European Commission - Fact Sheet

Questions and Answers on the proposal to amend the European Market Infrastructure Regulation (EMIR)

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What is EMIR and why is the Commission proposing to amend it?

The European Market Infrastructure Regulation (EMIR) is a centrepiece of the legislation introduced in the wake of the financial crisis to make financial markets safer and more stable. Specifically, EMIR aims to reduce risks to the financial system arising from derivatives transactions by increasing the transparency of the over-the-counter (OTC) derivatives market – a market in which derivative contracts are not traded on an exchange, but privately negotiated between two counterparties. The regulation also strives to mitigate the counterparty credit risk and reduce the operational risk associated with OTC derivatives (for technical terms, see glossary at the end of the MEMO).

The Commission has carried out an extensive assessment of EMIR to ensure that EU legislation is working effectively, efficiently and at minimum cost, both for citizens and businesses. EMIR (Article 85(1)) required the Commission to undertake this review. It is also part of the Commission's Regulatory Fitness and Performance programme (REFIT) of 2016.

What has EMIR achieved so far?

Since EMIR was introduced in 2012, an increasing share of derivatives trades is reported to trade repositories, which make the data available to supervisors. This makes markets more transparent for supervisors and efficient for end users and reduces systemic risk. The requirements on central counterparties and trade repositories have made them safer and more resilient. On the basis of one single authorisation, they can offer their services throughout the EU without the need to register within the host Member State. At the same time, information exchange and cooperation between the supervisors of central counterparties, their clearing members and linked financial market infrastructures have been deepened and a significant degree of supervisory convergence has been reached by establishing EMIR colleges for central counterparties. In addition, the European Securities and Markets Authority (ESMA) now acts as the single supervisor for trade repositories throughout Europe.

What led the Commission to make these proposals?

In 2015, the Commission carried out an extensive assessment of the current rules. This included a public consultation with more than 170 contributions from a broad range of stakeholders, as well as reports from the European Securities and Markets Authority (ESMA), the European Systemic Risk Board (ESRB) and the European System of Central Banks (ESCB). The Call for Evidence on the EU Regulatory framework for financial services carried out between September 2015 and January 2016 provided further evidence on the state of play of EMIR implementation.

In November 2016, the Commission adopted the EMIR report, which indicated that no fundamental change should be made to the nature of the core requirements of EMIR. They are integral to ensuring transparency and mitigating systemic risk in the derivatives market and for which there is general support from authorities and market participants. On the other hand, the report pointed to the possibility of amending EMIR in some specific areas so as to eliminate disproportionate costs and burdens on certain derivatives counterparties and to simplify rules without compromising the essence of the legislation. The Commission is therefore proposing corresponding amendments to EMIR today.

Who will benefit from these changes?

Simpler and more proportionate rules will reduce costs and burdens for market participants without compromising financial stability. Greater transparency of Over-The-Counter (OTC) derivatives positions and exposures will enable authorities to identify any potential problems at an earlier stage and to take timely action to address any risks, benefitting the resilience of financial markets. Improved access to clearing will allow additional market participants, in particular from the "real economy", to manage and hedge their risks. Indeed, these reforms will reduce the likelihood of sudden shocks and business disruptions. It will also contribute to generating a less volatile business development.

What are the main proposed amendments to EMIR?

Reporting obligations

Transactions between a financial counterparty and a non-financial counterparty not subjected to the clearing obligation will now be reported by the financial counterparty on behalf of both counterparties. This is in order to reduce the reporting burden for small non-financial counterparties. Transactions concluded between companies belonging to the same group (so-called 'intragroup transactions') where at least one of the two counterparties is a non-financial company will no longer have to be reported. Such trades represent a relatively small proportion of all OTC derivative transactions and do not significantly contribute to systemic risk.

Exchange-traded derivatives or ETDs which are derivative transactions concluded on exchanges will be reported only by the CCP on behalf of both counterparties. Starting in January 2018, all ETDs will have to be cleared by CCPs. This modification will therefore not place an additional burden on the CCPs. In parallel, it will reduce it for the other counterparties. Nor will it lead to any data loss.

