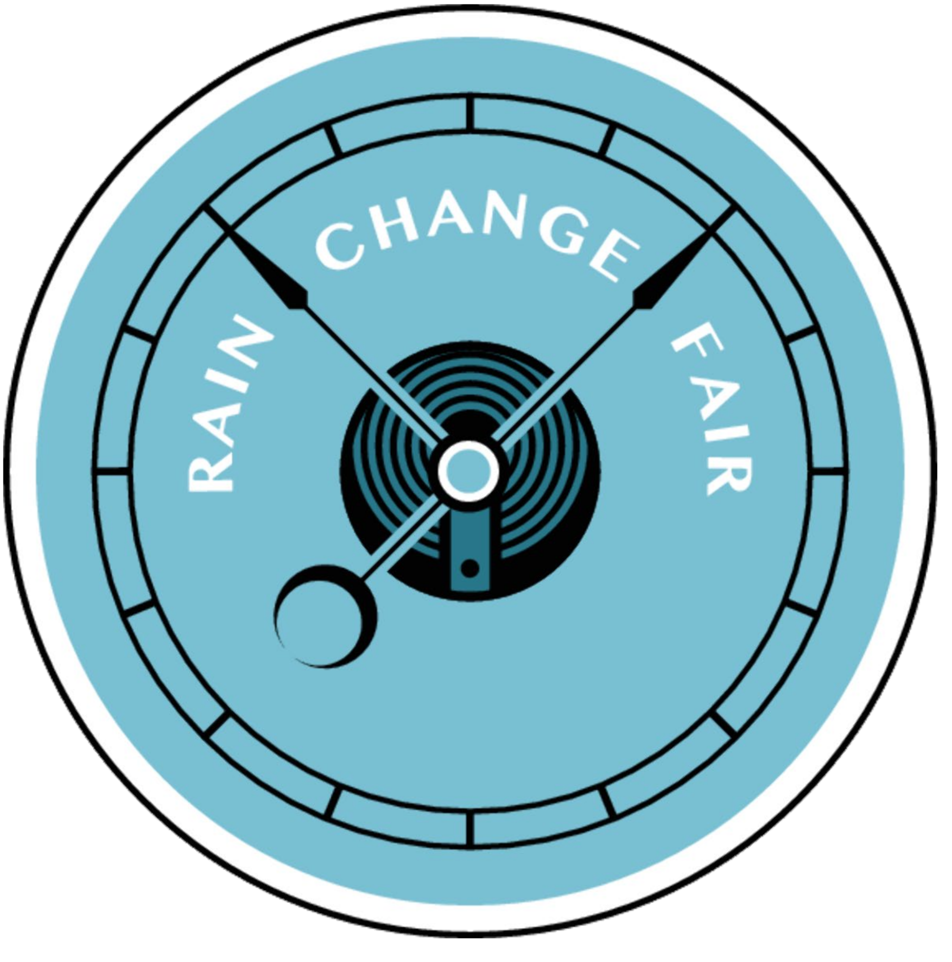
Deloitte.



EMIR Refit

What's changing?

May 2019

Introduction

The European Markets Infrastructure Regulation ("EMIR") entered into force in 2012 and implemented significant reforms in the derivatives space covering clearing, reporting, risk mitigation, and margin and collateral exchange. The regulation has affected a vast number of firms that are still grappling with the requirements it introduced.

Between 2015 and 2016, the EU Commission conducted an extensive review of EMIR and its impact on the industry. The Commission found that, although no fundamental amendments needed to be made to the core requirements under EMIR, the legislation could benefit from amendments on certain aspects, in order to reduce disproportionate costs and burdens on counterparties without compromising the objectives of the regulation.

