

Group Briefing

April 2019

EMIR Refit – Are you clear on its clearing (and other) implications?

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This document contains a general summary of developments and is not a complete or definitive statement of the law. Specific legal advice should be obtained where appropriate.

EMIR is being amended, and the changes (known as **EMIR Refit**) could be in force as early as the end of May 2019. This briefing considers the impact of EMIR Refit on over-the-counter derivative contracts, from the perspective of both financial counterparties and non-financial counterparties. In particular, it sets out the calculation and notification obligations that will go live on the date that EMIR Refit comes into force.

EMIR IS BEING AMENDED

The European Market Infrastructure Regulation (**EMIR**) is being amended, and the changes (known as **EMIR Refit**) could be in force as early as the end of May 2019.

EMIR Refit is generally regarded as a positive development for smaller derivatives users and relaxes some of the current EMIR obligations. However, market participants (including infrequent users of derivatives) will need to be ready to calculate their volumes of over-the-counter (**OTC**) derivatives contracts and, if necessary, prepare for regulatory notifications and clearing, from the date that EMIR Refit comes into force.

AMENDED DEFINITION OF FINANCIAL COUNTERPARTIES

EMIR Refit will widen the definition of “**financial counterparty**” to include:

- » all alternative investment funds (**AIFs**) established in the EU (EMIR currently categorises, as financial counterparties (**FCs**), only those AIFs managed by an alternative investment fund manager (**AIFM**) authorised or registered under the Alternative Investment Fund Managers Directive); and
- » all central securities depositories authorised under the Central Securities Depositories Regulation.

EMIR Refit will specifically exclude the following from the definition of “**financial counterparty**”:

- » UCITS and AIFs set up exclusively to service employee share purchase plans; and
- » an AIF that is a securitisation special purpose entity (if, where relevant, its AIFM is established in the EU).

FINANCIAL COUNTERPARTIES AND CLEARING UNDER EMIR REFIT

The current position under EMIR

Under EMIR, an FC is subject to the clearing obligation in respect of all OTC derivative contracts, irrespective of their aggregate value.

The clearing obligation is already live for 'Category 1' and 'Category 2' FCs.

The clearing obligation for 'Category 3' FCs takes effect on 21 June 2019. 'Category 3' FCs are those whose aggregate month-end average of outstanding gross notional amount of non-centrally cleared derivatives is equal to or below €8 billion, subject to certain conditions.

The position under EMIR Refit – clearing exemption for “small financial counterparties”

Under EMIR Refit, a specific type of FC, commonly referred to as a “small financial counterparty” (referred to in this briefing as an SFC) will be exempt from the clearing obligation.

The clearing thresholds for the SFC exemption under EMIR Refit to apply are:

- » €1 billion in gross notional value for credit derivatives contracts;
- » €1 billion in gross notional value for equity derivatives contracts;
- » €3 billion in gross notional value for interest rate derivative contracts;
- » €3 billion in gross notional value for foreign exchange derivative contracts;
- » €3 billion in gross notional value for commodity and other OTC derivative contracts.

FC may carry out annual calculation

Under EMIR Refit, an FC that has taken positions in OTC derivative contracts may calculate, every 12 months, its aggregate month-end average position for the previous 12 months.

That calculation must include all OTC derivative contracts (speculative or hedging):

- » entered into by that FC; or
- » entered into by any member of the group to which the FC belongs.

For UCITS and AIFs, the calculation is at fund level and where the UCITS management company manages more than one UCITS, or where the AIFM manages more than one AIF, they must be able to show that the calculation at fund level doesn't result in:

- » a systematic underestimate of the positions of the funds that they manage, or the positions of the manager; and
- » the clearing obligation being circumvented.

If, once an FC makes this calculation, none of the above clearing thresholds are exceeded, that FC will be an SFC and will be exempt from clearing. It will, however, still be subject to EMIR's variation margin requirements.

Regulatory Forbearance for SFCs

ESMA previously acknowledged the potential difficulties that SFCs would face if EMIR Refit, which will exempt them from the clearing obligation, is not in force by 21 June 2019 (the deadline for certain SFCs (i.e. 'Category 3' FCs) to start clearing and trading some of their OTC derivative contracts on trading venues). In a recent statement, it encouraged regulatory forbearance.

(Read our recent briefing for further information: [EMIR Update: Small financial counterparties - ESMA statement regarding clearing and trading obligations.](#))

Notification and Clearing

If an FC:

- » does not make the above calculation on time or at all, or
- » makes the calculation and any clearing threshold is exceeded,

that FC (an FC+) must immediately notify the Central Bank of Ireland (CBI) and ESMA and make arrangements to clear (within 4 months) all OTC derivative contracts entered into with either another FC+, or with an NFC+ (see below in relation to NFC+).

Timing for Calculation and Notification

ESMA [recently clarified](#) that the date on which the above calculation should first be made is the date that EMIR Refit enters into force (and every 12 months thereafter). If an FC elects not to make the calculation, or makes the calculation and any clearing threshold is exceeded, it must notify the CBI and ESMA on the date that EMIR Refit enters into force.

An FC+ can subsequently become an SFC (and thereby become exempt from the clearing obligation) if it can demonstrate that its aggregate month-end average position for the previous 12 months does not exceed any clearing threshold.

Action Required

FCs will need to be in a position to make the above calculation on the date that EMIR Refit enters into force and, if required, to make the necessary notifications to the CBI and ESMA.

