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EMEA Centre for Regulatory Strategy

European Market and Financial Infrastructure Regulation (EMIR)

The countdown to implementation begins

Firms now have much greater certainty on the detailed requirements for EMIR and the timetable for implementation following today's publication of the European Commission's Technical Standards.

Surprising some, the Commission has taken the advice received from the European Securities and Markets Authority (ESMA) and the European Banking Authority (EBA) and adopted it without amendment. The lack of change to the complex implementation timetable will be disappointing to some firms. This signals a clear desire from the Commission that further delay to meeting G20 commitments in this area is not acceptable. In practical terms this means that implementation programs will need to step up a gear in the New Year in order to meet the looming compliance dates.

Key areas of focus

EMIR introduces sweeping requirements for the risk management and reporting of over-the-counter (OTC) derivative transactions. All participants who transact in OTC derivatives will be affected in some shape or form. EMIR will ultimately lead to fundamental changes within the market.

Today's standards cover the following important areas:

- the data set to be reported to trade repositories for OTC and exchange-traded derivatives;
- the supervisory framework for central clearing counterparties (CCPs) including stringent capital requirements;
- what constitutes eligible collateral for margin payments;
- the client money segregation requirements for firms who offer client clearing;
- the details of how and when firms should perform risk mitigation techniques such as trade confirmation and portfolio reconciliation; and
- the thresholds for determining which non-financial firms will need to clear and exchange margins for derivative trades.

Only one area of the ESMA proposed standards, relating to supervisory colleges for CCPs, has not been adopted.

However, this is seen as procedural and will not affect the process for CCP authorization or implementation timelines.

Hot topics

As the industry gets to grips with the detail of the requirements a number of hot topics and implementation challenges are emerging:

1. Confirmation requirements

EMIR requires that non-cleared derivatives must be confirmed, by electronic means where possible, and within strict timelines. EMIR allows for a phased implementation approach depending on counterparty type and asset class but even allowing for this, operational challenges are evident particularly for smaller participants and less liquid products.

2. Client money segregation

EMIR places a strong emphasis on the individual account segregation of client monies and sets a higher benchmark than the corresponding requirements in the Dodd-Frank Act. This means that firms who offer client clearing will need to be in a position to offer individual account segregation not only to their clients but also to the clients of their clients, so-called ‘indirect clients’. Clients can opt for the lesser protections afforded by omnibus accounts if they so choose. Banks are currently working through the practical implications of these requirements and significant change is needed by some.

3. Data reporting requirements for exchange-traded derivatives

In addition to the wide-ranging reporting requirements for OTC derivatives, EMIR requires similar reporting for exchange-traded derivatives. This poses two challenges. Firstly the data set of reporting fields has been derived from an OTC derivative perspective and some of the data fields do not have a direct read-across to the listed world. Secondly, exchange-traded derivatives are not captured by Dodd-Frank so firms who are in the midst of getting ready for US reporting will need to consider the inclusion of this additional product set.