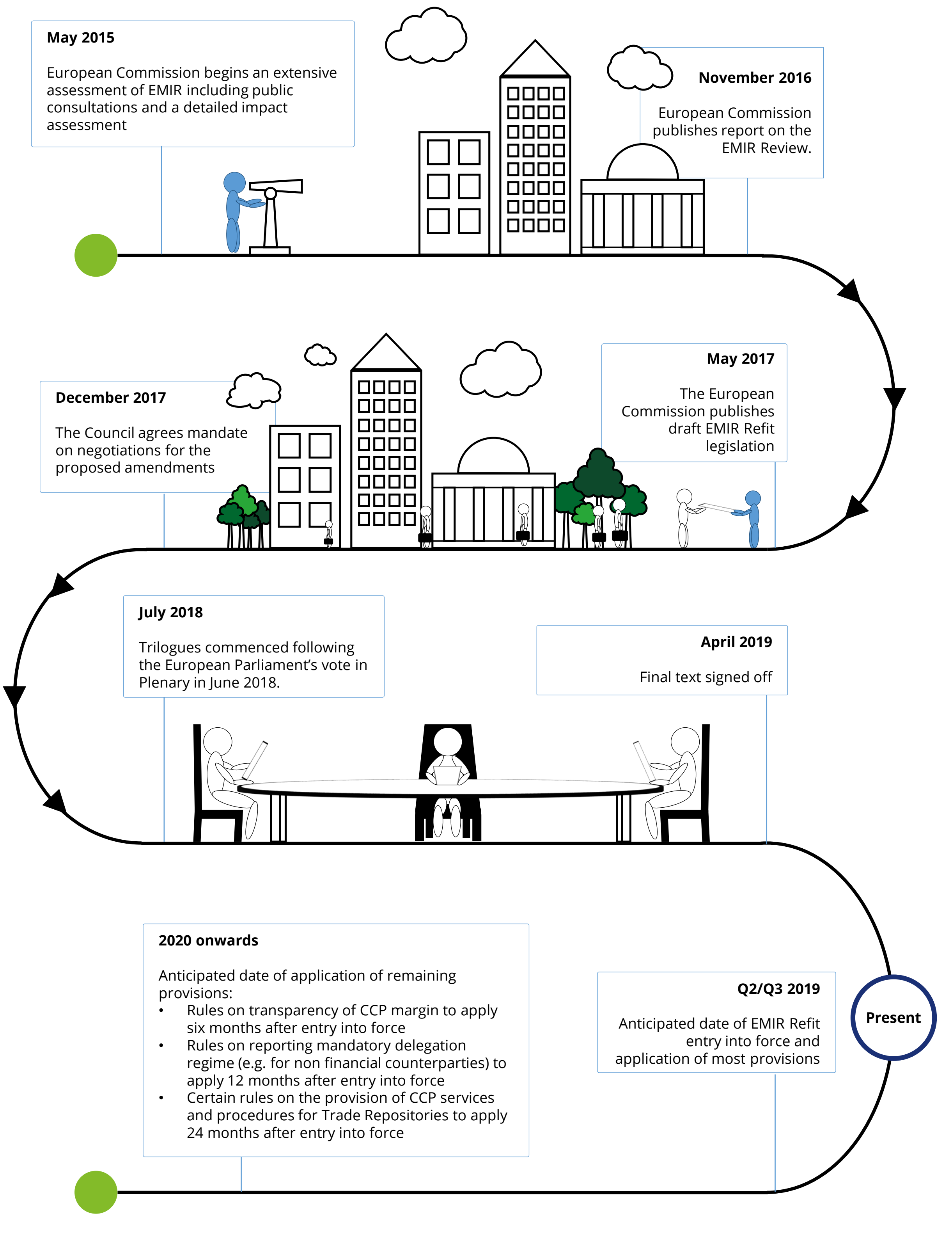
The agreed amendments (known as EMIR Refit or EMIR 2.1) will lead to some substantial changes under EMIR. For example, key changes include the concept of Small Financial Counterparties that will be exempt from clearing, and the introduction of specific requirements around the accessibility and affordability of clearing services.

Furthermore, the UK Financial Conduct Authority (FCA) has confirmed HM Treasury's intention to include changes under EMIR Refit in the UK equivalent EMIR regime so that the UK will implement EMIR Refit amendments as they are being implemented in the EU.[1]

This paper summarises the key EMIR Refit changes following final agreement signed off in the European Parliament plenary on 18 April and how they may affect firms. This document does not consider revisions to CCP supervision that are contained in the EMIR 2.2 package.

[1] *https://www.fca.org.uk/news/statements/fca-statement-reporting-derivatives-under-uk-emir-regime-no-deal-scenario*

Legislative Timeline



Clearing Obligation

The clearing obligation was introduced under EMIR as a means of reducing the operational and counterparty risks posed by uncleared OTC derivatives in the most standardised asset classes. It was not long before many smaller market participants found complying with the obligation would lead to a significant increase in costs when engaging in the relevant asset classes.[2] For smaller counterparties, clearing services can incur high fees passed onto them from clearing members, not to mention the further operational considerations required by providers of indirect clearing.

Non-Financial Counterparties faced challenges that they had not experienced before. Many smaller firms struggled with the administrative burden of calculating thresholds on a 30 working day rolling average basis, and others fell foul of the large net caused by breaching any of the asset class thresholds. This left certain firms in a situation whereby their trading in a single asset class made their less frequent trades in other asset classes much more expensive – as they would be subject to the clearing obligation for all asset classes, not just the ones for which they breached the threshold.

