

## AIMA SUMMARY

EU Regulation on OTC derivatives, central counterparties and trade repositories (EMIR)

---

February 2012



## Executive Summary

On 9 February 2012, political agreement was reached on an agreed position on the European Market Infrastructure Regulation (EMIR) text. During the trilogue negotiations, which began in October 2011, the parties agreed several important compromises which have led to several important results for AIMA members, including:

- A strong requirement for central counterparties (CCPs) and clearing members to offer 'individual client segregation', along with a more detailed description of the protections this affords;
- Client representation on CCPs' risk committees, along with ensuring that no one group of representatives comprises a majority of the committees' voting rights;
- Client representation on the board of the CCP;
- A limited form of mandatory 'frontloading' for contracts with greater than a minimum remaining maturity;
- The ability for buy-side firms to access clearing via indirect clearing arrangements;
- A recognition regime for third country CCPs to allow them to provide clearing services in the EU; and
- A provision to allow parties subject to two different clearing regimes (e.g., EMIR and the Dodd-Frank Act) to effectively comply with both without duplication.

ESMA has started consulting on approximately 30 "level 2" measures ahead of submitting draft measures to the Commission by the end of September 2012. The Commission will need to approve these technical standards. The key articles of EMIR will start applying six months following the adoption of those standards, so, at the earliest, sometime in Q2/Q3 2013.

## 1. Introduction

This note provides an update for AIMA Members on the European Commission's (the Commission) EMIR proposal, including:

- the progress of the legislation to date;
- issues raised during the trilogue negotiations;
- a summary of the agreed position; and
- next steps and what to expect in level 2.

The details included within this AIMA summary are based on a version of the EMIR text agreed on 9 February 2012. Minor amendments to the text, including renumbering of certain of the articles and paragraphs may occur before EMIR is published in the EU Official Journal.

## 2. Progress to date

On 15 September 2010, the Commission published its draft proposal for a Regulation on OTC derivatives, central counterparties and trade repositories (the Commission Proposal). Collectively, the various amended versions of the Commission Proposal are commonly referred to as the European Market Infrastructure Regulation or 'EMIR'.

On 24 May 2011, the European Parliament's (EP) Economic and Monetary Affairs (ECON) Committee passed a number of amendments to the Commission Proposal. On 5 July 2011, the EP in plenary session approved the ECON Committee text (the EP Text).

On 4 October 2011, the Finance Ministers of the 27 Member States, sitting as the Council Committee on Economic and Financial Affairs (ECOFIN), approved a final version of their amended text (the Council Text).

Under the ordinary legislative procedure, representatives of the Commission, the EP and the Council engaged in tri-party negotiations (known as “trilogues”) between 10 October 2011 and 9 February 2012 to seek to reach agreement on a common text of EMIR. Significant numbers of political and technical trilogue meetings were held during this period, including many more meetings of the Council and MEPs independently to align their positions.

On 9 February 2012, agreement was reached on an agreed position on the EMIR text (the Agreed text). It is expected that the Agreed Text will be formally approached by the EP in the March plenary session and in Council at the March financial ministers meeting (ECOFIN). The text will then be passed to ‘jurist linguists’ who will review the Agreed Text and produce a final agreed version of EMIR. It is expected that the text will be published in the Journal of the European Union and enter into force sometimes in Q2 2012. This does not mean, however, that the entirety of the regulation starts applying as there is a need to finalise binding technical standards first. Those will be adopted sometimes in Q4 2012 and they will start applying six months following their adoption by the European Commission so sometimes in Q2 or Q3 2013.

### 3. Issues raised during the trilogue negotiations

There have been significant discussions during the trilogue negotiations on a number of issues, which the Commission, Council and EP have felt strongly about and which have slowed down reaching agreement on the Agreed Text. In particular, the issue of authorisation of a CCP by a competent authority, ESMA and a college of supervisors has proven particularly divisive. There has been concern by some parties that the college mechanism could be used to block authorisation of certain CCPs in pursuit of member states own national interests. This issue has led to a high level of involvement from European financial ministers in discussions and an agreement of a complex authorisation procedure for CCPs that balances the demands of member states with the rights of ESMA and the college to block certain applications where there is good cause.

