

EMIR (EUROPEAN MARKET INFRASTRUCTURE REGULATION)



Considering the lessons from the 2008 financial crisis, the G20 leaders made a commitment during the 2009 Pittsburgh Summit to enhance transparency on the derivatives market and mitigate the current risk generated by transactions that were mostly carried out on an over-the-counter (OTC) basis. The declared objective was to implement the measures adopted by the end of 2012.

EMIR (effective as from August 2012) is Europe's translation of these measures into a regulation similar to the Dodd Frank Act (DFA), which equally sets out regulations for the same transactions in Title VII thereof.

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 margin and variation margin) and the operational risk.
2. **TRANSPARENCY** by setting an obligation of reporting to a Derivatives Trade Repository.
3. **INFRASTRUCTURE**:
 - More stringent requirements for clearing houses.
 - Establishment of a European legal framework for Trade Repositories.

1. Overview

- Key aspects of the Regulation

- Obligation of reporting to a Trade Repository (effective as from 2014)

TRANSPARENCY

EMIR sets a reporting requirement for all derivatives contracts.

The reporting should be made to a Trade Repository selected from the list of ESMA-agreed Repositories. The collected data will be accessible to both national regulators and ESMA. This is a bilateral reporting (required from both parties to the contract). This obligation transcends the G20 requirements, given that it equally applies to listed derivatives (ETDs), namely contracts concluded on a regulated market. The inclusion of ETDs and the bilateral reporting are two notable differences compared with US requirements (DFA).

The reporting obligation applies also on certain contracts closed prior to the implementation date (12 February 2014). Initially, ESMA's objective was to be well ahead of the game, such that immediately EMIR comes into operation, it would have gained a practical insight into the OTC derivatives universe. Two types of contracts are involved by this backloading:

- Those still open at the effective date of EMIR (16/08/2012) and closed prior to the effective date of the obligation
- Those concluded as from 16/08/2012 and closed before 12/02/2014

Initially set for 12 February 2017 (3 years after the implementation date of the reporting obligation), the deadline for reporting these contracts has been shifted to 12 February 2019

- Operational risk mitigation techniques for uncleared contracts (effective from 2013)

EMIR sets out risk mitigation requirements for contracts not bound by a clearing obligation (either because the product is not or because at least one of the parties to the contract is not bound by same).

RISK MITIGATION

These requirements apply to various processes, including: contract confirmation, portfolio valuation and compression, portfolio reconciliation and dispute management.

- Counterparty risk mitigation techniques for uncleared contracts (as of 2017)

The key EMIR requirement, namely the initial / variation margin exchange obligation for uncleared contracts, only came into application in early 2017 (Delegated Regulation (EU) 2016/255).

RISK MITIGATION

Effective from 1 March 2017, the exchange of variation margins is mandatory (except in special cases). Although the law has set this as a firm date, the various regulators (local, European or international) have all admitted, in one way or the other, that implementing this obligation poses a challenge considering the high volume of contracts that will need to be revised. As for the initial margin exchange obligation its implementation is spread out over several years (2017-2020).

IN BRIEF:

	2 parties above 3000 billion €	2 parties above 2250 billion €	2 parties above 1500 billion €	2 parties above 750 billion €	2 parties above 8 billion €	At least 1 party below 8 billion €
Initial Margin (IM)	06/02/2017	01/09/2017	01/09/2018	01/09/2019	01/09/2020	No IM
Variation Margin (VM)	06/02/2017	01/03/2017	01/03/2017	01/03/2017	01/03/2017	01/03/2017
VM (FX forwards) ^(*)	03/01/2018	03/01/2018	03/01/2018	03/01/2018	03/01/2018	03/01/2018

^(*) Cf. item on FX forwards below.

Kindly note that this implementation schedule is aligned with the international schedule, save for the first deadline (namely 6 February 2017).

- Clearing obligation (effective from June 2016)

RISK MITIGATION

The clearing obligation is applied on a product-by-product basis. It is endorsed by the European Commission based on a proposal by ESMA. The products considered by the latter are derivatives eligible for clearing by a CPP (Central Counterparty Clearing House) accredited pursuant to EMIR. In practice, new agreements are notified to ESMA, whereupon the latter begins its analysis and consultations. In addition to the standard procedure, ESMA may notify the European Commission of any derivatives that it feels may be submitted to the compensation, but are not admitted by an agreed CCP.

The register of products submitted to the clearing obligation is available on the ESMA website (cf. below).

A contract should be cleared if the product is subject to clearing and if both parties to the contract are equally subject to same. Implementation of the obligation is spread out over time, depending on the type of the parties. There are 4 different categories: members of a CCP (Cat. 1), active financial counterparties (Cat. 2), other financial counterparties (Cat. 3) and NFC+ non-financial counterparties (Cat. 4).