These issues were identified during the EMIR Review, and a number of changes are targeted at reducing the costs and mitigating the operational burden of clearing.

Key

✓ Potential reduction in operational burden (may not affect all firms within the category)

— Potential increase in operational burden (may not affect all firms within the category)

Summary of changes to the clearing obligation and an indication of the operational effect of each change.

Changes	Financial Counterparty	Non-Financial Counterparty (+)	Non-Financial Counterparty (-)	Pension Scheme Arrangement
Removal of frontloading requirement means certain financial counterparties will no longer be required to clear/novate relevant OTC derivative contracts	✓			
Introduction of fair, reasonable, non-discriminatory, and transparent (FRANDT) commercial terms for the provision of clearing services will create a greater burden for clearing service providers, which will have to ensure compliance with specified principles, while other firms may benefit from greater access, and potentially less expensive and onerous provision of clearing services	— FCs that provide clearing services will be required to comply with new requirements ✓ All other FCs that access clearing indirectly or through clearing members will benefit from requirements	✓		
Frequency for calculating clearing threshold for NFCs to be annual rather than over 30 working days, which will reduce the operational cost of monitoring the threshold		✓	✓	
Definition of Financial Counterparty expanded to include certain additional Alternative Investment Funds, and Central Securities Depositories which may bring previously out of scope entities under the clearing and margining requirements		—	—	
Introduction of "small financial counterparties" will exempt firms that fall under the threshold from the clearing obligation while remaining subject to the margin requirements[3]	✓			
NFCs that choose to calculate their position will be subject to the clearing obligation only with regard to the asset classes that exceed the threshold. NFCs that choose not to calculate their positions, will be subject to the clearing obligation in all asset classes. This reduction in scope of the clearing obligation means more flexibility for NFCs.		✓	✓	
Temporary exemption from the clearing obligation for pension scheme arrangements will be extended for another two years, with a possibility of two further one year extensions				✓

[2] *http://www.fsb.org/wp-content/uploads/P070818.pdf*

[3] *"The excess of the clearing threshold for at least one class of OTC derivative by a financial counterparty, calculated at the group level, should however trigger the clearing obligation for all classes of OTC derivatives given the interconnectedness of financial counterparties and the possible systemic risk to the financial system that may arise if those derivative contracts are not centrally cleared."*

Margin Requirements

The margin requirements form part of the risk mitigation principles under EMIR and were formulated as a means to mitigate counterparty risk in uncleared OTC derivatives.

The margin requirements have been phased in with separate timelines for the initial margin (IM) and variation margin (VM) requirements. The obligation to exchange VM initially extended to physically settled FX Forwards, as there was no clear delineation between an FX Spot and FX Forward in the legislation. The VM obligation caused substantial disruption amongst smaller FCs and NFCs as they are light consumers of FX derivatives.

The regulatory technical standards on margin requirements offered regulatory relief for firms by delaying the VM requirements for FX Forwards until MiFIR entered into force in January 2018.

The changes in EMIR Refit include a limitation on the requirement to exchange VM on physically settled FX forwards and swaps to systemic firms.

The changes also include expanded requirements around the use of internal models for valuation and collateral exchange, where national competent authorities would have to validate risk management procedures.

Key

Potential reduction in operational burden (may not affect all firms within the category) ✓

Potential increase in operational burden (may not affect all firms within the category) —

Summary of changes to the margin requirements and an indication of the operational effect of each change.

Changes	Financial Counterparty	Non-Financial Counterparty (+)	Non-Financial Counterparty (-)	Central Counterparty
Mandatory exchange of VM on physically settled FX forwards and swaps to be limited to transactions between the most systemic counterparties	✓ Relief for non-systemic counterparties	✓		
Competent authorities to validate firms' risk management procedures for the timely, accurate and appropriately segregated exchange of collateral which involve the use of internal models, as well as significant changes to those procedures, before they are applied	—	—		
CCPs to provide clearing members with tools to simulate their IM requirements and with a detailed overview of the IM models they use				—

Reporting Obligation

The reporting obligation under EMIR aimed to usher in a new era of transparency in the derivatives market. The dual reporting implementation was vast in scope and content, requiring all counterparties to submit reports for all OTC and ETD derivatives. The reporting obligation also required firms to report key events throughout the lifecycle of the trade, daily valuations for FCs and all collateral/margin exchanges.

Given the ambitious nature of the reporting obligation, it has not been an easy road for many firms to navigate. A number of factors such as the complexity of the reporting requirements, lack of nuanced guidance, and inconsistencies between reporting templates from each trade repository, have contributed to difficulties faced by firms.

