

Guide to

European Markets Infrastructure Regulation ('EMIR')

A. Introduction - Legal Framework

1. The Cyprus Securities and Exchange Commission has prepared this document with the aim to provide the industry with an outline of EMIR requirements.
2. OTC derivatives lack transparency as they are privately negotiated contracts and any information concerning them is usually only available to the contracting parties. They create a complex web of interdependence which can make it difficult to identify the nature and level of risks involved. The financial crisis has demonstrated that such characteristics increase uncertainty in times of market stress and, accordingly, pose risks to financial stability.
3. Therefore, on 4 July 2012, the European Parliament and the Council adopted the Regulation 648/2012 on OTC derivatives, central counterparties and trade repositories (European Markets Infrastructure Regulation – 'EMIR' as it is known).

In general, EMIR lays down conditions for mitigating the risks mentioned above and improving the transparency of derivative contracts.

EMIR came into force on 16 August 2012.

4. EMIR applies to any entity established in the EU that has entered into an OTC derivative contract (derivative contract means a financial instrument as set out in points (4) to (10) of Section 3 of Annex I to Directive 2004/39/EC) and applies indirectly to non-EU counterparties trading with EU parties. It also applies to Central Counterparties (CCPs) and Trade Repositories (TRs).

If you enter into OTC derivative contracts, we therefore recommend that you carefully read this document in order to have an overview of the obligations set in EMIR and assess whether it applies to you.

5. EMIR lays down:

- i. Uniform requirements for the performance of activities of CCPs.
- ii. Uniform requirements for the performance of activities of TRs.
- iii. Obligations to counterparties who enter into derivative contracts.

EMIR identifies two main categories of counterparty to an OTC derivative contract: Financial Counterparties ('FC') and Non-Financial Counterparties ('NFCs').

The obligations to counterparties under EMIR are:

- All counterparties with outstanding derivative contracts must report details of those contracts, and any new contracts they enter into, to an authorized or recognized TR (**'Reporting Obligation'**).
- Counterparties, who enter into OTC derivative contracts subject to clearing obligation¹, must centrally clear the contracts through an authorized or recognized CCP (**'Clearing Obligation'**).
- **All counterparties** are required to comply with operational risk management requirements when entering into non-cleared OTC derivative contracts (**'Risk Mitigation Techniques'**).

6. In addition to the above Regulation, the EMIR framework is made up of the technical standards, which can be viewed [here](#).

For better implementation of EMIR framework, the European Commission and European Securities and Markets Authority ('ESMA') have released some Frequently Asked Questions on EMIR (which can be viewed here: [EU Commission FAQs](#), [ESMA Q&As](#)).

¹ *The European Commission will specify, through Regulatory Technical Standards, the classes of OTC derivatives that should be subject to clearing obligation.*

B. Authorisation and supervision of CCPs

7. Where a legal person established in the Union intends to provide clearing services as a CCP, it shall apply for authorisation to the competent authority of the Member State where it is established.

A CCP established in a third country may provide clearing services to clearing members or trading venues established in the Union only where that CCP is recognized by ESMA.

A CCP will be authorized/recognised to clear specific class/classes of OTC derivatives that have been declared subject to clearing obligation according to EU Regulatory Technical Standards.

8. EMIR lays down the conditions necessary for authorization/recognition of a CCP, as well as the obligations that must be adhered by CCPs at all times.
9. As far as Cyprus is concerned, CySEC is designated the competent authority for the authorisation and supervision of CCPs established in Cyprus.
10. ESMA will publish on its website a list of the authorised and/or recognized CCPs, as well as a list of all the classes of OTC derivatives subject to clearing obligation that will be cleared by each CCP.

C. Authorisation and supervision of TRs

11. Where a legal person established in the Union intends to centrally collect and maintain the records of derivatives as a TR, it must be registered with ESMA.

A TR established in a third country may provide its services and activities to entities established in the Union only after its recognition by ESMA.

TRs will be able to collect and maintain the records of those classes of derivative contracts for which they are registered.

12. EMIR lays down the conditions necessary for registration/recognition of a TP, as well as the obligations that must be adhered by TRs at all times.

13.ESMA will publish on its website a list of the registered/recognised TRs, as well as the class of derivative contracts that they accept to register.

D. Financial Counterparties

14.FCs definition

The following entities are considered as FCs under EMIR [Article 2(8)]

- i. An investment firm
- ii. A credit institution
- iii. An insurance undertaking
- iv. An assurance undertaking
- v. A reinsurance undertaking
- vi. A UCITS, and where relevant, its management company
- vii. An institution for occupational retirement provision
- viii. An alternative investment fund

15.FCs requirements under EMIR

According to EMIR, FCs have the following obligations:

- i. Reporting obligation (Article 9)
- ii. Clearing obligation (Article 4)
- iii. Operational risk management requirements - Risk mitigation techniques (Article 11)

16.Reporting obligation (Article 9)

- i. FCs must ensure that the details of any derivative contract (i.e. both Exchange Traded Derivatives and OTC Derivatives and whether cleared or not, including intra-group transactions) they have concluded and of any modification or termination of the contract are reported to a registered/recognised TR within one working day of their conclusion, modification or termination [Article 9(1)].