INTEREST RATE SWAPS (IRS) & CONTRACT DEFAULT SWAPS (CDS)

	Categ 1	Categ 2	Categ 3	Categ 4
IRS wave 1	21/06/2016	21/12/2016	21/06/2019	21/12/2018
CDS	09/02/2017	09/08/2017	21/06/2019	09/05/2019
IRS wave 2	09/02/2017	09/07/2017	21/06/2019	09/07/2019

NON DELIVERABLE FX FORWARDS (NDFX)

No clearing obligation for now.

- Accreditation of CCPs (effective from 2014)

Since EMIR requires compensation for products considered standard, there was a need to ensure that Clearing Houses (CCPs) are robust.

INFRASTRUCTURE

Apart from specific requirements for derivatives OTC contracts, the regulation introduces further requirements (capital needs, governance, operational procedures, risk hedging, clearing member default management, etc...). These obligations apply to all CCPs regardless of the type of product cleared.

EMIR requires all CCPs located within the Union to obtain their agreement under EMIR (no grandfather clause for already operational CCPs). Agreement needed by CCPs of non-EU countries (third country CCPs) to offer services to

regulated entities in the Union (trading / affirmation platforms and clearing members) is given by ESMA. Initially, the European Commission must have recognised that the jurisdiction of the third country is equivalent to the European one. *The register of accredited CCPs is available on the ESMA website (cf. below).*

Kindly note that CCP defaults are dealt with in the regulation on *CCP recovery and resolution*.

INFRASTRUCTURE

- Accreditation of Trade Repositories (effective from 2013)

EMIR introduces the European statute for Trade Repositories and sets out the regulatory framework for their activities (agreement, oversight requirements, etc.). ESMA may carry out on-site investigations or inspections and levy penalties or fines in case of duly-established negligence or violation.

- Other aspects:

- FX forwards (definition and level playing field)

RISK MITIGATION

On two occasions, FX forwards were addressed specifically.

It should be noted firstly that FX derivatives are not submitted to the clearing obligation. As a result, they fall under the uncleared contracts regime. In addition, they are exempted from the initial margin exchange obligation. Thus, they are bound by the variation margin exchange obligation with effect from 1 March 2017 (at the latest).

Within FX derivatives, physically-settled FX forwards differentiated themselves from the others because they were considered or not as financial instruments depending on the EU Member State (following the translation of MIFID into local law), which made them included or excluded from the scope of EMIR. The revised MIFID (MiFID II) has clarified this aspect by highlighting the (rare) cases where these products may not be considered as financial instruments. Effective as from early 2017, the EMIR delegated regulation (2016/2251) on uncleared contracts provided for a temporary exemption valid until the coming into application of MIFID II. This took place on 3 January 2018, thereby introducing a de facto obligation of variation margin exchange

However, the issue of applying variation margins to physically-settled FX forwards remains pending. In practice, the variation margin exchange obligation validated internationally was domesticated 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 were informed by industry about the issue of competition and considered the complaint admissible. By December 2017 ending, Europe's three regulators (ESMA, EBA and EIOPA) tabled a proposed amendment to Delegated Regulation 2016/255 to the European Commission.

- Covered bonds and Securitization Special Purpose Entity

RISK MITIGATION

OTC contracts concluded by a covered bond entity in connection with a covered bond or by a SSPE in connection with a securitisation may face issues to comply with EMIR requirements. Therefore, and under certain conditions they both have been exempted from the clearing obligation by the Securitisation Regulation (2017/2402) amending EMIR level 1. In addition, EMIR level 2 exempts under certain conditions covered bonds from bilateral exchanges of initial and variation margins for non-cleared contracts.

- Intersection with MIFID II / MIFIR (2018)

RISK MITIGATION

EMIR identified products considered as sufficiently standardised to undergo mandatory clearing. MIFIR supplements this process by identifying within the family of mandatorily-cleared products, those that will be considered as sufficiently liquid to further undergo a trading obligation on a trading venue (regulated market, MTF or OTF). The products identified by the European Commission are:

- For IRSs: fixed versus variable interest rate swaps in Euros, USD and GBP.
- For CSD: iTraxx Europe Main and iTraxx Europe Crossover

On the other hand, with the implementation of EMIR, OTC derivatives contracts may be submitted to a clearing obligation, whereas there was no previous equivalent for listed derivatives (ETDs). MIFIR harmonises the requirements by imposing a clearing obligation for all ETDs.

- Combined with MIFID II / MIFIR: Indirect clearing (3/01/2018)

RISK MITIGATION

The indirect compensation principle was introduced in EMIR to allow counterparties submitted to the clearing obligation to comply accordingly. Not all counterparties are members of a CCP. Moreover, it may even be difficult for them to be clients of a clearing member. Indirect clearing gives them access (under certain conditions) to a CCP as clients of a client of a CCP's clearing member.

