



## EMIR REFIT (EMIR REVIEW)

EMIR, which is the European translation of the G20 leaders' commitment made during the 2009 Pittsburgh Summit to enhance transparency on the derivatives market and mitigate the current risk generated by those transactions, has entered into force in August 2012. In accordance with Article 85 of EMIR, the European Commission was requested to review and prepare a general report on EMIR for submission to the European Parliament and the Council. Based on several assessments covering different topics (impact of EMIR on the use of OTC derivatives, efficiency of the margin requirements, application of the clearing obligation, access of CCPs to trading venues, access of CCPs to central bank liquidity facility, ...), the purpose of such review was to determine if the framework stemming from EMIR has proven to allow achieving the objectives of the regulation and if some adjustments was to be made.

In parallel the European Commission has established in 2012 the Regulatory Fitness and Performance programme (known as REFIT) aiming to make EU law simpler and to reduce the costs and burden of a regulation while still achieving intended benefits.

The review of EMIR has been undertaken under the REFIT programme.

Since at the time of the analysis not all the EMIR key measures were in place and some came recently into operation (e.g. the mandatory clearing, the bilateral exchange of margins for non-cleared contracts), the review has not been exhaustive. Thus, the Commission stated that no fundamental change should be made but proposed amendments in specific areas coming under the overall REFIT programme.

To be reminded, EMIR is built on three main pillars:

1. **RISK MITIGATION** for OTC derivatives contracts:
  - The clearing obligation for all products considered sufficiently standardised.
  - For uncleared transactions, the rules have been strengthened to mitigate the counterparty risk (by setting an obligation of bilateral exchange of initial and variation margin) and the operational risk.
2. **TRANSPARENCY** by setting an obligation of reporting transactions to a Derivatives Trade Repository.
3. **INFRASTRUCTURE**:
  - More stringent requirements for central clearing houses.
  - Establishment of a European regulatory framework for Trade Repositories.

### 1. Overview

#### - Key aspects of the Review

- Clearing obligation

Under EMIR a contract is to be cleared if the product is subject to the mandatory clearing and if both parties to the contract are equally subject to the same obligation. With regards to parties, those concerned are financial counterparties (FCs) and a sub-set of non-financial counterparties (NFCs) - the ones qualified NFC+. Still under EMIR a NFC becomes a NFC+ when it holds positions above at least one of the 5 thresholds that each applies to a specific assets class. EMIR Refit makes two proposals in relation to parties.

RISK MITIGATION

#### FC TO BECOME FC+ OR FC-

The European Commission (EC) took into consideration the burden EMIR currently imposes to small financial counterparties due to the mandatory clearing and the difficulties they faced when trying to build a clearing set-up (be a client of a clearing member or a client of a client of a clearing member).

