

01 February 2022

Circular on Regulation N^o 648/2012 – The European Market Infrastructure Regulation ('EMIR'/the 'Regulation')

- Supervisory Interactions: General Findings

1.0 Introduction

This Circular is being addressed to all market participants, particularly entities who enter into derivative contracts and which fall within the scope of EMIR, namely, financial ('FC') and non-financial counterparties ('NFC') as defined under EMIR (jointly hereinafter referred to as 'Counterparties').

This Circular should be read in conjunction with [EMIR](#), its Delegated Regulations and previous circulars issued by the Authority, as the case may be.

2.0 Purpose of the Circular

This Circular presents the findings that were discovered during the EMIR-related supervisory interactions conducted by the Authority during 2021.

3.0 Supervisory Inspections

Since 2014, the Authority has been conducting supervisory inspections in order to verify the extent of implementation of the Regulation by the industry, and to review the relevant controls and procedures for the proper conduct of business in terms of EMIR.

MFSA officials within the Authority's Securities and Markets Supervision Function, have analyzed the results and have identified a number of issues which were commonly raised during these interactions.

This Circular presents the MFSA's findings relating to how Counterparties adhere to the respective requirements emanating from EMIR. Without prejudice, the Circular also provides recommendations of what are considered to be good practices for entities to seek to adhere to their legal obligations. Please note that such recommendations are only aimed to provide guidance and should not be in any way construed as legal advice and/or interpretation. The obligation to ensure that Counterparties satisfy the requirements of the applicable laws and that their policies and procedures are kept up-to-date, rests solely with the directors of the companies. Furthermore, this Circular provides the MFSA's position as at the date of publication and could be subject to change depending on any clarifications which ESMA might issue from time to time.

3.1 Supervisory Inspections - Findings

3.1.1 Counterparty Classification and Clearing Obligation Thresholds

EMIR Refit provides a new regime to determine when FCs and NFCs are subject to the clearing obligation.

Under the EMIR Refit, FCs and NFCs will decide whether or not to calculate their positions in OTC derivative contracts against the clearing thresholds in gross notional value¹. In the event that counterparties decide to calculate their clearing thresholds, they should every 12 months, calculate their aggregate month-end average position for the previous 12 months. Where a FC or an NFC decides not to calculate its positions against the clearing thresholds, it will become subject to the clearing obligation for all OTC derivatives pertaining to any class of OTC derivatives for which the clearing obligation is applicable.

On the other hand, if a FC calculates its positions and the result of that calculation exceeds the clearing threshold, the FC will become subject to the clearing obligation for all OTC derivative contracts pertaining to any class of OTC derivatives for which the clearing obligation is applicable. In the case of an NFC, where an NFC calculates its positions and the result of that calculation exceeds the clearing thresholds, the NFC will become subject to the clearing obligation only for the OTC derivative contracts in asset classes for which the result of the calculation exceeds the clearing thresholds.

Counterparties are required to immediately notify the Authority:

- (1) If they decide not to calculate their positions against the clearing thresholds;
- (2) When the result of the calculation exceeds the clearing threshold;
- (3) When they no longer exceed the clearing thresholds.

During the inspections, MFSA officials have encountered instances whereby Counterparties failed to provide the clearing threshold calculation in accordance with EMIR Refit. Consequently, such Counterparties were not in a position to confirm their classification for the purposes of EMIR. As aforementioned, Counterparties which do not calculate their positions against the clearing threshold would be expected to clear all OTC derivative contracts for which the clearing obligation applies. Accordingly, in the event where Counterparties do not clear their OTC derivative contracts, they are required to provide adequate substantiation to this effect.

¹EUR 1 billion for equity derivative contracts
EUR 1 billion for credit derivative contracts
EUR 3 billion for interest rate derivative contracts
EUR 3 billion for foreign exchange derivative contracts
EUR 3 billion for commodity derivative contracts and others

3.1.2 Risk Mitigation Techniques

EMIR specifies that all entities should have the appropriate arrangements in place in order to mitigate risks when entering into OTC derivative contracts which are not cleared by a CCP.

As a general remark, the majority of Counterparties have sought to satisfy the requirements relating to Risk Mitigation techniques. Nevertheless, although carrying out Risk Mitigation techniques in practice, a number of Counterparties did not have the necessary documentation in place relating to the same.

It is important that all Risk Mitigation techniques are documented. During the inspections, MFSA officials have come across instances whereby although confirmation was being done, this was not documented, and parties would have verbally agreed to adopt a 'passive approach' when it comes to trade confirmations. This approach would only be possible as long as the parties would have agreed to this beforehand and in writing.

Prior to the inspection, the MFSA expects to be provided with the necessary documentation which cover all Risk Mitigation requirements under EMIR.

On the other hand, entities who held documentation, have either implemented tailor-made bilateral agreements with their counterparts, or chose to enter into standard master agreements such as ISDA agreements. When making use of standard master agreements, Counterparties should confirm whether the standard agreement covers all the Risk Mitigation requirements under EMIR. For instance, certain counterparties have opted to become EMIR-compliant by becoming signatories to specific EMIR protocols. When signing such protocols, it is important to ensure that both Counterparties are signatories to these protocols to ensure compliance. In the instance where a master agreement was in place prior to the coming into force of EMIR, Counterparties should ensure that they become compliant by having their standard master agreement updated via an amendment agreement.

MFSA officials have also come across instances whereby the agreements relating to Risk Mitigation techniques were incomplete or unsigned.

3.1.3 EMIR Procedures

A number of Counterparties were unable to provide a set of written procedures which establish the processes carried out in order to be compliant with the requirements emanating from EMIR. It is recommended that all Counterparties entering or intending to enter into derivative contracts, should have a detailed set of written procedures in place to ensure their compliance with EMIR.

3.2 Data Quality – Findings

Article 9 of EMIR requires the details of derivative contracts entered into by the Company to be reported no later than the working day following the conclusion, modification or termination of a derivative contract (i.e. T+1). Reporting has to be made to a Trade Repository, nevertheless, such details are ultimately received by the Malta Financial Services Authority as the Maltese competent authority in terms of EMIR.

On an ongoing and regular basis, the Authority carries out offsite monitoring of transaction reports which are submitted by counterparties to trade repositories in accordance with the aforementioned Article 9 of EMIR.

During the Authority's offsite monitoring, *inter alia*, the Authority has noticed the following:

- Counterparties that report their derivative transactions in an untimely manner;
- Counterparties that do not report their derivative transactions;
- Counterparties that do not report all the required mandatory data fields;
- Counterparties that fill in the incorrect field details.

MFSA expectations

In view of the fact that the Regulation has been into force since 2012, and taking into consideration substantial exchange of bilateral correspondence between the MFSA and Counterparties regarding their reporting obligations, as well as a number of supervisory inspections held with several Counterparties and the various MFSA Circulars issued to the industry, the Authority expects Counterparties to be fully compliant with the applicable requirements contained under EMIR.

Specifically, but not exclusively, the MFSA expects Counterparties to be fully compliant with the requirements of Article 9 of EMIR, thus ensuring timely and complete reporting of the details of any derivative contract concluded and of any modification or termination of the contract to a registered trade repository.

Failure to submit timely and complete derivative transaction reports is in breach of Article 9 of EMIR, which could in turn warrant regulatory action in terms of article 11 of Subsidiary Legislation 345.17 (Financial Markets Act, (OTC Derivatives, Central Counterparties and Trade Repositories) Regulations).

Please be guided accordingly.

Should you have any queries in relation to the above, please do not hesitate to contact the Authority on EMIR@mfsa.mt.