The third country provisions have also been carefully negotiated between parties on the one hand support open international borders for CCP providers and, on the other hand, those parties who take a more reluctant stance on the recognition of third country CCPs and trade repositories (detailed below).

The application of the clearing obligation to pension schemes has continued to be a contentious issue with many wishing to ensure that obligations are not applied to pension schemes where they would incur unreasonable costs. This has resulted in pension schemes being provided with a limited three-year exemption from the clearing obligation (extendable for up to six years) after EMIR is published in the Official Journal.

Throughout the trilogue process, AIMA has continued to engage with the trilogue participants on technical issues that are important to clients subject to the clearing arrangements.

There has been some discussion at the start of negotiations about what level of segregation of client collateral (i.e., full/‘individual client segregation’ or omnibus segregation) and which will be the default option for clients. As a compromise between the parties in favour of full segregation and those against, clients will be given an equal choice between the two models and will be required to specify which option they would like. The definition of segregation has also been worked on to ensure it is workable and effective in practice.

The EP, from the beginning of negotiations, was keen to see CCP risk committees being comprised of representatives all of the main users and constituents of a CCP, including clearing member clients. Sell-side participants and their trade bodies had advocated that only clearing members should be represented on risk committees and the Council had supported this position. In the end, the EP was able to get its preferred text in to the final agreement.

### 4. Summary of the Agreed Text

#### *a) Scope - Articles 1 and 2*

The Agreed Text provides that the clearing obligation (Article 3) and the risk mitigation techniques for uncleared swaps (Article 6) shall be applicable only to OTC derivatives. The new organisational requirements

for CCPs (including the collateral and segregation provisions) will apply to all CCPs clearing derivatives and other financial instruments. The reporting obligation (Article 7) will be applicable to all derivatives, which will allow market regulators to collect information on the entire derivatives market in a coordinated, comprehensive and consistent manner.

The obligations of EMIR apply primarily to 'financial institutions', which, importantly for AIMA members, includes (among others) the following types of institution:

- investment firms as authorised under MiFID;
- UCITS funds and their managers; and
- alternative investment funds managed by alternative investment fund managers authorised or registered in accordance with the new AIFMD.

If a counterparty to an OTC derivative does not fall within the definition of a 'financial institution', it will be classified as a 'non-financial counterparty'. Non-financial counterparties, established in the EU, will be subject to the clearing obligation if:

- the rolling average position,
- not objectively measurable as reducing risks directly related to the commercial activity or treasury financing activity of the counterparty or of that group,
- over 30 business days
- exceeds a clearing threshold (the threshold is yet to be determined).

Non-financial counterparties must comply with the requirements for uncleared trades (Article 6) and the reporting requirement (Article 7) in all cases. Even if parties are not classified as a financial or non-financial counterparty by virtue of being established in the EU, if they:

- (i) transact with either a financial or non-financial counterparty; and
- (ii) would be subject to clearing obligation if they were established in the EU,

they will be required to clear their OTC derivative trades and report information on those trades.

The clearing obligation further applies between third country entities that would be subject to the clearing obligation if they were established in the EU, provided that the contract has a "direct, substantial and foreseeable effect within the EU" or where such obligation is necessary or appropriate to prevent the evasion of any provisions of EMIR<sup>1</sup>.

The Agreed Text includes an exemption from the clearing obligation for "intragroup trades" and, in certain circumstances, the obligations for those trading in uncleared OTC derivatives. Article 2a describes separately for financial and non-financial counterparties the details of what would be considered an intragroup trade. Pension schemes are also provided with a limited exemption from the clearing obligation for three years following the entry into force of EMIR (see 'Transitional provisions, reports and entry into force of EMIR - Articles 68 - 72' below).

