

EMIR – the obligation to clear and margin OTC derivative trades

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Agenda

- Introduction
- Clearing obligation
- Margin obligation

Introduction

G20 statement in Pittsburgh:

"All standardised OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end-2012 at the latest. OTC derivative contracts should be reported to trade repositories. Non-centrally cleared contracts should be subject to higher capital requirements".

European Market Infrastructure Regulation (EMIR)

- Brings in:
 - reporting to trade repositories
 - clearing obligations
 - risk mitigation for uncleared trades
 - requirements for central counterparties (CCPs) and trade repositories (TRs)
- Will apply to EU firms even when trading with non-EU firms
- More regulation for derivatives in MIFID/MIFIR and CRD IV

Clearing Obligation under EMIR

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Agenda

- Background: application of clearing obligation (CO)
- Where are we now?
- Meeting the clearing obligation

Background: Application

- OTC derivative contracts entered into or novated from date CO takes effect (or during frontloading period if applicable) must be cleared by an authorised/recognised CCP
- Applies to contracts between any combination of Financial Counterparties (FCs) and Non Financial Counterparties exceeding clearing threshold (NFC+s)
- Applies where:
 - ≥ 1 of the counterparties is in the EU (NB equivalence may be available);
 - In limited circumstances, neither in EU

Which NFC's are caught?

- CO applies to all future OTCD contracts once breach ≥ 1 threshold below (becoming NFC+)

Gross notional value	Class of OTC derivative
€1bn	credit
€1bn	equity
€3bn	interest rate
€3bn	Foreign exchange
€3bn	Commodity and others (combined)

- Exclude transactions designed to reduce risks to commercial or treasury financing activity
- Includes contracts entered into by all non financial entities within NFC's group

Where are we now?

- In accordance with “bottom up approach”, ESMA has been analysing the classes of OTC derivatives cleared by CCPs which have been re-authorised under EMIR
- Resulted in ESMA consultation papers on interest rate swaps (IRS), credit default swaps (CDS) and foreign-exchange non-deliverable forwards (NDF)
- Key issues: frontloading, categorisations, timescales (including phase-ins) and intragroup treatment

OTC IRS (G4 currencies)

- Dec 2014 – Commission informed ESMA of its intention to endorse draft RTS with amendments
- Jan 2015 – ESMA resubmitted RTS + opinion (incl approach to intragroup exemption)
- Once RTS finalised, Council and European Parliament have maximum 3 month objection period, extendible by 3 months
- Lord Hill – CO as early as April 2016

Phase-ins/ Frontloading

		Phase in for CO post entry into force	Frontloading post entry into force
Cat 1	Clearing members (CM) on entry into force which are CM of: <ul style="list-style-type: none"> • ≥ 1 class of OTCDs set out in that RTS; & • ≥ 1 CCP authorised or recognised to clear ≥ 1 of those classes 	6 mths	2 mths for FCs only
Cat 2	<ul style="list-style-type: none"> • Non Cat 1 FCs and AIF NFC+s whose group's aggregate month-end average of outstanding notional amt of OTC derivs \geq €8bn (assessed over 3 mths following RTS publication mth) 	12 mths	5 mths for FCs only
Cat 3	Non Cat 1 or 2 FCs and AIF NFC+s	18 mths	N/A
Cat 4	Other NFC+s	3 yrs	N/A

Mixed category trades - Less stringent rule applies

Hypothetical example

- NB this is not an actual or an expected timeline, and is provided for illustrative purposes only
- Oct 2015 entry into force (20 days post OJ publication)

Contract	Frontloading commences	Clearing
Cat 1 to Cat 1	Dec 2015 for FCs	April 2016
Cat 2 to Cat 1/2	Mar 2016 for FCs	Oct 2016
Cat 3 to Cat 1/2/3	N/A	April 2017
Cat 4 to Cat 1/2/3/4	N/A	Oct 2018

- Voluntary clearing also possible

Key exemptions and equivalence

- Commission proposed 2 year extension to exemption for specified pension scheme arrangements (PSAs) until 16 August 2017
 - objectively measurable as reducing investment risks directly relating to the financial solvency of defined PSAs
- PSAs under A2(10)c&d will need to self assess (i.e., no application) against list of approved entity/arrangement types and relevant criteria
- Exemption for covered bond derivatives s.t. meeting RTS conditions (NB no application)

Key exemptions and equivalence (cont.)

- Exemption for intragroup transactions
 - Domestic tx – Can apply now via EMIR portal
 - EU to EU tx – Check both competent authorities in a position to accept application/notification
 - EU to 3rd country tx - consider finalised RTS
- Where A13 (jurisdiction) equivalence applies, counterparties can follow 3rd ctry's rules.
- But in the absence of this, A25 (CCP) equivalence should still enable relevant 3rd country CCPs to be used for the purpose of meeting the clearing obligation.