Individuals who are not carrying out an economic activity and consequently are not considered as undertakings are not subject to the reporting obligation (*modified 3/4/2014*).

ii. Reporting start date - Backloading [Article 9(1)]

- The reporting start date is the date where a TR for a particular derivative class has been registered.
- Derivative contracts which were entered into before 16 August 2012 and remain outstanding on the reporting start date have to be reported within 90 days of the reporting start date.
- Derivative contracts which were entered into before 16 August 2012 or entered into thereafter but are not outstanding on the reporting start date have to be reported within 3 years of the reporting start date.

Based on ESMA's latest timetable (13/9/2013), the first registration decisions for TRs are expected to be made not before 7 November 2013. Consequently, counterparties' reporting to trade repositories is not expected to start before February 2014.

iii. Format and frequency of derivative contract reports

The format and the frequency of derivative contract reports are set in the Commission Implementing Regulation (EU) No 1247/2012.

iv. Reporting details

The details to be reported are clearly set in the Commission Delegated Regulation (EU) No 148/2013.

v. Record Keeping

As from 16 August 2012, FCs are required to keep a record of any derivative contract they have concluded and any subsequent modification, for at least 5 years following termination of the contract [Article 9(2)].

vi. Outsourcing/Delegation

Reporting obligation may be delegated. However, when delegating such duties, FCs must ensure that the details for such derivative contracts are not reported twice. Irrespective of the delegation, it is noted that the responsibility to report remains with FCs.

vii. Legal entity identifier

FCs when reporting to TRs must use a Legal Entity Identifier ('LEI').

The LEI is a 20-digit, alpha-numeric code that connects to key reference information that enables clear and unique identification of companies participating in global financial markets.

Please see the LEI Regulatory Oversight Committee website for more information.

17. Clearing obligation

- i. FCs are required to clear all OTC derivatives that has been declared subject to clearing obligation after (a) CCPs have been authorized and (b) the classes of derivative contracts subject to clearing obligation have been defined in an EU's Regulatory Technical Standards. Neither (a) nor (b) have been accomplished.

ii. Clearing obligation matrix

A clearing obligation will apply to OTC derivatives contracts subject to clearing obligation between any combinations of:

Counterparty	FC	NFC+ ²	NFC- ³
FC	√	√	×
NFC+	√	√	×
NFC-	×	×	×

Note: Mandatory clearing obligations will apply to contracts concluded between counterparties where a) one or more of the counterparties is in the EU, and b) none of the counterparties is in the EU but the contract has a direct, substantial and foreseeable effect within the Union or where such an obligation is necessary or appropriate to prevent the evasion of any provisions of EMIR.

It is clarified that when an OTC derivative contract is concluded between a FC and an individual, this contract is not required to be cleared through a CCP provided that the individual is not carrying out an economic activity and is consequently not considered as undertaking (modified 3/4/2014)

iii. Intragroup exemptions [Article 4(2)]

OTC derivatives contracts that are intragroup transactions as specified in Article 3(2) are not subject to the clearing obligation provided that a notification procedure is followed [Article 4(2), counterparties fall under the above exemption must notified their competent authorities in writing at least 30 days before using exemption and the respective competent authorities are not object to this].

18.Operational risk management requirements - Risk mitigation techniques for OTC derivative contracts NOT cleared by a CCP (Article 11)

- i. FCs that enter into an OTC derivative contract which is **not** cleared by a CCP, are required to ensure, exercising due diligence, that appropriate procedures and arrangements are in place to measure, monitor and mitigate operational risk and counterparty credit risk, including at least:
 - The **timely confirmation** (as from 15 March 2013), where available, by electronic means, of the terms of the relevant OTC derivative contract. Article 12 of RTS 149/2013 specifies

² NFC above the clearing threshold (see part E)

³ NFC below the clearing threshold (see part E)

exactly the time frame. In addition, FC must have procedures in place for unconfirmed OTC derivative contracts outstanding for more than five business days [Article 12(4), RTS 149/2013].

- Formalized processes (as from 15 September 2013) which are robust, resilient and auditable in order to **reconcile portfolios**, to **manage the associated risk** and to **identify disputes** between parties early **and resolve them**, and to **monitor the value** of outstanding contracts.

Portfolio reconciliation – FCs to an OTC derivative contract must agree in writing or other equivalent electronic means with each of their counterparties on the arrangements under which the portfolios must be reconciled. Such agreement must be reached before entering into the OTC derivative contract. Article 13 of RTS 149/2013 specifies the frequency where the portfolio reconciliation must be performed.