#### ***b) Clearing obligation and procedure- Articles 3 and 4***

Those parties within the scope of EMIR will be subject to the clearing obligation for OTC derivative contracts pertaining to a class of OTC derivatives that has been declared subject to the clearing obligation in accordance with Article 4 and, then, listed on a register maintained by ESMA. Counterparties must clear those eligible contracts with either an authorised EU regulated CCP or a third-country recognised CCP that is granted permission to clear that class of derivatives. Counterparties for this purpose will be either:

- a clearing member;
- a client; or
- a party intermediating between clearing members and clients to permit indirect clearing arrangements.

---

<sup>1</sup> This provision mirrors similar language in Article 722(d) of the US Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. It additionally creates a wide extraterritorial scope to EMIR and the terms of the Article as drafted will be a concern to many non-EU firms who may struggle to obtain certainty on whether the obligations of EMIR will apply to them.

The clearing obligation will be applicable to OTC derivative contracts entered into or novated on or after:

- the clearing obligation takes effect (specified in the ESMA register); or
- between the date at which an authorised or recognised CCP is authorised to clear a class of derivatives but before a clearing obligation takes effect, provided that the contract has a specified minimum remaining maturity ('frontloading').

The procedure for determining which contracts will be subject to the clearing obligation will include (i) a competent authority authorising a CCP for clearing a class of OTC derivatives, (ii) the competent authority notifying ESMA of that authorisation, and (iii) ESMA submitting to the Commission a draft regulatory technical standard for endorsement setting out which classes of derivatives should be subject to the clearing obligation, the date from which the obligation would take effect (including the possibility to phase in obligations separately for different types of counterparty) and the minimum remaining maturity on the contract for the purpose of frontloading.

ESMA may also make a proposal to impose a clearing obligation on a class of OTC derivatives not currently being offered for clearing by a CCP. In this circumstance, ESMA shall consult with the European Systemic Risk Board (ESRB) and shall conduct a public consultation on the suitability of the class of OTC derivatives for clearing. Following such consultations, ESMA may prepare regulatory technical standards for submission to the Commission for endorsement.

For the purpose of preparing regulatory technical standards and the classes of contract that should be subject to the clearing obligation, ESMA shall consider criteria including the degree of standardisation, the volume and liquidity and the availability of reliable pricing data for contracts. When considering when the clearing obligation for a particular class of derivatives should take effect, ESMA must consider a number of factors including the expected volume of trading, the ability to handle that expected volume and the period of time it would take counterparties time to put in place arrangement to clear those contracts through a CCP.

#### *c) Uncleared trades - Article 6*

Financial and non-financial counterparties that enter into OTC derivative contracts that are not required to be cleared are required to measure, monitor and mitigate operational, counterparty and credit risks. This must involve at least ensuring (i) timely confirmation of the terms of the contract (including via electronic means, if possible); (ii) a formalised process for reconciling portfolios, identifying and resolving disputes and monitor the value of outstanding contracts; (iii) daily mark-to-market or reliant and prudent mark-to-model valuation of outstanding contracts; and (iv) the timely, accurate and appropriately segregated exchange of collateral. For financial counterparties, they must hold appropriate amounts of capital to cover risks not covered by appropriate exchanges of collateral. These requirements shall apply to all OTC derivative contracts that are entered on or after the entry into force of EMIR. Counterparties may also request further segregation of assets provided as collateral by distinguishing them in separate accounts.

To prevent regulatory arbitrage opportunities between cleared and uncleared OTC derivatives, ESMA and the Commission may set appropriate margin standards and 'prudential procedures and arrangements'.

#### *d) Reporting obligation - Article 7*

Counterparties and CCPs will be required to report the details of any derivative contract (OTC or exchange-traded) which they have concluded, modified or terminated to an EU-registered trade repository or a third country recognised trade repository (or if no trade repository is available, details must be reported to ESMA). Parties must report details of their derivative contracts that were concluded, modified or terminated after the entrance into force of EMIR or that were concluded before entry into force of EMIR but which are still outstanding when EMIR came into force. Although all parties are subject to the reporting obligation, Article 7 includes that details of derivative contracts shall be reported without duplication and that any counterparty to the derivative may delegate their reporting obligation to another party.

