

MFSA

MALTA FINANCIAL SERVICES AUTHORITY

European Markets Infrastructure Regulation (‘EMIR’)

A Note on EMIR

On the 4th of July 2012, the European Parliament and the Council adopted the European Markets Infrastructure Regulation (‘EMIR’) which requires:

- [i] All derivative^[1] contracts to be reported to an authorised or recognised trade repository (**‘Reporting Obligation’**);
- [ii] Certain classes of OTC Derivative contracts entered into by Financial Counterparties and Non-Financial Counterparties to be centrally cleared through an authorised or recognised Central Counterparty (**‘Clearing Obligation’**); and
- [iii] Counterparties to apply certain risk mitigation measures when entering into non-cleared OTC Derivative contracts (**‘Risk Mitigation Techniques’**).

The aim of this document is to provide the industry with an outline of what is required from Financial Counterparties and Non-Financial Counterparties under EMIR. This circular forms part of a series of circulars already issued by the MFSA, which can be viewed through the following [link](#).

1. What are Financial Counterparties and Non-Financial Counterparties?

A Financial Counterparty (‘FC’) is that counterparty to a transaction, which is either:

- An investment firm;
- A credit institution;
- An insurance undertaking;
- An assurance undertaking;
- A reinsurance undertaking;
- A UCITS, and where relevant, its management company;
- An institution for occupational retirement provision; or
- An alternative investment fund managed by Alternative Investment Fund Managers (‘AIFM’s).

^[1] ‘Derivative’ means a financial instrument as set out in points (4) to (10) of Section C of Annex I to Directive 2004/39/EC as implemented by Article 38 and 39 of Regulation (EC) N^o 1287/2006.

A Non-Financial Counterparty ('NFC') is an undertaking established in the European Union other than a Financial Counterparty or a Central Counterparty ('CCP'). Such companies might for instance include airlines, energy companies, shipping companies, etc...

2. Reporting Obligation

EMIR stipulates that the details of any derivative contract concluded by both FCs and NFCs should be reported directly to a Trade Repository ('TR'). This would also include any modifications or terminations to such contracts. This reporting obligation should therefore not be done through the MFSA.

Reporting to the TR is required to be done no later than one working day following the conclusion, modification or termination of a derivative contract. The details to be reported to TRs as required under the reporting obligation are clearly set in the Commission Delegated Regulation (EU) N^o 148/2013, which can be accessed through the following [link](#).

The reporting obligation applies to those derivative contracts which:

- [i] Were entered into before the 16th August 2012 and which remained outstanding on that date; or
- [ii] Are entered into, on or after the 16th August 2012.

EMIR explains that the reporting obligation may be delegated. However it is specified that when delegating such duties counterparties should then ensure that the details for such derivative contracts are not reported twice. However, this responsibility remains with the counterparty.

Please note that ESMA is currently in the process of authorising TRs. The reporting obligation will commence only after ESMA has authorised TRs for the specific asset classes. In its latest timetable, ESMA envisaged that the earliest possible date to commence reporting would be the 23rd September 2013.

The following is ESMA's indicative timetable in relation to EMIR^[2]:

^[2] Accessed 21.06.2013 <http://www.esma.europa.eu/page/European-Market-Infrastructure-Regulation-EMIR>