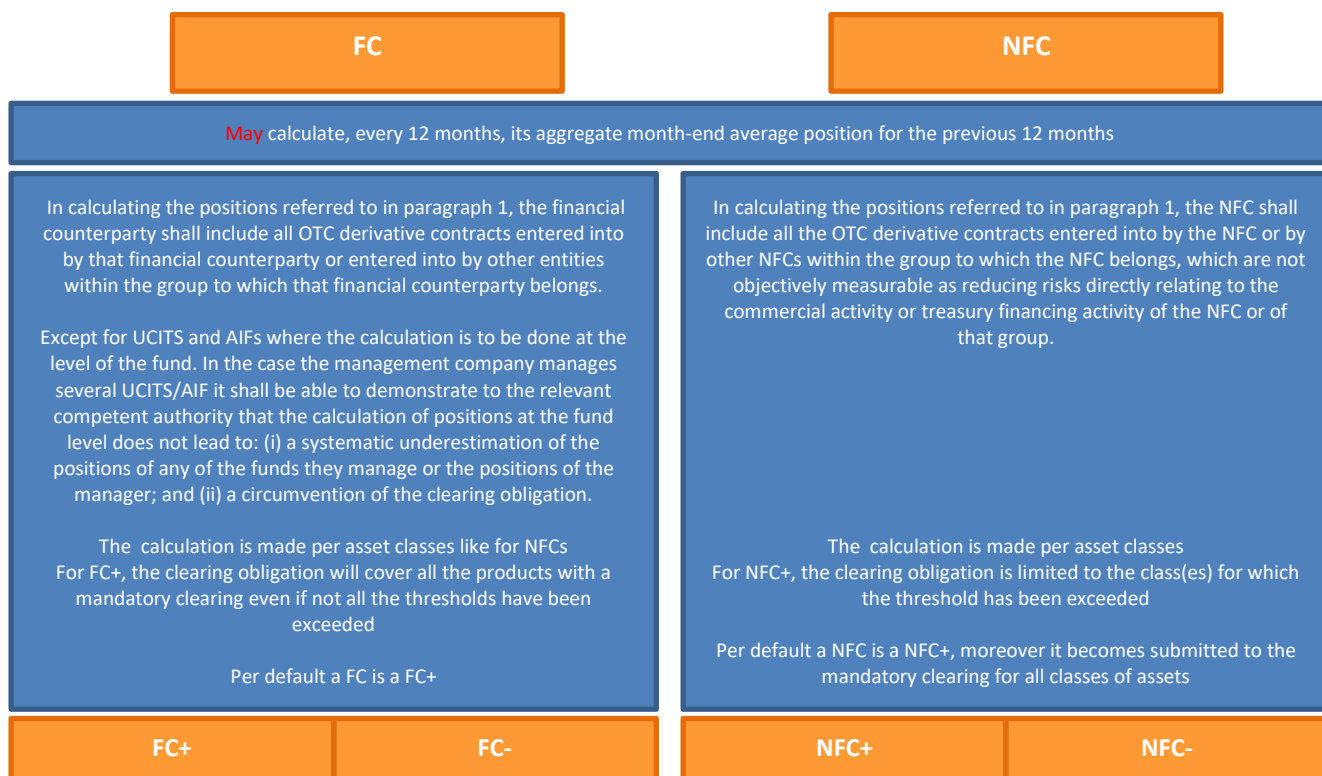
Thus, EMIR Refit introduces a distinction within FCs between FC+ and FC-. A FC+ will be fully submitted to the clearing (irrespective of the asset classes), whereas a FC- will never be. Practically the FC- category should correspond the current EMIR Category 3 for which the start of the clearing requirement was postponed until 21/06/2019. However, the calculation still needs to be done. Even more since the rules to be used are not the same as in EMIR. Indeed, the period

to be considered will be the previous 12 months whereas it was the months of January, February and March 2016 in EMIR. In addition, the calculation is per asset class, using the same thresholds as the ones decided for the NFC+/NFC- classification in EMIR, instead of a single threshold. Finally, it should be kept in mind that a financial counterparty that does not make the exercise will be qualified FC+.

**NFC+**

Whereas today a NFC+ is submitted to the clearing obligation for all the products subject to mandatory clearing even if the NFC exceeds only one threshold (and even for a class of assets not concerned by the clearing, e.g. commodities), tomorrow the clearing requirement will only apply to the assets class(es) for which the threshold has been exceeded. The position to be compared to the thresholds will be determined in the same way as for FCs (i.e. the Aggregate Average Notional Amount). Important to note, a NFC that doesn't determine its qualification will be considered as a NFC+ exceeding all the thresholds.

**IN BRIEF:**



- Access to the clearing (FRANDT)

**RISK MITIGATION**

The EC wants to ease the access to clearing for counterparties that have no direct access to CCPs either by promoting the indirect clearing or by limiting the cases where a clearing member may not onboard a new client. Therefore, EMIR Refit requires clearing members and clients providing clearing services to do it under Fair, Reasonable And Non-Discriminatory and Transparent (FRANDT) commercial terms. This requirement applies to OTC derivatives contracts. The level 2 should bring clarity and precision on those terms.

- FX Forwards

**RISK MITIGATION**

According to EMIR, there should be exchange of variation margins for physically-settled FX Forwards as of the entry into application of MIFID2/MIFIR on the 3<sup>rd</sup> January 2018. But the variation margin exchange obligation validated internationally was translated in different ways from one region to another. Whereas the European Union enshrined it in the law, the USA instead opted for guidelines enacted by regulators (same approach applied in Asia). The European authorities have been alerted by the industry of what constitutes an unlevel playing field situation, but too late for the EC to amend accordingly its EMIR Refit proposal. Eventually this topic is mentioned only in a recital but covers both FX forwards and FW swaps and leaves room for a potential extension to other types of contracts (in particular equities options) by stating that *“International convergence should also be ensured with regard to risk-management procedures for other classes of derivatives”*. The point shall be addressed in a delegated regulation.