Other notable points

- » **Pension Schemes**
The temporary exemption from the clearing obligation for pension scheme arrangements (PSAs) will be extended for a further 2 years. It should be noted that some PSAs may be SFCs, and may benefit from the SFC exemption from clearing.
- » **Frontloading**
EMIR Refit will remove the 'frontloading' obligation i.e. the requirement to clear OTC derivative contracts entered into before the related clearing obligation takes effect.
- » **Margining for Foreign Exchange (FX)**
EMIR Refit will include a recital acknowledging that the need for international convergence means that mandatory exchange of variation margin on FX forwards and FX swaps should (for physically-settled FX) be limited to transactions between the most systemic counterparties (i.e. credit institutions and investment firms).

FCS - ADDITIONAL POINTS TO NOTE ON REPORTING

Backloading

The 'backloading' obligation will be removed by EMIR Refit. (Read our recent briefing for further information: [EMIR Update: Small financial counterparties - ESMA statement regarding clearing and trading obligations.](#))

Responsibility for Reporting

- » **Where an FC transacts with an NFC-**, EMIR Refit provides the FC will be responsible and liable for reporting (for an NFC+, or an NFC- that chooses to report, the NFC will continue to be responsible and liable).
- » EMIR Refit clarifies that for:
 - » **OTC derivative contracts entered into by a UCITS**, the management company will be solely responsible and liable for reporting.
 - » **OTC derivative contracts entered into by an AIF**, the AIFM will be solely responsible and liable for reporting.
 - » **OTC derivative contracts entered into by an institution for occupational retirement provision (IORP) without legal personality**, the authorised entity responsible for its management will be responsible and liable for reporting.

NON-FINANCIAL COUNTERPARTIES AND CLEARING UNDER EMIR REFIT

The current position under EMIR

Under EMIR, non-financial counterparties (NFCs) must, where any clearing threshold has been exceeded (the clearing thresholds are set out earlier in this briefing), clear all OTC derivative contracts, irrespective of whether or not they belong to a class for which the clearing threshold has been exceeded.

The position under EMIR Refit

EMIR Refit will allow NFCs to clear only those OTC derivative contracts which relate to the asset class for which the clearing threshold is exceeded. NFCs above a clearing threshold will still be required to exchange margin for OTC derivative contracts for which the clearing obligation is not exceeded.

Calculation

Under EMIR Refit, NFCs, like FCs, that have taken positions in speculative OTC derivative contracts may calculate, every 12 months, their aggregate month-end average position for the previous 12 months. If:

- » the calculation is made on time, and no clearing threshold is exceeded, the NFC (an NFC-) is not required to clear its OTC derivative contracts (and is also exempt from mandatory margin rules);
- » the calculation is made and one or more clearing thresholds are exceeded, the NFC (an NFC+) must notify the CBI and ESMA and make arrangements to clear (within 4 months) all OTC derivative contracts relating to the asset class(es) for which the clearing threshold is exceeded;
- » the calculation is not made on time or at all, the NFC (an NFC+) must notify the CBI and ESMA and make arrangements to clear (within 4 months) all OTC derivative contracts.

Timing

As mentioned above, ESMA recently clarified that the date on which the above calculation should first be made is the date that EMIR Refit enters into force (and every 12 months thereafter). If an NFC elects not to make the calculation, or makes the calculation and any clearing threshold is exceeded, it must notify the CBI and ESMA on the date that EMIR Refit enters into force.

An NFC+ can subsequently become

exempt from the clearing obligation if it can demonstrate that its aggregate month-end average position for the previous 12 months does not exceed a clearing threshold.

Action Required

NFCs will need to be in a position to make the above calculation on the date that EMIR Refit enters into force and, if required, to make the necessary notifications to the CBI and ESMA.

NFCs - ADDITIONAL POINTS TO NOTE ON REPORTING

Backloading

The 'backloading' obligation will be removed by EMIR Refit. (Read our recent briefing for further information: [EMIR Update: Small financial counterparties - ESMA statement regarding clearing and trading obligations.](#))

Intra-Group Exemption

An exemption from the reporting obligation is available for intra-group transactions where:

- » at least one counterparty is an NFC;
- » both counterparties are fully consolidated;
- » both counterparties are subject to appropriate centralised risk evaluation, measurement and control procedures; and
- » the parent undertaking is not an FC.

Counterparties must notify the CBI of their intention to apply this exemption.

Responsibility for Reporting

Where an FC transacts with an NFC-, EMIR Refit provides the FC will be responsible and liable for reporting (for an NFC+, or an NFC- that chooses to report, the NFC will be responsible and liable).

KEY CONTACTS

If you would like to discuss the contents of this briefing in more detail, or if you require any assistance with assessing the impact of EMIR Refit on your business, please contact any member of our team.



PHIL CODY
PARTNER,
HEAD OF DERIVATIVES GROUP
+1 212 782 3290
phil.cody@arthurcox.com



AIDEN SMALL
PARTNER,
DEBT CAPITAL MARKETS
+353 1 920 1072
aiden.small@arthurcox.com



BRENDAN WALLACE
SENIOR ASSOCIATE,
DEBT CAPITAL MARKETS
+353 1 920 1069
brendan.wallace@arthurcox.com



BARRY SEXTON
ASSOCIATE,
DEBT CAPITAL MARKETS
+353 1 920 1278
barry.sexton@arthurcox.com

arthurcox.com

Dublin
+353 1 920 1000
dublin@arthurcox.com

Belfast
+44 28 9023 0007
belfast@arthurcox.com

London
+44 207 832 0200
london@arthurcox.com

New York
+1 212 782 3294
newyork@arthurcox.com

Silicon Valley
+1 650 943 2330
siliconvalley@arthurcox.com