 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org. Follow us on Twitter, LinkedIn, Facebook and YouTube.