

Briefing

December 2017

(Updated 19 December 2017)

EMIR Update: Variation Margin; SSPEs

Ireland Law Firm of the Year 2017
Chambers Europe Awards

Best Firm in Ireland 2016 & 2017
Europe Women in Business Law Awards

Best National Firm for Women in Business Law 2016 & 2017
Europe Women in Business Law Awards

Best National Firm Mentoring Programme 2016 & 2017
Europe Women in Business Law Awards

Ireland Law Firm of the Year 2016
International Financial Law Review (IFLR) Europe Awards

Ireland Law Firm of the Year 2016
Who's Who Legal

Americas International Tax Firm of the Year 2016
International Tax Review

Advised on the 'Deal of the Decade' – Merger of Lafarge and Holcim
Mergermarket European M&A Awards

Following on from the European Commission's recent proposal to amend EMIR, the EU Council (in its most recent compromise text) has suggested taking most physically-settled FX forwards out the scope of EMIR's mandatory variation margin provisions, and not treating securitisation special purpose entities (SSPEs) as financial counterparties (FCs). The European Supervisory Authorities (ESAs) have, in a more recent development, also encouraged regulatory forbearance in respect of the obligation to exchange variation margin on physically-settled FX forwards.

BACKGROUND

On 4 May 2017, the Commission proposed some targeted reforms to improve the functioning of the derivatives market in the EU, particularly in respect of smaller in-scope counterparties. See our briefing on the proposed regulation [here](#).

EU COUNCIL COMPROMISE PROPOSAL

In its most recent compromise proposal on the draft regulation, the EU Council proposed taking physically-settled FX forwards outside the scope of EMIR's mandatory variation margin provisions (with the exception of transactions between credit institutions).

As discussions on the draft regulation

are ongoing and the draft regulation is highly unlikely to be in place before 3 January 2018 (the effective date of MiFID II), the EU Council's proposal offered little practical comfort to buy-side entities struggling to put in place EMIR-compliant variation margin documents and procedures by 3 January 2018. As such, it was expected that national competent authorities or other regulatory bodies would provide a statement of policy, or an indication of forbearance, in respect of physically-settled FX forwards.

STATEMENT BY THE ESAs

On 24 November 2017, the ESAs issued an important [statement](#) noting that they had been made aware of challenges for

certain counterparties in exchanging variation margin for physically-settled FX forwards from 3 January 2018.

In that statement, the ESAs noted that any formal change to the rules on variation margin would need to take place by way of an amendment to the relevant Level 2 regulation, and that they would work on this with a view to submitting proposed amendments to the Commission by 24 December 2017. They also suggested that transactions between institutions (i.e. MiFID investment firms as well as credit institutions) should be in scope for exchanging variation margin on physically-settled FX forwards.

On 18 December, the ESAs then published their [draft amendments to the relevant Level 2 regulation](#), formally proposing that the requirement to exchange variation margin for physically-settled FX forwards would apply only to transactions between institutions (i.e. credit institutions and investment firms within the meaning of the Capital Requirements Regulation, or equivalent entities located in third countries that would meet the

definition of “*institution*” if they were located in the EU).

The ESAs, in both their statement and in the Executive Summary at the start of the draft amending legislation, recommended that competent authorities (e.g. the Central Bank of Ireland) should “*generally apply their risk-based supervisory powers in their day-to-day enforcement of applicable legislation in a proportionate manner*” as the legislative changes are unlikely to be in place by 3 January 2018.

STATEMENT BY THE CENTRAL BANK OF IRELAND

On 19 December 2017, the Central Bank [welcomed](#) the ESAs statement in its [Markets Update \(Issue 10/2017\)](#), noted the ESAs’ intention to propose targeted amendments to the relevant Level 2 regulation and confirmed that “*...in accordance with the recommendations from the ESAs and pending the outcome from their review, the Central Bank will apply its risk-based supervisory powers in the day-to-day enforcement of applicable legislation in a proportionate manner.*”

STATEMENT BY UK FINANCIAL CONDUCT AUTHORITY (FCA)

On 7 December 2017, the FCA had also [confirmed](#) that it supported the ESAs’ statement. The FCA went on to note that it would “*not require firms whose physically settled FX forwards are likely to be outside the scope of the amended requirements to continue putting processes in place to exchange variation margin*”, but noted that it continues to recognise that the exchange of variation margin is a prudent risk management tool.

EMIR REFORM: SSPEs

Separately, in its most recent compromise proposal on the proposed regulation to amend EMIR, the EU Council proposed the deletion of the Commission’s suggestion that SSPEs be included within the definition of “*financial counterparty*”. If this proposal is agreed, this will come as a relief to the securitisation and structured finance industry as it means that SSPEs will not be subject to the obligation to exchange variation margin imposed on FCs.



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