- Reporting to a Trade Repository

TRANSPARENCY

EMIR Refit proposes several measures to lighten the reporting:

- For transactions between a FC and a NFC- the FC will be responsible and legally liable for reporting on behalf of the two parties; thus it remains a double side reporting with NFC- responsible to provide the FC with the data needed (LEI and classification).
- Intragroup transactions involving at least one NFC will be exempted but only if the parent company is a not a financial counterparty.
- Reporting for listed derivatives, required both by EMIR and MIFIR, will have to be assessed by 18 months after the entry into force

In addition, EMIR Refit requires ESMA to work on specifications with regards to the reporting format (use of international identifiers, frequency of the reporting, ...).

- Pension Scheme Arrangements

RISK MITIGATION

Under EMIR, pension scheme arrangements benefited from a 3 years exemption from the clearing obligation since there was no technical solution developed by CCPs for the transfer of non-cash collateral as variation margins. The same assessment has been done in the light of EMIR's review. Thus, it is proposed a new extension by two or three years (depending on the size) of the temporary exemption.

It should be noted that the first period has ended in August 2018 (3 years after the entry into force of EMIR) while the second one will start only at the entry into force of EMIR Refit leaving the industry with a several months intermediary period during which the obligation should apply. Therefore, ESMA has published a letter where it officially announced that it did not expect regulators to focus their oversight primarily on pension scheme arrangements considering that the exemption would be renewed as part of EMIR Refit.

- Scope of financial counterparties

RISK MITIGATION

EMIR Refit changes slightly the definition of a Financial Counterparty. Now IORPs and CSDs are also in the scope. On the contrary Securitisation Special Purposes Entities (SSPEs) and Employee Share Purchase Plans (ESPP) are not qualified FC as well as UCITS when "set up exclusively for the purpose of serving one or more employee share purchase plans" and AIF when "set up exclusively for the purpose of serving one or more employee share purchase plans", or AIF when being a "SSPE as referred to in Article 2(3)(g) of Directive 2011/61/EU".

- **Other aspects:**

- Asset Protection

INFRASTRUCTURE

EMIR Refit brings clarity on the future of assets covering the positions held in a CCP in case of an insolvency of the CCP or of one of its members. EMIR Refit states clearly that those assets shall not be considered part of the insolvency estate.

- Suspension of the clearing obligation

RISK MITIGATION

There might be circumstances (other than a CCP's resolution, which will be dealt via the Recovery & Resolution European proposal) where a clearing obligation should be removed or at least suspended. If it is already feasible, the current framework doesn't allow a swift change. Indeed, the suspension shall follow the same process as the launch of the obligation and thus take several months, far away from one can expect in such emergency cases. EMIR Refit will ease the process and thus shorten the delay.

- Frontloading

RISK MITIGATION

Frontloading is related to the clearing obligation. It requires entities to clear contracts entered or novated before the start of the clearing obligation if the remaining maturity was higher than the minimum remaining maturity (MRM). It should be noted that the original requirement has already been modified to limit its impact. EMIR Refit puts an end to this topic by removing any mention to a MRM.

- Operational risk mitigation techniques for uncleared contracts

The EC considered that this requirement has been applied differently across the EU and thus, asks ESMA to work on a procedure for a “a priori supervisory approval of the risk-management procedures that require the timely, accurate and appropriately segregated exchange of collateral, and of significant changes to the risk-management procedures”.

RISK MITIGATION

- Backloading

Backloading is related to the reporting obligation. It requires entities to report historic contracts (i.e. those open when EMIR entered into force but closed before the start of the reporting obligation). Initially set for 12 February 2017 (3 years after the implementation date of the reporting obligation), the deadline under EMIR for reporting these contracts was shifted to 12 February 2019. EMIR Refit removes this obligation.

TRANSPARENCY

- CCPs

EMIR Refit requires CCPs to provide their members with details on the initial margins Model they use and with tools to simulate the initial margins a clearing member will have to post.

TRANSPARENCY

- Trade Repositories (TR)

Several measures with regards to TR are included in the EMIR Refit proposal and cover a wide range of areas (from the registration process for an extension to an increase of the fines a TR may be imposed on, via the improvement of the quality of data as well as the availability of the latter).