Authorised and Recognised CCPs

- 16 EMIR authorised EU CCPs: Nasdaq OMX, EuroCCP, KDPW, Eurex Clearing, CC&G, LCH Clearnet SA, ECC, LCH Clearnet Ltd, Keler CCP, CME, CCP.A, LME, BME Clearing, OMIClear, Holland Clearing House, Athex Clear
- 10 EMIR recognised non-EU CCPs: ASX Clear (Futures) Pty and ASX Clear Pty (**Australia**), HKSCC, HKFE, OTC Clearing Hong Kong and SEHK Options Clearing House (**Hong Kong**), Japan Securities Clearing and Tokyo Financial Exchange (**Japan**), Central Depository (Pte) and Singapore Exchange Derivatives Clearing (**Singapore**)

Clearing Obligation – IRS (non G4 currencies)

- ESMA consultation closed last week on:
 - fixed-to-float IRS denominated in CZK, DKK, HUF, NOK, SEK and PLN; and
 - forward rate agreements denominated in NOK, SEK and PLN
- Next step - ESMA to consider consultation responses and decide on next steps

Clearing Obligation – OTC CDS

- Untranched itraxx Europe Main and Crossover, 5 year maturity
- ESMA consultation closed Sept 2014
- RTS likely to be submitted to Commission after IRS RTS finalised

Clearing Obligation – OTC foreign exchange non-deliverable forwards (NDFs)

- Feb 2015 – ESMA published feedback statement following consultation last year
- Clearing obligation not proposed at this stage as more time needed to address main concerns raised during consultation (market infancy and international convergence)

Meeting the clearing obligation

- Counterparties may meet the clearing obligation as a direct clearing member, client of a clearing member or indirectly through a clearing member
- CCPs and clearing members must offer, and clients will need to choose between:
 - individual client segregation; and
 - omnibus client segregation

Meeting the clearing obligation (cont.)

FCs and NFC+s should:

- Consider products you use to see which may be subject to clearing/FL
- Put in place relevant clearing arrangements as soon as possible (including to frontload, where applicable) – consider time to onboard
- Determine your counterparty category (NB notifications re: NFC+), and identify which of your counterparties will also be within scope
- If wishing to use an exemption, assess compliance with conditions and consider notification/application process

Summary

- IRS clearing potentially from April 2016 (and frontloading possibly sooner)
- It takes time to put in place clearing arrangements, so take steps ASAP

Questions?

OTC Derivatives: Margin

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Background

- Not all derivatives can be CCP-cleared
- G-20 origin; BCBS/IOSCO responsibility
- Working Group on Margining Requirements (WGMR) published standards in 2013; timing extended earlier this year (operation begins in September 2016)
- Implementation in Europe through RTS expected to be finalised in early Autumn

Application

- All OTC derivatives covered
- Market participants subject to the Clearing Obligation in scope
- Variation margin (VM) to cover current exposure; 1-way at any one time
- Initial margin (IM) to cover future exposure; 2-way throughout
- Eligible assets – highly liquid; hold their value

Qualifications

- IM exclusion – below Eur 8 billion (in notional amount)
- IM threshold - up to Eur 50 million (in IM provided)
- Minimum transfer amount – Eur 500,000

- Intragroup exemption – conditions
- Swaps linked to covered bonds – conditions
- FX exchanges – only VM
- One-way obligations, e.g. options – one-way margin
- Concentration limits

Cross-border: EMIR position

- EMIR applies to transactions between
 - 2 EU firms (which includes branches elsewhere)
 - an EU firm and a non-EU firm (which includes EU branches of a non-EU firm) from a non-equivalent jurisdiction
- BUT it can be disapplied for transactions between an EU firm and a non-EU firm from an equivalent jurisdiction – substituted compliance

Cross-border cont.

- Discussion amongst authorities to harmonise requirements – through WGMR monitoring group and otherwise
- Focus on aspects which are common to transactions where multiple rules may apply

Operation: phase-in - VM

- 2016 (September) for most systemically important entities
- 2017 (March) for rest

Operation: phase-in - IM

- 2016 (September) for entities (on a group basis) with Eur 3 trillion (in notional amount)
- 2017 (September) – Eur 2.25 trillion
- 2018 (September) – Eur 1.5 trillion
- 2019 (September) – Eur 0.75 trillion
- 2020 (September) – other (above 8 billion)

What should you do next?

- VM/IM application/timing – consider your category, together with the categories of your counterparties
- Implementation steps – including document changes, use of IM model, operational procedures

Questions?