Commodity Markets Council – Europe

CMCE strategy paper on EMIR review

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1. EMIR review

Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories (**EMIR**) was adopted on 04 July 2012 and entered into force on 16 August 2012. Article 85(1) EMIR requires the European Commission to review and report to the Council of Ministers and European Parliament on application of the legislation generally and specifically on *inter alia* the impact of the legislation on "non-financial firms" use of OTC derivative contracts. The provision directs the Commission to provide any appropriate proposals for amending the legislation and its implementing measures with the report. The provision sets a deadline of 17 August 2015 for the report.

The Commission commenced this review of the legislation in early 2015. It held a public consultation on the review on 21 May 2015 to which CMCE responded.[1] The Commission published an initial report on the review on 23 November 2016.[2] The Commission is expected to publish a final report on the review by the end of this quarter. It is also expected to adopt any proposed amendments to EMIR or propose amendments to EMIR implementing measures at this time. Any proposed legislative amendments would be subject to amendment and adoption by the European Parliament and Council under the ordinary legislative procedure. Any amendments to implementing measures would be subject to scrutiny by the European Parliament and Council.

2. Prospective changes to the legislation

The Commission's interim report concludes that "no fundamental change should be made to the nature of the core requirements of EMIR, which are integral to ensuring transparency and mitigating systemic risks in the derivatives markets". Instead, the Commission intends to propose a series of amendments to EMIR provisions to address concerns raised by the European Supervisory Authorities (**ESAs**), industry and other stakeholders.

Working documents provided to EU Member State experts on 02 December 2016 provide some insight into the thinking of the Commission services on EMIR amendments. Issues relevant to CMCE are summarised below:

2.1 Clearing and margining requirements for NFCs

Noting the formal input to the review of the European Securities and Markets Authority (**ESMA**) on the use of OTC derivatives by non-financial counterparties (NFCs), the Commission suggests the following options:[3]

[1] European Commission: Public consultation on [EMIR] (21 May 2015) [link].

[2] European Commission: Report from the Commission to the European Parliament and the Council under Article 85(1) [EMIR] [COM(2016)857] (23 November 2016) [link].

[3] ESMA: EMIR Review Report no.1: Review on the use of OTC derivatives by non-financial counterparties [ESMA/2015/1251] (13 August 2015) [link].

- Remove the hedging exemption and increase in the clearing thresholds;
- Provide more detailed guidance on application of the hedging exemption; or
- Exempt NFCs entirely from EMIR clearing and margin requirements.

2.2 Access to clearing

Recognising that some, typically small financial counterparties (**FC**) have limited or no access to clearing services, the Commission considers EMIR amendments including:

- A temporary or permanent exemption for "small FCs" from the clearing obligation;
- A requirement for clearing members and others to offer clearing services on a fair, reasonable and non-discriminatory basis;
- A new "direct membership" model to provide small FCs access to clearing services through a third party.

The Commission also recognises that national insolvency regimes have generally precluded the development of indirect clearing arrangements. It considers new EMIR provisions that would, in effect, apply the legislation's provisions on managing defaults over and above national insolvency law. The Commission also considers eliminating the frontloading requirement as a means of reducing the regulatory burden of mandatory clearing.

2.3 Reducing and simplifying reporting

The Commission recognises that the reporting obligation has been a very considerable investment for little if any return. It considers options to amend the Article 9 EMIR reporting obligation including:

- Exempt all Article 3 EMIR intragroup transaction from the reporting obligation;
- Exempt all intragroup transactions with one NFC counterparty from the reporting obligation;
- Require single-sided reporting and/or only FCs to report transactions;
- Require only single-sided reporting for exchange-traded derivative (**ETD**) transactions;
- Require trading venues or CCPs to report ETD transactions;
- Align ETD reporting requirements with those set out in Article 26 MiFIR;
- Disapply requirement to backload transaction reports
- Reduce data fields for backloaded transaction reports.