Counterparties must report details of a derivative contract including (i) the parties to the contract; (ii) the rights and obligations of the contract; (iii) the type of contract; (iv) the underlying maturity; (v) notional value; (vi) price; and (vii) settlement date. Details about the format, frequency and the date by which

reports must be made will be specified in implementing technical standards prepared by ESMA and adopted by the Commission.

Along with the reporting obligation, all counterparties must keep records of the details that would be required to be reported for at least five years following termination of the contract.

Articles 51 to 67 set out an authorisation regime for trade repositories and their on-going obligations. Trade repositories must be established in the EU and will register with ESMA. Parties will be able to report trades to third country trade repositories only where they meet strict third country requirements, similar to those for third country CCPs (see below). Of importance to counterparties will be trade repositories' requirements to ensure that data recorded is kept private and confidential.

#### *e) Access to CCPs and trade venues - Article 8*

Another area of contention has been with regard to 'Access to a CCP' (Article 8) and 'Access to a venue of execution' (Article 8a).

Article 8, which provides that a CCP must accept contracts for clearing from any execution venue on a non-discriminatory basis, is only applicable to CCPs which clear OTC derivatives. This has been the agreed position to date between the Council Member States, whereby the 'vertical silo'<sup>2</sup> model of certain exchange and clearing offerings in a number of Member States will not be impacted by the provision. This has been opposed by other Member States who wish to see more competition in trading and clearing services in Europe following the implementation of EMIR.

These issues have been raised again in the discussions surrounding the Commission proposal for a 'Markets in Financial Instruments Regulation' (MiFIR), which contains open access provisions applicable to all financial instruments. Article 8a, which requires venues of execution to provide trade feeds to CCPs, is also only applicable to venues of execution listing OTC derivatives. This provision was first removed and then reinstated immediately prior to the approval of the Council Text on 4 October 2011.

#### *f) CCP authorisation and supervision - Articles 10 - 22*

CCPs wishing to provide any clearing services (for all derivatives and other clearable financial instruments) must seek authorisation from the competent authority in their member state of establishment. Such authorisation shall be effective throughout the EU. As a condition of authorisation, CCPs must have permanent and available capital of at least EUR 7.5 million and otherwise have capital proportionate to the risks stemming from their activities as will be further developed in regulatory technical standards.

The procedure for granting authorisation has been a particularly contentious issue among the member states in the Council. The agreed procedure is that a CCP will submit applications for authorisation to the competent authority of the jurisdiction in which they are established, including all information necessary to assess the application. The competent authority shall then forward completed applications to a college of regulators, comprising the competent authorities for the CCP, the largest clearing members, venues of execution, CSDs, relevant members of the ESCB, the central banks of issue of the most relevant EU currencies of the financial instruments cleared and ESMA. Upon receipt of the CCP application, the college shall conduct a risk assessment of the CCP, prepare a report on that assessment and then issue a 'simple majority' opinion on whether the CCP meets the requirements of EMIR and should, thus, receive authorisation. The CCP's competent authority is required to consider the opinion of the college and, where it disagrees with the opinion, must give a fully reasoned written account of its decisions and why it disagrees with the college's opinion.

What has been particularly contentious during trilogue negotiations is the ability for the college, on a unanimous vote (excluding the CCP's competent authority), to block the authorisation. It is feared that such powers could be used for political motives and many of the member states have feared that existing, nationally important CCPs could be prevented from gaining necessary authorisation. Where this power is exercised, the college must provide a fully reasoned opinion on why the CCP does not meet the requirements of EMIR and the CCP's home competent authority may seek ESMA intervention to help settle any dispute.

---

<sup>2</sup> A vertical silo model exists where a group of companies includes both an exchange and a central clearinghouse. The exchange routes all trades to be cleared only with its own central clearing house and the central clearing house only accepts trades from the exchange.

Where two thirds of the college members disagree with granting the CCP authorisation, they may also seek ESMA's help in reaching a settlement.

