# 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.

The EMIR review process started in 2015 has led to two regulations amending the 2012's text.

The first one (known as EMIR Refit or 2019/834) has been published in May 2019 and will enter into force on the 17th of June. Thus some of the original requirements will be modified or even will finally not apply. The second one dedicated to the supervision of CCPs with major new requirements applying on non-EU CCPs is named EMIR 2.2 (or 2019/2099) and has entered into force on the 1st January 2020.

## 1. Overview

### - Key aspects of the Regulation

- <u>Obligation of reporting to a Trade Repository (effective as from 2014)</u>

**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. This obligation has been finally removed in the perspective of EMIR Refit.

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

**RISK MITIGATION**

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).

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)

**RISK MITIGATION**

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).

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.*

This implementation phase-in was aligned with the 2015's international schedule, save for the first deadline (namely 6 February 2017). However, one should note that:

- The Basel Committee and IOSCO agreed to a one year extension of the final implementation phase (the 01/09/2020 becomes the 01/09/2021) and to create an additional implementation phase whereby as of 1 September 2020 covered entities with an AANA of non-centrally cleared derivatives greater than €50 billion will be subject to the requirements.

| Initial Margin | 2 parties above 3000 billion € | 2 parties above 2250 billion € | 2 parties above 1500 billion € | 2 parties above 750 billion € | 2 parties above 50 billion € | 2 parties above 8 billion € |
|---|---|---|---|---|---|---|
| Date | 01/09/2016 | 01/09/2017 | 01/09/2018 | 01/09/2019 | 01/09/2020 | 01/09/2021 |

- Due to the Covid-19 and its impacts, the Basel Committee and IOSCO have decided a one-year postponement of phase 5 and phase 6 (announced the 3rd of April)

| Initial Margin | 2 parties above 3000 billion € | 2 parties above 2250 billion € | 2 parties above 1500 billion € | 2 parties above 750 billion € | 2 parties above 50 billion € | 2 parties above 8 billion € |
|---|---|---|---|---|---|---|
| Date | 01/09/2016 | 01/09/2017 | 01/09/2018 | 01/09/2019 | 01/09/2021 | 01/09/2022 |

- 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. The original EMIR

defined 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* |

Due to EMIR Refit the dates for categories 3 and 4 will not apply as such. The new date will be the date determined based on the entry into force of EMIR Refit (4 months after 17/06/2019). It should also be noted that the category 3 disappears; EMIR Refit has splitted FC into FC+ and FC-.

NON DELIVERABLE FX FORWARDS (NDFX)

No clearing obligation for now.

- <u>Accreditation of CCPs (effective from 2014)</u>

**INFRASTRUCTURE**

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

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**

- <u>Accreditation of Trade Repositories (effective from 2013)</u>

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:

- <u>FX forwards (definition and level playing field)</u>

**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.

The FX topic has been addressed by EMIR Refit but only via a recital that restrits mandatory variation margins for FX forwards and FW swaps to contracts between the most systemic counterparties. In addition the recital 21 opens the door to other cases of international regulatory divergence.

- 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:

- Next steps for the original EMIR

Amid the 2012's requirements the one still under progress is about the exchange of initial margins for 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 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 international calendar in relation to the exchange of initial margins (as recommended in 2019)..

In May 2020, the ESAs have issued an updated version of their draft RTS issued in December 2019, taking into account the new calendar for initial margins (as proposed by the Basel Committee and IOSCO in response to the Covid 19).

| Initial Margin | 2 parties above 3000 billion € | 2 parties above 2250 billion € | 2 parties above 1500 billion € | 2 parties above 750 billion € | 2 parties above 50 billion € | 2 parties above 8 billion € |
|---|---|---|---|---|---|---|
| Date | 01/09/2016 | 01/09/2017 | 01/09/2018 | 01/09/2019 | 01/09/2021 | 01/09/2022 |

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.

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."*

With regards to the two temporary exemptions (see above), several associations have cosigned and sent two letters dated 30 April 2020 to the European Commission and the three European regulators. Pointing out the importance of intra-group transactions and an unchanged situation for equities and index options, they request a longer extension of the two exemptions (resp. January 4, 2024 and December 21, 2023), or permanent for stock and index options. Otherwise, they ask for public consultations to be launched on these two exemptions, as soon as possible due to the current uncertainty while the deadlines are close. Finally, they point to the need to move forward in the process of adopting equivalency.

- Review of EMIR

The review of the regulation began in August 2015 according to the 2012's regulatory text and leads to two texts :

EMIR REFIT

See our dedicated Fiche To Know More (the text has entered into force on the 17th of June 2019)

EMIR CCP (PROPOSED ON 13 JUNE 2017)

See our dedicated Fiche To Know More (the text has entered into force on the 1st of January 2020)

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

European Parliament - Presentation / 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

BIS and IOSCO one year extension

Draft amended text for non cleared contracts

**SGSS/CAO/REG** contact: Sylvie Bonduelle sylvie.bonduelle@sgss.socgen.com