2.4 Requirements for trade repositories

The Commission's non-papers also recognise the problems with trade repository data and suggest that the quality of data is so low as to preclude competent authorities using data for supervision and other purposes. The Commission considers requiring trade repositories to take steps to validate transaction data received and to grant counterparties access to certain types of reported data held by trade repositories.

3. Suggested CMCE priorities

For all the soothing noises of the interim report, the Commission is unlikely to propose sweeping changes to the EMIR regime. Its freedom of action in respect of NFCs is constrained by hedging exemptions in MiFID II and MiFIR. It cannot simultaneously disapply the clearing obligation and promote a market in indirect clearing services. While it may give ground on ETDs, it considers double-sided reporting essential for even a low level of quality transaction data.

CMCE has previously advocated:

- Increasing the clearing thresholds set out in Article 11 of Commission Delegated Regulation (**CDR**) 149/2013;
- Disapplying the 'breach one, clear all' requirement;
- Amending the Article 2(7) EMIR definition to exclude derivative contracts executed on multilateral trading facilities (**MTFs**) that are cleared by a CCP;

- Amending the ESMA Q&A guidance on the hedging exemption to correct for inconsistencies with Article 10 CDR 149/2013;
- A two-year derogation to the clearing obligation for so-called “category 3” FCs;
- Applying the reporting obligation to FC or nominated NFC counterparties for OTC transactions; and
- Requiring only CCPs to report ETD transactions.

3.1 Clearing and margining requirements for NFCs

CMCE should focus advocacy and lobbying efforts on amendments to Article 10 EMIR, Articles 10 and 11 CDR 149/2013 and the corresponding ESMA Q&A guidance.

(a) Assuming that the Commission maintains the hedging exemption, it is unlikely to propose changes to the current clearing thresholds. Yet CMCE’s argument that current thresholds are too low and ‘capture’ systemically-irrelevant market participants is somewhat supported by ESMA’s formal input to the EMIR review. The group should continue to advocate an increase to the “FX” and “commodities and other” thresholds. This will focus policy maker attention on the application of the hedging exemption, and in particular on varying interpretations by competent authorities.

(b) Similarly, the group should advocate for amendments to Article 10 EMIR that would require a NFC+ counterparty to clear or margin only those OTC derivative contracts within the class of OTC derivative contracts for which it exceeds the clearing threshold. CMCE’s argument on the risk and relevance of incidental OTC transactions is credible and emphasises an unintended, negative consequence of the clearing threshold mechanism.

(c) With the pending application of MiFID II, the Commission may be more amenable to amending the Article 2(7) EMIR definition in respect of contracts executed on a MTF that must be cleared by an EMIR-authorised CCP. The CMCE should seek such an amendment, mindful that there will be knee-jerk opposition to any such amendment from some market operators.

(d) CMCE’s principal objective should be a review of and amendments to Article 10 CDR 149/2013 and/or the ESMA Q&A guidance at OTC Answer 10(3)(c), mindful of differing interpretations and requirements across competent authorities. Amendments including express references to the use of hedging portfolios in Article 11(1) CDR 149/2013 and qualifications to OTC Answer 10(3)(c)(i) and (iii) would facilitate CMCE members in respect to EMIR requirements as well as, by extension, the requirements of Articles 2(1)(j) and 57(1) MiFID II.

3.2 Access to clearing

CMCE should support any new definition of a “small FC” that may be exempted from one or more EMIR requirements. The group has little to lose and something to gain from any such amendment. Amendments on access to clearing generally will be a priority of clearing firms servicing CMCE members and the group should let these firms and their industry groups lead advocacy and lobbying on these amendments.

3.3 Reducing and simplifying reporting

CMCE should advocate amendments to Article 9 EMIR to (a) permit FC/nominated NFC reporting of transactions, and (b) mandate CCP-only reporting of ETD transactions. It is likely that other, more influential and better resourced industry groups will lead lobbying on amendments to the reporting obligation. CMCE will likely benefit if these lobbying efforts are successful and should lend support to these efforts.

3.1 Requirements for trade repositories

CMCE should not lobby on amendments that concern trade repositories specifically.