INFRASTRUCTURE

- **Progress update and way forward:**

- FRANDT

ESMA has issued on the 2<sup>nd</sup> of June its technical advices as regards the FRANDT criteria. One should recall that the application of the FRANDT principles doesn't apply to cash equities transactions.

In the first version of the Technical advices (subject to consultation in 2019), ESMA considered that all information intended for clients (the management process, the criteria used to define the client's risk profile, the client's classification, general contractual terms, technical requirements, pricing structure, additional services, etc.) were to be available on the clearing service provider's public website.

The final version revisits this principle while structuring the onboarding process. The public information will be those already required under EMIR and MIF2, plus a presentation of the onboarding process, some key commercial terms and a template to submit a RFP. ESMA, in fact, distinguishes three steps in the management of a client: the RFP sent by the latter, the commercial proposal that follows and the agreed terms reflecting the signed agreements.. Most of the information targeted by the Technical advices will therefore be exchanged bilaterally via the commercial proposal (list of costs, onboarding costs, risk assessment methods, technical requirements, etc.). It should be noted that ESMA has abandoned the idea of client classification.

ESMA also discusses two issues raised in the responses to its consultation: the scope of OTC derivatives contracts concerned (only contracts subject to the clearing obligation? all contracts cleared for a product subject to the obligation? any contract cleared voluntarily or by obligation?) and the territoriality of the FRANDT criteria (to be applied to any European or third country service provider, to any European or third country client insofar as the service is provided in Europe?). ESMA recognises that EMIR is not precise enough and that these two subjects would deserve clarification from the Commission (they are not in the mandate given to ESMA).

- EMIR Refit and MIFIR

On the current misalignment between the trading obligation (MIFIR) and the clearing obligation (EMIR Refit), ESMA's current view is to have an alignment between the two requirements; in other words a Financial Counterparty not submitted to the clearing obligation under EMIR (namely a FC-) will not be submitted to the trading obligation under MIFIR. Same for Non-financial Counterparties. ESMA is also seeking opinion on the trading obligation suspension. EMIR Refit provides

for a swift suspension (in some very specific cases) of the clearing obligation. Thus came the question of a similar trading suspension. ESMA is envisaging a standalone suspension of the trading obligation. In its final report issued on the 7<sup>th</sup> of February 2020, ESMA has confirmed its initial proposals (alignment of MIFIR on EMIR and a stand-alone suspension mechanism for the Derivative Trading Obligation).

- Non-cleared contracts

Work has been undertaken by the European bodies (ESAs) with regards to the requirements applied on non cleared contracts. On the 5<sup>th</sup> of December 2019 they have published their draft amended text of the RTS 2016/2251 and thus addressed different open points:

- The main one relates to the requirement for variation margins on FX forwards. Again (a first draft amendment was submitted to the EC end of 2017 but never adopted), the ESAs propose to allow a derogation for physically settled FX forwards where one of the counterparties is not an institution (an investment firm or a credit institution). Moreover, they extend this derogation to physically settled FX swaps.
- The draft covers also two temporary exemptions contained in the initial EMIR and about to end. The first one is on single-stock equity options and index options. The ESAs propose an additional one-year extension (the new date will be the 4<sup>th</sup> of January 2021). The second temporary exemption was on certain intragroup transactions involving a third country entity where no equivalence exists between the EU and the third country. The temporary regime would be aligned to the one for the clearing obligation (ie the 21 December 2020).

Eventually, the ESAs have considered the new international calendar in relation to the exchange of initial margins. Important: the Basel Committee and IOSCO have decided another one-year delay for the phases 5 and 6 due to the Covid-19. Thus the ESAs proposal would have to be updated accordingly.

One should have in mind what the ESAs wrote *“The ESAs cannot disapply EU law. However, in view of the remaining steps mentioned above that the draft RTS need to go through before being finalised and entering into force, and in light of some of the relevant deadlines, with regards to the bilateral margin requirements and the treatment of physically settled FX forward and swap contracts, intragroup contracts, equity option contracts and the implementation of the last phase of the initial margin requirements as proposed in the draft RTS, the ESAs expect competent authorities to apply the EU framework in a risk-based and proportionate manner until the amended RTS enter into force.”*

A new version of the draft has been issued by the ESAs on the 4<sup>th</sup> of May 2020, followed by a new one since the former was still waiting for its adoption.