Two regulations were published jointly (namely 2017/2154 related to MIFIR and 2017/2155 amending EMIR regulation 149/2013). Both regulations revisit the issue of access to indirect clearing of OTC derivatives (EMIR provision) and ETDs (MIFIR provision). They set out the obligations applicable to the various providers of indirect clearing services (CCPs, clearing members and the client).

- **Progress update and way forward:**

- Clearing

The next steps as far as clearing is concerned have been set for mid-2019. It must be borne in mind that the aim of the revised EMIR (EMIR Refit) is to ease some obligations when applied to small-size Financial Counterparties as well as for NFC+. More especially, small-size financial counterparties should be exempted from clearing and the obligation applied on NFC+ should be reduced. Depending on the effective date of EMIR Refit, some of the currently planned obligations may be removed after having started. Therefore, ESMA has issued a statement end October 2018 with regards to certain intragroup transactions and to NFC+ requesting competent authorities to "not prioritise their supervisory actions" towards such contracts. A same statement has been published on the 31 January 2019 to cover the case of small financial counterparties.

EXEMPTION FOR INTRA-GROUP TRANSACTIONS INVOLVING AN ENTITY IN A NON-EU COUNTRY.

Following a consultation (in August 2018), ESMA proposed to extend the temporary exemption provision in EMIR. The new date would be 21/12/2020 for all products. This extension is justified by the current lack of any equivalent in non-EU countries.

EXEMPTION FOR PENSION SCHEME ARRANGEMENTS

Since the exemption granted to pension scheme arrangements has ceased on 17 August 2018 (was valid for 3 years), ESMA 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.

- Margin exchange

Adoption by the European Commission of the proposed amendment on FX forwards (variation margin exchange) is still pending. Here too, the issue would be addressed once and for all by EMIR Refit since it should endorse the exemption.

In its 2018 work plan, ESMA has declared its interest in working together with other ESAs on risk mitigation techniques for uncleared contracts related to covered bonds (a consultation will be organised).

- Covered bonds and Securitization Special Purpose Entity

The ESAs have issued two draft proposals (12.12.2018) aiming to:

- specify the criteria to be used for the application of the exemption of the clearing for both (as required by the Securitisation Regulation)
- amend the EMIR delegated regulation on non-cleared contracts by including a conditional exemption of initial and variation margins for SSPE (already existing for covered bonds)

These two proposals are now to be adopted by the European commission.

- Reporting

Due to the still undergoing discussions on EMIR Refit, ESMA has issued a statement (31.01.2019) with regards to the backloading requirement on reporting entities since such obligation is to be removed from EMIR Refit.

- Revised EMIR

The review of the regulation began in August 2015 according to the 2012's regulatory text. The European Commission published two proposals:

EMIR REFIT (PROPOSED ON 4 MAY 2017)

See our dedicated Fiche To Know More

EMIR CCP (PROPOSED ON 13 JUNE 2017)

The aim of EMIR CCP (EMIR 2.0) is to enhance the oversight of European CCPs and address non-EU country issues:

- For EU CCPs, the oversight is more pan-European. Cooperation between regulators and central banks in charge of the Union's currency also feature among the proposals, while ESMA's role is amended accordingly.
- For CCPs in non-EU countries, the regulation introduces a classification of CCPs into Tier 1 / Tier 2, depending on the systemic risk they may pose for the Union. The process for recognising "Tier 2" CCPs will be more stringent.
- The EC may even require a "Tier 2" CCP to relocate its activities to the EU, if necessary.

A final agreement was reached in trilogue. On third country CCPs supervision (i.e. tiering criteria between Tier 1 and Tier 2 CCPs including super systemic CCPs; relocation decision; review of recognition; requirements that CBIs can impose on Tier 2 CCPs; and transitional arrangements) the wording "Last resort measure" when referring to relocation for super systemic CCPs will stay. However ESMA may recommend to not recognise a CCP, with or without prior classification of the CCP or some of its services as a Tier-2 entity.

The EC will shortly adopt a number of delegated acts to define the scope and content of certain provisions, drawing on public consultations and relevant assessments. Before their adoption, these delegated acts will be subject to a public consultation.

2. Reference law(s) and effective date

[European Parliament - Presentation](#)

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[European Parliament - Procedure File](#)

[Level 1 law](#)

[Level 2 laws \(delegated regulations\) published in 2013](#)

[Level 2 law \(delegated regulation\) on counterparty risk for uncleared contracts](#)

[Register of clearing obligations](#)

[Register of CCPs accredited under EMIR](#)

[Q&A by ESMA](#)

[ESMA's October 2018 statement on the clearing obligation](#)

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