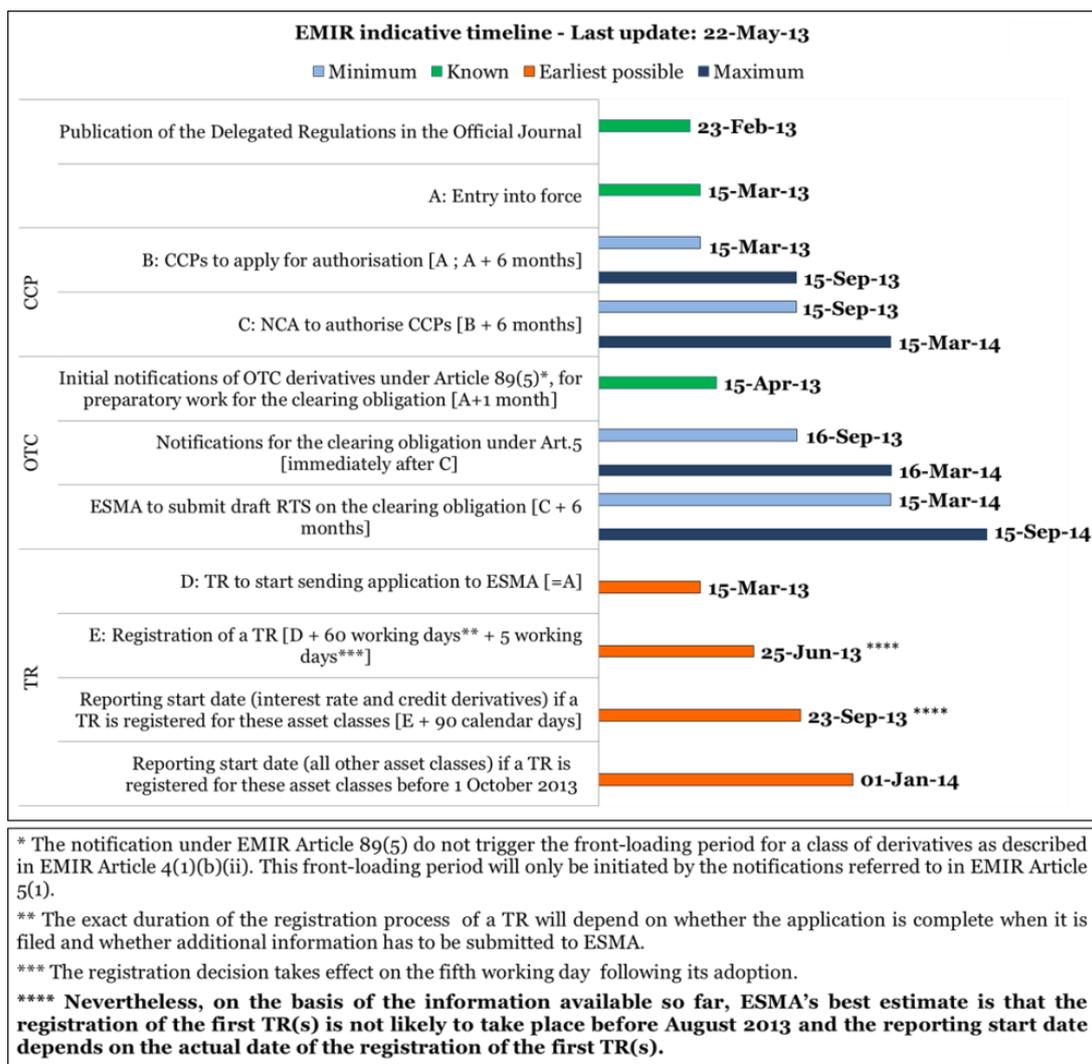


Diagram 1: Indicative Timeline for the Implementation of EMIR

3. Clearing Obligation

The clearing obligation applies only to OTC derivative contracts which are entered into between:

- [i] Two FCs;
- [ii] A FC and a NFC+^[3];
- [iii] Two NFC+s;
- [iv] A FC or a NFC+ and an entity that would be subject to the clearing obligation if it were established in the Union (i.e. similar to a FC or NFC+); or
- [v] Two entities established in one or more third countries that would be subject to the clearing obligation if they were established in the Union (i.e. being similar to a FC or NFC+), provided that the contract has a direct effect within the Union.

^[3] Non-Financial Counterparty exceeding the clearing threshold

Counterparty	FC	NFC +	NFC – ^[4]
FC	√	√	×
NFC +	√	√	×
NFC -	×	×	×

Table 1: Clearing Obligation Matrix

The NFC clearing thresholds are highlighted below:

- [i] €1 billion in gross notional value for OTC credit derivative contracts;
- [ii] €1 billion in gross notional value for OTC equity derivative contracts;
- [iii] €3 billion in gross notional value for OTC interest rate derivative contracts;
- [iv] €3 billion in gross notional value for OTC foreign exchange derivative contracts; and
- [v] €3 billion in gross notional value for OTC commodity derivative contracts and other OTC derivative contracts not provided for in the above-mentioned points [i] to [iv].