Clarifications are introduced as to who has the responsibility for reporting in certain very specific circumstances, i.e. in derivative transactions involving a mutual fund UCITS or an alternative investment fund (AIF). In these cases, it is the management company or the manager who will have to report the transaction.

Finally, historic transactions (i.e. those which were entered into before the start of the reporting obligation and are still outstanding on that date; 'backloading') will no longer need to be reported. In practice, this requirement has proved difficult to fulfil, as certain data which need to be reported were not available when EMIR entered into force. This resulted in many reporting errors and reduced the quality of the data in trade repositories. Since many of these transactions are considered obsolete, this amendment will not have a significant impact on authorities' ability to monitor risk in the derivatives market.

Quality of data reported to trade repositories

In order to improve data quality and transparency and ensure coherence with reporting requirements under the Securities Financing Transactions Regulation (SFTR), two types of changes are introduced.

From now on, trade repositories will be explicitly required to implement procedures to verify the completeness and the accuracy of the data reported to them. They will also have to establish procedures for reconciling (i.e. cross-checking and comparing) data with other trade repositories in cases where the other counterparty reported their side of the transaction to a different trade repository. Trade repositories will now also be required to allow counterparties which delegated reporting to another entity to view the data which was reported on their behalf. Secondly, the scope of the technical standards on reporting which ESMA can develop is expanded to allow further harmonisation of reporting rules and specification of the details of the new requirements for trade repositories.

Moreover, trade repositories will have to create procedures ensuring the orderly transfer of data to another trade repository following customer requests. This helps counterparties wishing to change the trade repository to which they report their transactions. It also reduces the frequency of data interruption and duplication of reporting.

Clearing obligation for non-financial counterparties

Contracts by non-financial firms over a 'clearing threshold' will continue to have to be cleared through a CCP. However, the proposed amendments will allow firms to only clear those classes of derivatives which breach the clearing threshold. OTC derivatives used to hedge risks related to their activities continue to be subtracted from the firm's overall position and do not count towards the threshold set for the clearing obligation.

In order to lower the operational burden for these firms and align the treatment of cleared and non-cleared derivatives, non-financial counterparties will now be required to assess their situation vis-à-vis the clearing obligation only once a year, based on the average activity over the months of March, April and May.

Clearing obligation for small financial counterparties

To increase incentives for clearing services to provide for smaller counterparties without compromising financial stability, and in addition to the important proposals to remove disincentives by changing the calculation of the Leverage Ratio under the Commission proposal amending the Capital Requirements Regulation. Firstly, it will require that institutions offering clearing service do so under fair, reasonable and non-discriminatory (FRAND) commercial terms. Secondly, the proposal also clarifies the interaction of the EMIR default management tools with insolvency laws by clarifying that assets and positions recorded in clients' accounts will not be considered to be part of the CCP's or clearing member's

insolvency estate.

In addition, for the smallest financial counterparties such as small banks - which account for the majority of counterparties but an insignificant part of derivatives trades - the proposal introduces a 'clearing threshold'. Currently, financial counterparties have to clear each OTC derivative for which a clearing obligation exists once the respective phase-in period is over. New evidence shows that it is not economically feasible for financial counterparties with a limited volume of activity on the OTC derivatives markets to fulfil the clearing obligation. Therefore, the proposal relieves the small financial counterparties from the clearing obligation by introducing a 'clearing threshold'.

Clearing obligation for pension funds

Certain pension funds, defined under EMIR as pension scheme arrangements ('PSAs'), face structural difficulties to participate in central clearing. While CCPs tend to only accept cash from their clients to meet variation margin calls, PSAs typically limit their cash positions in order to yield higher returns for their policy holders. By requiring PSAs to centrally clear, they would have to shift part of their assets into cash. This would have a negative impact on the revenue of future pensioners.

