

EMIR REFIT What it means for Corporate NFCs

13 June 2019

Derivatives regulation in Europe is changing and for many corporate treasurers the relevant requirements are going to become less onerous. The European Market Infrastructure Regulation (648/2012), known as EMIR, is being changed with effect from 17 June 2019 by the EMIR REFIT Regulation¹. One of the aims of the amendments is to make the regime simpler, reducing the costs and burden of compliance, especially for corporates and other non-financial counterparties (NFCs). The key changes relevant to these entities relate to categorisation and the reporting obligation.

On the entry into force of EMIR REFIT on 17 June 2019, all non-financial counterparties (NFCs) will be required to use a new methodology to calculate whether their OTC derivatives position exceeds the clearing threshold and so whether they are NFC- or NFC+. As the clearing thresholds are very high (EUR3bn gross notional for interest rate, FX and commodity derivatives) and exclude derivatives used for hedging purposes, the great majority of NFCs are likely to see no change in their categorisation. For those entities that are affected, certain notifications to ESMA and the NFC's national competent authority will be required.

Categorisation

New Methodology for Threshold and Notification Requirements

Under EMIR, NFCs are required to calculate the level of their OTC derivatives positions for the purposes of determining whether they fall below the clearing threshold. If an NFC falls above the clearing threshold, this will mean it is categorised as an NFC+ and may be required to centrally clear its derivative trades or exchange specified levels of margin. Almost all corporate and other end-users of derivatives are categorised as NFC- entities. This is due to the high clearing thresholds - EUR3bn for interest rate, FX and commodity derivatives and EUR1bn for equity and credit derivatives, all calculated on a gross notional basis and with the exclusion of hedging transactions from the calculation.

Under EMIR REFIT, from 17 June 2019 the threshold calculations must be based on the aggregate month-end average positions in respect of all OTC derivatives (at group level) for the previous 12 months. This differs from the methodology used to date, which looks at a rolling average position over 30 working days.

As the clearing thresholds and hedging exclusion are not changing under EMIR REFIT, in the vast majority of cases we expect that the new calculation methodology will have no impact on entities which are currently NFC- for the purposes of EMIR. However, in order to continue to be treated as an NFC- entity, NFCs are required to calculate whether their OTC derivative positions (excluding hedging transactions) exceed any of the clearing thresholds. This must be done on the basis of the methodology introduced by EMIR

¹ <https://eur-lex.europa.eu/eli/reg/2019/834/oj>

REFIT (i.e. on the basis of the aggregate month-end average positions in respect of all OTC derivatives (at group level) for the previous 12 months). This calculation should be done on an annual basis.

Entities which are NFC- under the current regime, which continue to fall below the clearing thresholds according to the new EMIR REFIT methodology, will not need to notify ESMA or their national competent authority of this.

If an NFC exceeds one or more thresholds according to the new methodology, it must immediately notify ESMA and its national competent authority (NCA) of this. Notification (and the obligation to clear derivatives) is also technically required for any NFC which does not do the calculation at all.² However, in practice it is unclear how or whether ESMA or any NCA would enforce the obligation to clear in respect of an NFC- entity which continues to be below the clearing thresholds under the new methodology but which did not notify ESMA or its NCA of a failure to carry out the calculations at the time required. For any NFC which ceases to exceed the relevant clearing thresholds, notification should also be made.³

This means that corporates and other NFCs should be careful to ensure that (a) they perform the relevant calculation at least once a year, and (b) from 17 June 2019 they do so on the basis of the methodology introduced by EMIR REFIT. It would be advisable to record the relevant calculations for posterity. Any confirmations given by an NFC to its derivatives counterparties in relation to its

classification under EMIR will also need to be made based on the new methodology.

Threshold: Application by Asset Class

A welcome change introduced by EMIR REFIT for NFC+ entities is that an NFC+ is only required to clear OTC derivatives in the asset class or classes in respect of which it exceeds the relevant threshold. The position before 17 June 2019 is that if an NFC exceeds the threshold in respect of a single asset class, it is required to clear in respect of all in-scope derivatives (regardless of asset class).

The notification an NFC+ provides to ESMA and its NCA when EMIR REFIT comes into force should include details of the asset class or classes in respect of which its OTC derivative positions exceed the threshold. If an NFC has not carried out the relevant calculations it will have to notify ESMA and its NCA and will be subject to the clearing obligation for *all* in-scope classes of OTC derivatives.

Additionally, it is worth noting that while the changes introduced by EMIR REFIT mean that an NFC+ may be required only to clear OTC derivatives in a limited number of asset classes, the NFC+ will continue to be subject to the relevant margin requirements in respect of non-cleared OTC derivatives in all asset classes.

Reporting

Exemption for Intra-group Transactions

EMIR REFIT introduces an exemption, available from 17 June 2019, from the obligation to report intra-group transactions where at least one of the parties is an NFC (or an entity outside the EU that would be an NFC if established in the EU). There are conditions to be satisfied for such exemption

² https://www.esma.europa.eu/sites/default/files/library/esma70-151-2181_public_statement_on_refit_implementation_of_co_regime_for_fcs_and_nfcs.pdf

³ If relevant, UK NFCs should make a notification to the FCA in relation to the NFC clearing obligation using the Clearing Obligation Notification Form and using the new

EMIR notification system “Connect” which is ready for user registrations ahead of 17 June 2019 notification deadline. See FCA Updates from March and May and most recently on 11 June 2019 at <https://www.fca.org.uk/firms/european-market-infrastructure-regulation-emir/news>

to apply. For this purpose, “group” is defined by reference to EU definitions for accounting purposes. The exemption is not available if one or both parties has a parent undertaking that is a financial counterparty (FC). In order to rely on the exemption, both parties must notify their NCA. The exemption will be valid unless the NCA determines within 3 months, using the information provided, that the conditions are not satisfied.⁴

Responsibility for Reporting

EMIR REFIT will also make changes with effect from June 2020 as to which party bears legal responsibility for reporting transactions to trade repositories, placing greater responsibility on FCs. However, these changes are unlikely to have a significant impact on most NFCs, which in practice often delegate reporting obligations to their FC counterparties. Any NFC which currently deals with reporting itself will, however, need to consider in due course whether it needs to discuss with its FC counterparties whether it should continue to do so.

Preparing for 17 June 2019 and beyond

Should you require any assistance in relation to EMIR REFIT, please do not hesitate to contact a member of our team.

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For further information, please speak to your usual Slaughter and May contact.

⁴ For UK entities, see FCA Update May 2019 including link to the new “EMIR: FCA Notification for an Intragroup Exemption from Reporting” form and FCA Update June 2019 for details of the new notification system “Connect”.