



EMIR review

Client briefing

Article

May 2017

The European Commission has published a revised draft of EMIR. This has been produced following the mandated review of EMIR. Whilst these proposals are far from the wide ranging amendments which many of those entities who are in scope of EMIR have been hoping for, there are some significant changes proposed. These will impact all entities that are subject to EMIR, and, it is hoped, will reduce the burden of this regime.

We have summarised the main proposals below.

Additional types of financial counterparty

Alternative Investment Funds which are not currently Financial Counterparties, CSDs authorised in accordance with the CSDR, and Securitisation Special Purpose Entities authorised in accordance with the Securitisation Regulation will also be classified as Financial Counterparties.

Exemption from the clearing obligation for small FCs

FCs will also be subject to a threshold test in relation to the clearing obligation. An FC will have to, on an annual basis, calculate its aggregate month-end average position (on a group basis) for months of March, April and May. The FC will only be subject to the clearing obligation if it exceeds the clearing thresholds. The clearing thresholds will be the same thresholds which are applied to the current NFC calculations. If the FC does not exceed any of the clearing thresholds, it will be known as a Small FC, and will not be subject to the clearing obligation. The clearing threshold test for FCs will work in the same way as the current NFC threshold test – i.e. if the FC exceeds the clearing threshold in one asset class, then it will be subject to the clearing obligation for all asset classes. This mechanic only applies to the clearing obligation, and does not provide an exemption for any other clearing obligation for Small FCs.

Changes to the NFC clearing threshold calculation

NFCs will now only have to carry out one clearing threshold calculation a year. The NFC will have to, on an annual basis, calculate its aggregate month-end average position for the months of March, April and May. In addition, the clearing obligation will only apply to those asset classes in which the NFC has exceeded the clearing threshold. So, an NFC which exceeds the clearing threshold in respect of commodity derivatives only, would no longer be required to clear IRS or FX derivatives.

Pension scheme arrangements

The temporary exemption from the clearing obligation for certain pension scheme arrangements will be extended for another three years.

Removal of the frontloading requirement

Frontloading will be abolished for all types of derivative contracts which are declared subject to the clearing obligation.

Suspension of the clearing obligation

The Commission is to have a specific power to temporarily remove and suspend the clearing obligation in respect of a class of OTC derivatives. This power can only be exercised where

- The class of OTC derivatives is not considered suitable for clearing anymore taking into account the original criteria by which the class was considered suitable for clearing
- A CCP ceases to clear the class of OTC derivatives and it is not possible for another CCP to clear the specific classes without interruption
- The suspension is necessary to avoid a serious threat to the financial stability of the Union.

The initial suspension will be for a period not exceeding three months, and there will be the ability to extend the suspension for a maximum period of 12 months.

Obligation to provide clearing services on fair, reasonable and non-discriminatory terms

Clearing members and clients (in the case of indirect clearing services) will be obliged to provide clearing services on fair, reasonable and non-discriminatory commercial terms. ESMA is tasked with drafting an RTS setting out the minimum standards that have been fulfilled with respect to

- The requirement to provide or offer clearing services on the basis of costs and risks
- The requirement to provide or offer clearing services on a non-discriminatory basis so that any differences in prices charged are proportionate to costs
- Risks and benefits connected to the clearing services offered
- A transparency obligation with respect to fees, prices, discount policies and other contractual terms and conditions regarding the price list.

This provision has been introduced due to the perceived difficulties that many smaller counterparties have experienced in trying to access clearing services in order to meet the clearing obligation. It is expected that this proposal will lead to amendments in the clearing service documentation currently offered to the market by clearing members.

Clarifications regarding client and indirect client account structures

Whilst these are not new ideas, the proposed amendments to EMIR make it explicitly clear that

- Assets held in a client account (whether an OSA or an ISA) shall be exclusively held on behalf of clients and shall not be part of the clearing member's pool of assets following its default or form part of the clearing member's insolvent estate. This is the case regardless of how the assets are provided - i.e. on a TTCA basis or otherwise.
- Any balance returned to a defaulting clearing member for the account of its clients shall not be commingled with the defaulting clearing member's estate and shall not be part of the clearing member's insolvent estate.
- In the case of indirect client clearing arrangements, assets held in client accounts shall be held exclusively on behalf of the indirect clients. They shall not be part of the clearing member's nor the client's pool of assets following the default of the clearing member, nor form part of either the clearing member's or the client's insolvent estate. This is the case regardless of how the assets are provided - i.e. on a TTCA basis or otherwise.

Transparency requirements in relation to CCP's initial margin models

CCPs will be required to provide their clearing members with (i) a tool to allow them to simulate their initial margin requirements and (ii) a detailed overview of the characteristics of the initial margin models used. The overview of the initial margin model shall be sufficiently detailed to

- Allow clearing members to understand the design and operational detail of the model
- Contain the key assumptions and limitations of the model
- Define the circumstances under which the assumptions are no longer valid.

In addition, CCPs will be required to publicly disclose their responses to the Disclosure Framework for Financial Market Infrastructures published by CPMI and IOSCO. In practice, many CCPs already make this disclosure.

Amendments to the reporting obligation

Backloading

The requirement to report historic transactions – i.e. those that were not outstanding on 12 February 2014 will be removed.

Exemption from the reporting obligation for certain intragroup transactions

Intragroup exemptions where at least one of the counterparties is an NFC will be exempted from the reporting obligation.

Reporting of ETDs

Only CCPs will be required to report ETD transactions.

Single-sided reporting for OTC trades with NFC-

For transactions between an FC and an NFC-, or a CCP and an NFC-, only the FC or the CCP will be required to make a report.

Reporting for UCITS and AIFs

Where a UCITS managed by a management company is required to make a report, the management company shall be responsible for making the report on behalf of the UCITS.

Where an AIF is required to make a report, the AIFM shall be responsible for making the report on behalf of the AIF.

We do not believe that either of these requirements would prevent the management company or AIFM from delegating the performance of the reporting to a third party, but this should be kept under review by those entities.

Trade repositories

The application process for those entities wishing to be trade repositories is to be made simpler. This is particularly so for those entities who are already trade repositories under the SFTR.

The cap in relation to a fine which a trade repository can be subject to for breaches of its EMIR obligations will be increased.

There are additional requirements for trade repositories in respect of the reconciliation of data between trade repositories and the obligation to grant access to counterparties in respect of their reported data in order to allow verification of its correctness.

What happens next

The proposals will now be sent to the European Council and the European Parliament for negotiation. This process is expected to take a number of months.

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