The proposal therefore extends the current temporary exemption for a further three years. This exempts PSAs from central clearing in order to allow the various counterparties at play, including CCPs and the clearing members that provide clearing services, to develop a viable solution. This proposal ensures that both pension funds and policy holders avoid facing estimated additional costs of up to €1.6 billion. Only if, due to unforeseen circumstances, more time is needed to develop a solution, it also provides a mechanism for the Commission to extend the exemption by two years.

Since PSAs are active users of derivatives, the proposal makes sure that the ultimate goal is that they participate in central clearing. It therefore establishes strict criteria to assess progress in developing clearing solutions for PSAs. The proposal further calls on the Commission to take into account market data from Union authorities and bodies, including ESMA, EIOPA, EBA, and the ESRB, for assessing whether PSAs pose a systemic risk and for estimating the impact that central clearing could have for pensioners. It also calls on the Commission to take into account the impact of related regulatory developments, such as the proposed changes to the calculation of the Leverage Ratio under the Commission proposal amending the Capital Requirements Regulation.

The fact that a number of small PSAs will benefit from the removal of small financial counterparties from the scope of the clearing obligation will help make the clearing obligation more proportionate for smaller counterparties, while not putting financial stability at risk.

CCP Transparency

In order to enable clearing members to gain predictability and to limit the tendency for CCPs to react in a pro-cyclical manner, CCPs are required to provide their members with simple tools allowing them to simulate the amount of collateral requested to clear future trades. Without revealing proprietary tools and patents, CCPs will make available a thorough description of their initial margin models to their clearing members for them to gain a clear understanding of their reach and their limitations.

Risk-mitigation technics for non-cleared OTC derivatives contracts

The proposal grants power to the ESAs to develop implementation and validation standards for risk-management procedures. It includes the internal models used to calculate the amount of collateral needed to be exchanged as part of the risk-mitigation technics for non-cleared OTC derivatives contracts as well as the segregation solutions envisaged by firms subject to this requirement to hold this collateral.

Registration and supervision of trade repositories

The proposal introduces a possibility to submit a simplified application for an extension of registration for trade repositories that are already registered under SFTR. To increase the efficiency and deterrent effect of the sanctions system, there is an increase of the upper limit of the basic amount of fines ESMA can impose on trade repositories.

Access to data held in trade repositories

The procedure to gain access to data held in third country trade depositories is simplified for EU authorities.

When will the changes enter into force?

The changes will enter into force once the co-legislators, the European Parliament and the Council have approved them. For some provisions there is a deferred application.

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GLOSSARY

Derivatives

A derivative is a financial contract linked to the future value or status of the underlying to which it refers, for example the development of interest rates or of a currency value, or the possible bankruptcy of a debtor. Over-the-Counter (OTC) derivative contracts are not traded on an exchange but instead privately negotiated between two counterparties, for instance a bank and a manufacturer.

EMIR

EMIR implements the 2009 G20 commitment to increase the stability of the OTC derivatives market in the EU. This commitment provides for all standardised OTC derivatives contracts to be cleared through central counterparties as well as OTC derivatives contracts to be reported to trade repositories.

EMIR establishes core requirements on OTC derivatives, central counterparties (CCP) and trade repositories (TR). These include:

1. Central clearing of standardised OTC derivative contracts;
2. Margin requirements for OTC derivative contracts that are not centrally cleared;
3. Operational risk mitigation requirements for OTC derivative contracts that are not centrally cleared;
4. Reporting obligations for derivative contracts;
5. Requirements for CCPs;
6. Requirements for trade repositories.

Central counterparties (CCPs)

A CCP is an entity that interposes itself between the two counterparties to a transaction, becoming the buyer to every seller and the seller to every buyer. A CCP's main purpose is to manage the risk that could arise if one of the counterparties is not able to make the required payments when they are due – i.e. defaults on the deal. CCPs are commercial firms. There are currently 17 European CCPs authorised and 28 third country CCPs recognised under EMIR most of which clear various exchange traded or over-the-counter derivatives.

Trade repositories

A trade repository is a data storage centre to which details of derivatives transactions are reported. Trade repositories process and aggregate this data and make it available to authorities responsible for supervising the derivatives market.

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