



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).

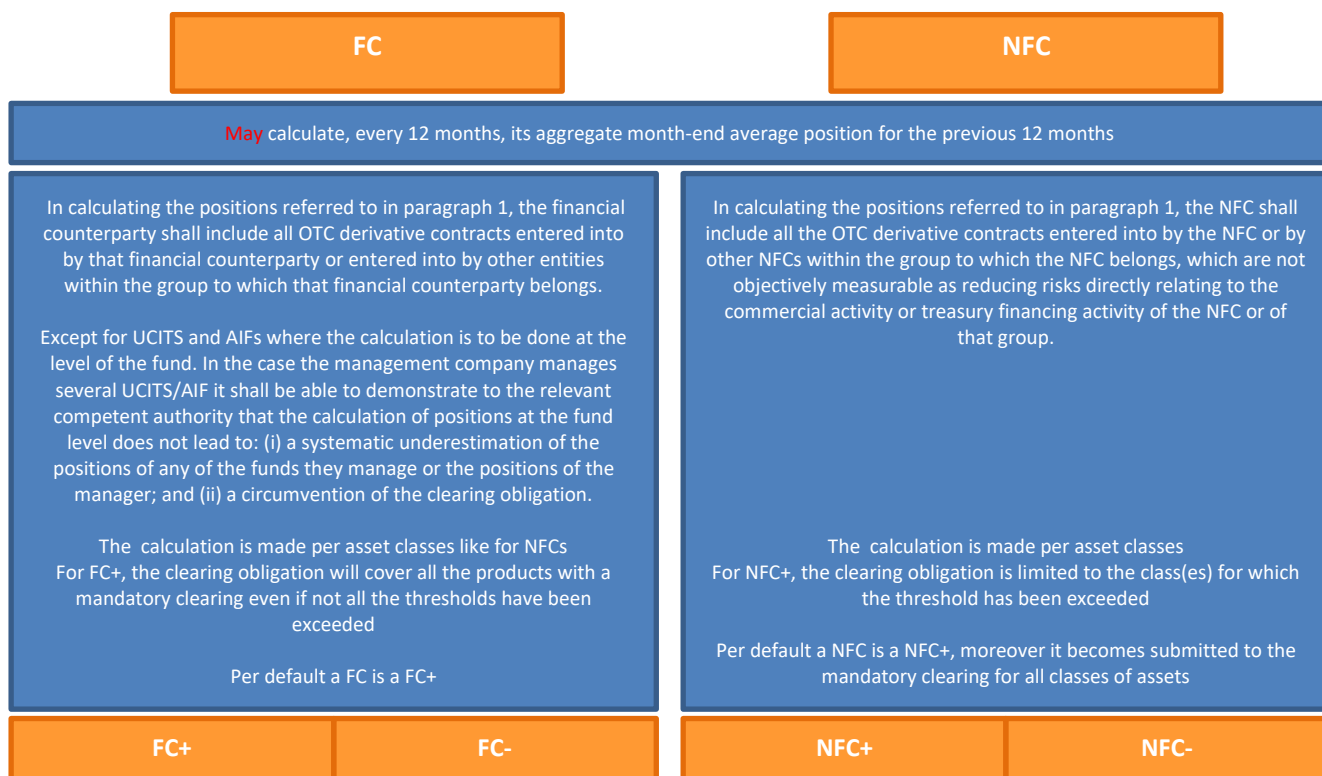
Thus, EMIR Refit introduces a distinction within FCs between FC+ and FC-. A FC+ will be fully submitted to the clearing (irrespective of the asset classes), whereas a FC- will never be. Practically the FC- category should correspond the current EMIR Category 3 for which the start of the clearing requirement 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 3rd 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:**

The regulation EMIR Refit (2019/834) has been published in the EU Official Journal on the 28th of May 2019 and entered into force on the 17th June 2019. Thus, the dilemma for the former “category 3 FC” and related to the clearing obligation as of the 21st of June disappears. On the other hand counterparties will have to be qualified for the entry into force; a counterparty is not required to determine its new situation; however, if not, then it will be considered a FC+ (rep a NFC+) and is required to notify ESMA and NCAs accordingly.

It should be noted that some of the changes brought by EMIR Refit will apply later.

The two consultations issued by ESMA in October 2019 are now closed.

As a recall:

- For a draft technical advice on FRANDT ESMA should provide the European Commission with. The topic is on how to specify the conditions under which the commercial terms are to be considered to be Fair, Reasonable, Non Discriminatory and Transparent (FRANDT) when providing clearing services to clients. The application of the FRANDT principles will be limited to OTC derivatives contracts (thus not on cash equities transactions)
- For a report to the Commission as regards 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 7th 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).

In the meantime work has been undertaken by the European bodies with regards to the requirements applied on non cleared contracts. On the 5th of December ESAs 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 4th 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).
- Finally, the ESAs have considered the new international calendar in relation to the exchange of initial margins.

It is now up to the European Commission to adopt the proposals and to the European Parliament and the Council to not object. Then the new text will be published in the Official Journal of the EU. In between competent authorities are expected by the ESAs to apply their supervisory tasks according to the future amended text.

2. Reference law(s) and effective date



[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](#)

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