The 23<sup>rd</sup> of November 2020 version includes the topics already discussed earlier, but also Brexit topics and proposes new end dates for the temporary exemptions:

- Initial margin exchanges: the text is based on the May 2020 version and therefore the schedule agreed by the Basel Committee and IOSCO (i.e. the next phases in September 2021 and September 2022)
- FX Forwards physically settled: ESAs reiterates their proposal for easing the requirement to exchange variable margins and extending this measure to FX Swaps
- Temporary exemption of initial and variable margins for individual equity options and index options: the proposal has been reviewed; the exemption would be valid until January 4, 2024, 3 years longer than in the 2019 version
- Temporary exemption of initial and variable margins for intra-group transactions involving a third country entity where no equivalence has been recognised between the European Union and the third country; the proposal has been reviewed; the exemption would be valid until June 30, 2022 (instead of December 21, 2020 in the 2019 version).
- Transfer into the Union of contracts originally concluded between a party of the Union of 27 and one in the UK: ESAs propose a legislative mechanism that will allow new contracts (the relocated ones) to benefit from the same exemptions as the original contracts under EMIR (for example, the exemption of bilateral exchanges of initial margin).

- Cleared contracts

On the 23<sup>rd</sup> of November 2020, ESMA published a draft RTS aiming at modifying the 3 delegated regulations on the clearing obligation. Two main topics are at the origin of this proposal:

- The temporary clearing exemption for intra-group transactions involving a third-country entity where no equivalence has been recognised between the European Union and the latter. Originally planned to end in 2019, it had already

been extended (at the end of 2018). Less than one month before the new deadline (December 21, 2020), the ESMA therefore proposes to maintain this exemption until June 30, 2022. The regulator justifies this proposal by the absence of new equivalences between the EU and third countries.

- Transfer into the Union of contracts originally concluded between part of the Union of 27 and part of the UK: ESMA proposes a legislative mechanism that will allow new contracts to benefit from the clearing exemption if the original contract was not subject to the clearing obligation. Strictly limited, this mechanism will only be available for a period of 12 months from the date of application of the text.

This draft is also an opportunity for ESMA to bring the 3 delegated acts into line with EMIR Refit. The regulator thus proposes to eliminate the Minimum remaining maturity, a concept that has become useless since the frontloading requirement has been abandoned.

The European Commission has eventually adopted the two draft RTS on the 23<sup>rd</sup> of December 2020. The process has entered now in the “non objection by the European Parliament or the Council” period. Then the new texts will be published in the Official Journal of the EU.

- Reporting to Trade Repositories

ESMA has issued a consultation on the 26<sup>th</sup> of March 2020 covering (closed on the 3<sup>rd</sup> of July 2020):

- the technical standards on reporting requirements, procedures to reconcile and validate the data and access by the relevant authorities under EMIR REFIT
- a revision of certain aspects of reporting to the TRs in order to align the reporting requirements in the EU with the global guidance on harmonisation of OTC derivatives data elements reported to TRs, as developed by the CPMI and IOSCO working group for the harmonisation of key OTC derivatives data elements (Harmonisation Group).

ESMA has published its final report on the 17<sup>th</sup> of December 2020

- Pension Scheme Arrangements (PSA)

ESMA has released (on the 17<sup>th</sup> of December 2020) its final report on PSA following its April 2020 consultation dedicated to the central clearing solutions for Pension Scheme Arrangements. ESMA suggests postpone by year the end of the temporary exemption (from June 2021 to June 2022).

- Others

On the 13<sup>th</sup> November 2020, ESMA issued its final report on post trade risk reduction (PTRR) services with regards to the clearing obligation and a potential clearing exemption.

- ESMA 2021 programme

Outputs announced by ESMA:

- Guidance on EMIR implementation regarding the clearing obligation and the bilateral margining requirements;
- Guidance on EMIR implementation of the changes introduced under Refit;
- Reports to the Commission mandated under EMIR (the review of the clearing thresholds or the report on the potential clearing solutions for pension scheme arrangements).

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**2. Reference law(s) and effective date**

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[European Parliament - Presentation](#)      [European Parliament - Procedure File](#)

[European Commission proposal](#)                      [final text \(2019/834\)](#)

[Draft amended text for non cleared contracts](#)

[Alignment of MiFIR with the changes introduced by EMIR Refit](#)

[Technical advices on FRANDT](#)

[ESMA final report on PSA](#)

[ESMA final report on PTRR](#)

[ESMA final report on reporting to Trade Repositories](#)

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