Following feedback from the industry, ESMA introduced significant amendments to the reporting regime in November 2017. These changes sought to address technical issues, clarify reporting, and align reporting formats between MiFID II and EMIR.

The changes in Refit are directed towards expanding the EMIR regulatory framework to enable principles identified under the Securities Financing Transaction Regulation (SFTR), and streamlining the existing reporting requirements. The changes aim, for example, to clarify where the responsibility for reporting lies between an FC and an NFC. The proposal that CCPs report ETDs on behalf of both counterparties has not been taken forward.

Key

Potential reduction in operational burden (may not affect all firms within the category) ✓

Potential increase in operational burden (may not affect all firms within the category) —

Summary of changes to the reporting obligation and an indication of the operational impact of each change.

Changes	Financial Counterparty	Non-Financial Counterparty (+)	Non-Financial Counterparty (-)	Central Counterparty
Requirement to report historic transactions removed	✓	✓	✓	
Intragroup exemption from reporting introduced where at least one counterparty is an NFC, or which is a third country counterparty that would otherwise qualify as a NFC (under certain conditions).	✓	✓	✓	
FCs to be responsible for reporting on behalf of both itself and an NFC that is not subject to the clearing obligation (NFC-)	—		✓	
The management company of a UCITS and manager of an AIF to be responsible and legally liable for reporting OTC derivative contracts entered into by the UCITS and AIF respectively	—	✓	✓	

How Deloitte Can Help

EMIR has continued to be a regulation fraught with difficulties and challenges. Throughout the evolution of the regulation, from the major reporting amendments in 2017 to the EMIR Refit requirements, Deloitte has been helping our clients ensure they are in the best position to meet the challenges faced by EMIR. Our expertise and experience with regulatory reform and technical knowledge in derivative markets allows us to support clients with a broad range of services that are tailored to their specific needs. An overview of our services is provided below, however, please get in touch if you would like to discuss your requirements.

Regulatory Health Check

The complexity and evolving nature of the EMIR regulation can make compliance a challenging proposition. The range of requirements means it can be difficult to know where you may or may not be operating in line with the regulations. Additionally, as the regulation matures, regulators are quickly losing their appetite to overlook non-compliance with the regulation.

If you are in doubt whether your firm fully meets applicable requirements under EMIR then our EMIR regulatory health check service may be what you need. The health check can be tailored to your specific needs, but includes:

- Review of EMIR applicability to identify provisions from the regulatory text that do or do not apply.
- Review of risk management procedures.
- Review of transaction reporting processes.
- Identification of gaps and definition of remedial actions.
- SME support in the implementation of remedial actions.
- Traceability back to underlying regulatory text

Transaction Reporting Reviews

The reporting requirements under EMIR are amongst the most onerous and complex in the regulatory world. The vast number of fields, lifecycle reporting and the requirement to match trades still poses a challenge for many firms. Firms using delegated reporting often face challenges in monitoring the reporting performed on their behalf. Recent regulatory enforcement for EMIR reporting failures has reinforced regulators' resolve around misreporting.

We provide a complete end to end transaction reporting review that dives deep into your transaction reporting implementation – reviewing embedded day to day processes, systems and governance to provide a complete view. Each review can be tailored to your specific requirements, including the following:

- Review of your regulatory reporting interpretation, and if necessary, support with creating one.
- Testing of submitted reports to identify timeliness, accuracy and completeness of trades.
- Review and definition of a target operating model for transaction reporting.
- Data quality and data lineage reviews.

EMIR Refit Implementation Support

Given the upcoming challenge of the amendments made under EMIR Refit, the need for an effective and efficient implementation is paramount. If you are looking to understand how EMIR Refit will impact your business, we can support your business in the scope, design and implementation of your project. The support will can be tailored to your specific project requirements, but can include:

- Regulatory Gap Analysis identifying applicability, scope and next steps to support project planning
- Creation of Business Requirements Documents where necessary.
- On going implementation support through our SME's who can advise throughout the implementation phase.
- Full implementation support covering the entire process.
- This support can be partnered with a wider EMIR compliance review if necessary, providing comfort that your current implementation is sound and supporting with the future requirements as an efficient and streamlined project.

Contacts

To learn more about our range of services to assist you in complying with EMIR requirements, please contact:

Matthew Ranson
Director
Risk Advisory
Deloitte & Touche LLP
mranson@deloitte.co.uk

Hussain Abdullah
Senior Manager
Risk Advisory
Deloitte & Touche LLP
husabdullah@deloitte.co.uk

Rosalind Fergusson
Senior Manager
Risk Advisory
Deloitte & Touche LLP
rfergusson@deloitte.co.uk