4. Approach for non-financial firms

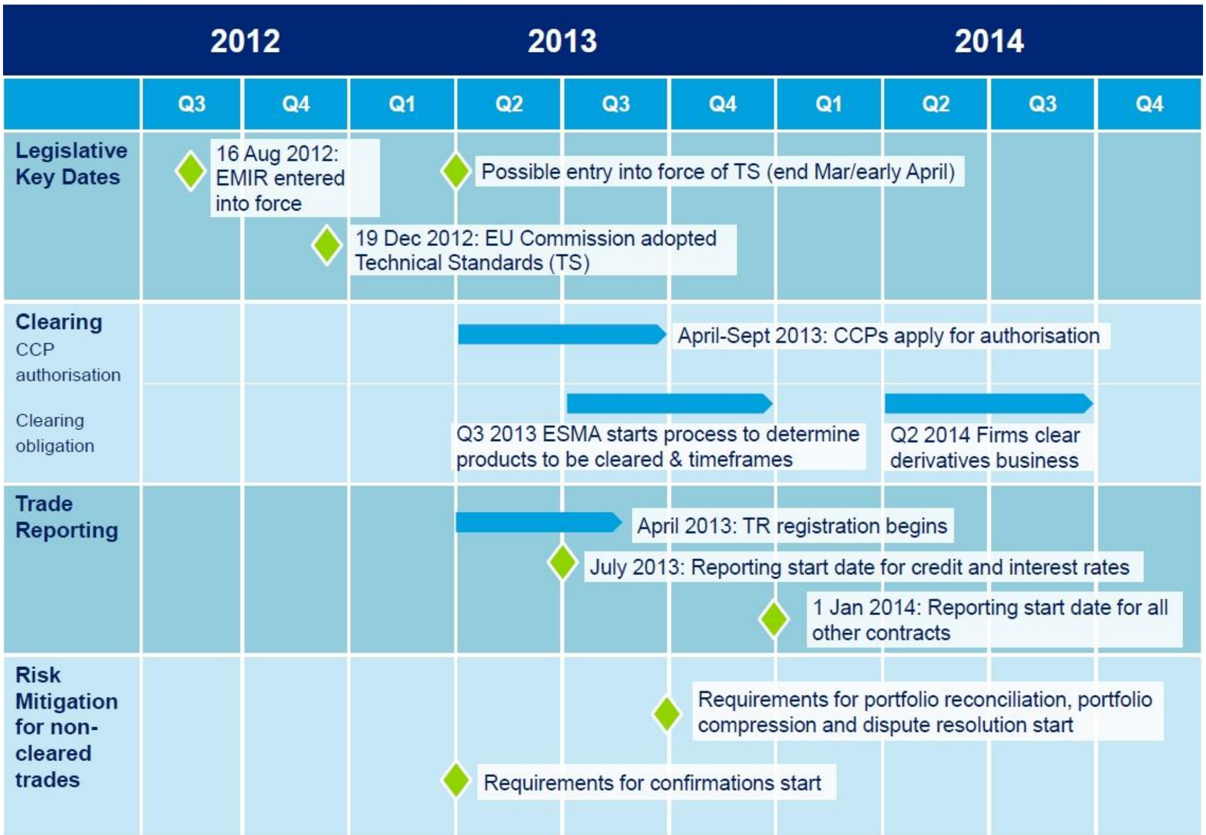
Non-financial firms who undertake derivatives business other than for hedging purposes will need to monitor the clearing thresholds carefully. This poses challenges not only for the non-financial firm but also for the financial counterparty, as transacting with a non-financial counterparty that is below the clearing threshold introduces a less demanding standard for trade confirmation and portfolio reconciliation. Financial counterparties will need to consider what this will mean from a client on-boarding perspective and non-financial firms will need to consider, some for the first time, compliance monitoring processes.

Next steps and implementation timetable

he bulk of today’s standards must still be endorsed by the European Parliament and the Council of Finance Ministries.

The Parliament has asked for a one month extension to the minimum one month deadline to allow for the Christmas period. In practical terms this means that if the Parliament and Council endorse these standards without amendment the likely implementation start date will be the end of March/early April 2013. But a demand for change would see the timelines push out considerably as the standards would need to go back to ESMA and/or the EBA.

The diagram below sets out what we see as the likely timetable if the standards are endorsed without change:



[Click here to view an enlarged copy of the timeline.]

In recent weeks some European politicians have voiced concerns over these requirements, particularly in relation to what is perceived as very tight compliance timeframes for non-financial counterparties. But given today's strong message from the Commission it remains to be seen whether delay is a politically tenable option.

There is of course still a major gap in the EMIR framework. The standards relating to the shape and form that margins for non-cleared derivatives should take are still to be developed. The EU is awaiting the outcome of international work in this area and the current expectation is for a consultation from end March 2013.

Notwithstanding these issues EMIR implementation should be a key priority for firms as we go into 2013.For further detail of the Standards proposed by ESMA and the EBA in September 2012, please consult the EMEA Centre for Regulatory Strategy briefing.

Please see our website for further information on the EMEA Centre for Regulatory Strategy or on the European Market and Financial Infrastructure Regulation (EMIR).

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