NFCs are required to fill-in specific forms when [exceeding the clearing threshold](#) and when [falling below the clearing threshold](#) respectively, and submit the said forms to ESMA (EMIR-notifications@esma.europa.eu) and the MFSA (emir@mfsa.com.mt) accordingly.

OTC Derivative contracts which are subject to clearing shall be cleared through a CCP. ESMA has not yet published the regulatory technical standards which should indicate the relevant class of derivatives that are subject to the clearing obligation along with the dates from which such an obligation shall take effect.

ESMA has indicated that the 15th June 2014 is the earliest possible date for the entry into force of this technical standard. Immediately after the entry into force of the technical standard ESMA will provide a list of derivative classes which are subject to the clearing obligation, in a [public register](#) which will be made publicly available by ESMA. The scope of this public register is meant to ensure transparency for market participants regarding the clearing obligation, i.e. the classes of OTC derivatives subject to the clearing obligation and the CCPs which clear them.

The clearing obligation shall apply to OTC derivative contracts which:

- [i] Are entered into on or after the date from which the clearing obligation takes effect; or
- [ii] Have been outstanding on that date and entered into since the date on which ESMA was notified of the CCP's authorisation (the 'front-loading' period as referred to in Diagram 1 above).

It is important to note that although the clearing threshold applies per asset class, once a NFC is over the clearing threshold, the clearing obligation shall apply to all OTC derivative contracts and not solely those related to that particular asset class.

Certain exemptions apply in relation to the clearing obligation, although prior approvals need to be sought from the Authority.

^[4] Non-Financial Counterparty below the clearing threshold

4. Risk Mitigation Techniques

All counterparties (FCs, NFC+s and NFC-s) that enter into an OTC derivative contract which is not cleared by a CCP, are required to ensure that appropriate procedures and arrangements are in place to measure, monitor and mitigate Operational Risk and Counterparty Credit Risk, including at least:

- [i] The timely confirmation of the terms of the relevant OTC derivative contract, by electronic means; and
- [ii] Formalised processes which are robust, resilient and auditable, in order to reconcile portfolios, to manage the associated risk and to identify disputes between parties early and resolve them, and to monitor the value of outstanding contracts.

EMIR specifies a number of high-level risk mitigation obligations, which include:

- [i] Timely Confirmation: A timely confirmation, by electronic means where possible, of all the terms of the OTC derivative contracts. EMIR specifies the time limits for a confirmation to be timely.
- [ii] Portfolio Reconciliation: Counterparties to an OTC derivative contract are required in terms of EMIR to agree with each of their counterparties in writing, or other equivalent electronics means, on the arrangements under which the portfolios shall be reconciled.
- [iii] Portfolio Compression: Portfolio compression involves parties netting trades to maintain the same risk profile but reducing the number of contracts and therefore the gross notional value.

FCs and NFC+s are also expected to mark-to-market on a daily basis, the value of outstanding contracts.

5. Conclusion

As a concluding note, EMIR in brief therefore requires:

- a) All derivative contracts as set out in points (4) to (10) of Section C of Annex I to Directive 2004/39/EC as implemented by Article 38 and 39 of Regulation (EC) N^o 1287/2006, to be reported directly to a TR;
- b) All OTC derivative contracts listed in ESMA's Public Register (once published) to be cleared through the relevant authorised CCPs; and
- c) FCs and NFCs that enter into those OTC derivative contracts which are not cleared by a CCP, shall have the necessary risk mitigation techniques in place.

Should you have any queries regarding EMIR, please do not hesitate to contact Mr Edward Grech [e-mail: egrech@mfsa.com.mt] or Mr Nathan Fenech [e-mail: nfenech@mfsa.com.mt].

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