Portfolio compression – Involves parties netting trades to maintain the same risk profile but reducing the number of contracts and therefore the gross notional value. FCs with 500 or more OTC derivative contracts outstanding with another counterparty must have in place procedures to regularly, and at least twice a year, analyse the possibility to conduct a portfolio compression exercise in order to reduce their counterparty credit risk and engage in such a portfolio compression exercise. FCs must be able to explain if they have concluded this is not appropriate.

Dispute resolution – FCs must have agreed detailed procedures and processes to a) identify, record and monitor disputes relating to the recognition or valuation of the contract and to the exchange of collateral counterparties, and b) resolve disputes in a timely manner with a specific process for those disputes that are not resolved within five business days.

Monitoring the value – FCs must mark-to-market on a daily basis the value of outstanding contracts. Where market conditions prevent marking-to-market, reliable and prudent marking-to-model must be used. Articles 16 and 17 of RTS 149/2013, clarifies the above.

Operational risk management requirements (Risk mitigation techniques) for OTC derivative contracts not cleared by a CCP, do not apply in the cases where the 'counterparty' of the FC is an individual provided that the individual is not carrying out an economic activity and is consequently not considered as undertaking (modified 3/4/2014).

E. Non-Financial Counterparty (NFC)

19.NFC definition

An undertaking established in the Union other than the entities referred to in point 14 above [Article 2(9)] and CCPs.

Examples: Energy companies, manufacturers, airline/shipping companies.

20.NFCs requirements under EMIR

NFCs have the same requirements under EMIR as FCs – Reporting obligation, clearing obligation (with some differences in application) and operational risk management requirements (risk mitigation techniques).

As far as Cyprus is concerned, CySEC is designated the authority responsible for ensuring that NFCs established in Cyprus comply with the obligations under EMIR.

21.Reporting obligation

NFCs have exactly the same reporting obligations as FCs (see point 16 above).

22.Clearing obligation

- i. EMIR treats NFCs differently than FCs depending on whether their positions in OTC derivative contracts exceed a certain 'Clearing Threshold'.

NFCs with positions in OTC derivative contracts above the 'Clearing Threshold' are subject to the same clearing obligation as FCs. NFCs with positions in OTC derivative contracts below the 'Clearing Threshold' are **not** subject to clearing obligation.

ii. Clearing Threshold

The 'Clearing Threshold' is a predefined amount dependent on the position held by a NFC in relation to one asset class of OTC derivative contracts (e.g. for credit derivatives). However, if the threshold is exceeded, NFCs will be required to clear OTC derivative contracts through a CCP for **all** asset classes (e.g. for interest rate and foreign exchange derivatives).

Clearing Thresholds		
•	€1 billion*	Credit derivative contracts
•	€1 billion*	Equity derivatives contracts
•	€3 billion*	Interest rate derivative contracts
•	€3 billion*	Foreign exchange derivative contracts
•	€3 billion*	Commodity derivative contracts and others

**in gross notional value*

When calculating clearing thresholds, NFCs may ignore OTC derivative contracts that meet the criteria provided in the RTS 149/2013 (e.g. those that are used for hedging purposes).

iii. Example

Firm A

•	€550 million	Credit derivative contracts
•	€800 million	Equity derivatives contracts
•	€1.1 billion	Interest rate derivative contracts
•	€2.5 billion	Foreign exchange derivative contracts
•	Zero	Commodity derivative contracts and others
→	Clearing threshold not exceeded	

Firm B

•	€1.7 billion	Credit derivative contracts
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•	€750 million	Equity derivatives contracts
•	€2.8 billion	Interest rate derivative contracts
•	€4.4 billion	Foreign exchange derivative contracts
•	Zero	Commodity derivative contracts and others
→	Clearing threshold is exceeded	
→	Clear ALL contracts	

iv. Notification procedure [Article 10]

NFCs exceeding the clearing threshold:

- Must immediately notify ESMA and CySEC (by completing the form that can be accessed [here](#)).
- Will become subject to the clearing obligation for future contracts if the rolling average position over 30 working days exceeds the threshold.
- Centrally clear all relevant future contracts, through a CCP, within four months of becoming subject to the clearing obligation.

In case a NFC that has become subject to the clearing obligation, can demonstrate (by completing the form that can be accessed [here](#)) to its competent authority (CySEC) that its rolling average position over 30 working days does not exceed the clearing threshold, then will no longer be subject to the clearing obligation.

23. Operational risk management requirements - Risk mitigation techniques

All NFCs (irrelevant of the clearing threshold) must have appropriate procedures in place to ensure that they are able to confirm the details of their non-cleared OTC derivatives contracts with counterparties.

The same operational risk management requirements (risk mitigation techniques), as those described in point 18 above, are applied to NFCs.

F. Summary of FCs and NFCs obligations under EMIR

	Clearing Obligation	Reporting Obligation	Risk Mitigation Techniques
FC	√	√	√
NFC+ ⁴	√	√	√
NFC- ⁵	-	√	√

⁴ *NFC above the clearing threshold*

⁵ *NFC below the clearing threshold*