Ongoing supervision of an authorised CCP is conducted by its member state of establishment's competent authority, which must provide information and consult with the college of supervisors on regular basis.

A similar authorisation and supervisory regime is applied to EU trade repositories, although EMIR emphasises and places requirements on the need for professional secrecy at trade repositories and sets out a detailed penalty regime for breaches of authorised trade repositories' obligations.

*g) Third Country issues - Articles 3, 9a and 23*

As stated above, the clearing obligations in Article 3 apply not only to trades between EU counterparties, between an EU counterparty and a third country counterparty, but to trades between two non-EU counterparties where:

- the contract has a direct, substantial and foreseeable effect within the EU; or
- it is necessary or appropriate to prevent the evasion of any provisions of EMIR.

The Agreed Text also introduces a new Article 9a on Mechanisms to avoid duplicative or conflicting rules. This is designed to address the issue that arises where an EU counterparty deals with a non-EU counterparty and the derivative contract may potentially be subject to both the EU clearing regime under EMIR and a third country regime (e.g., the US Dodd-Frank Act), with possibly conflicting or duplicative obligations for the counterparties. Article 9a provides that the Commission, assisted by ESMA, will first monitor and prepare reports for the Council and EP on duplicative or conflicting requirements in international laws applicable to EU counterparties that are similar to Articles 3, 5, 6 and 7 of EMIR.

The Commission may adopt implementing acts which declare that the legal, supervisory and enforcement arrangements of the third country are equivalent to the core obligations in EMIR, that professional secrecy is upheld and that the third countries' supervisory and enforcement regime is being effectively applied and enforced in an equitable and non-distortive manner. Where such implementing acts are approved, if at least one of the parties is established in that third country, the obligations under EMIR shall be deemed to have been fulfilled when the counterparties clear their trades in the third country jurisdiction. The Commission shall continue to monitor equivalent regimes of third countries on at least an annual basis and may withdraw the implementing acts under EMIR where the third country regime is no longer equivalent.

Article 23 provides the mechanism for recognition of CCPs established in third countries provide clearing services, so that they may provide services to EU counterparties, in the EU or elsewhere. The text provides that ESMA, in consultation with a college of relevant competent authorities and central banks, can recognise a third country CCP where:

- the Commission adopts an implementing act determining that the legal and supervisory arrangements of a third country ensure that:
  - third country CCPs comply with legally binding requirements which are equivalent to the requirements set out under Title IV of EMIR;
  - these CCPs are subject to effective supervision and enforcement in that third country on an ongoing basis; and
  - the legal framework of the third country provides for an effective equivalent system for the recognition of CCPs authorised under third country's legal regimes.
- the CCP is authorised in the relevant third country and is subject to effective supervision and enforcement requirements ensuring full compliance with the prudential requirements applicable in that third country; and
- a cooperation agreement is concluded between ESMA and the third country CCPs' regulator, which provides for appropriate exchanges of information and cooperation on supervision.

The third country of the CCP seeking recognition must also uphold standards to prevent money laundering and terrorist financing to the level specified by the Financial Action Task Force (FATF), as implemented in the EU. Before granting recognition, ESMA must consult with a range of European competent authorities (e.g., those of the Member States where the CCP wishes to provide services) on the third country CCP's

compliance with the conditions of Article 23. Within 180 days, ESMA will write to the third country CCP letting it know whether it has been granted recognition or not, along with a fully reasoned explanation for its decision. The equivalence assessment in Article 23 shall be conducted independently of the (very similar) equivalence decision in Article 9a.

A similar recognition regime is used for recognising third country trade repositories, so that EU counterparties can use these for their reporting obligation under Article 7.

When considering whether a third country CCP or trade repository is subject to 'equivalent' requirements in their home country, recital 5b makes clear that:

"such a system should be considered equivalent if it ensures that the substantial result of the applicable regulatory regime is similar to Union requirements and should be considered effective if those rules are being applied in a consistent manner".

#### ***h) CCP boards and risk committees - Articles 25 and 26***

AIMA has consistently sought to support changes to the text of Article 26 on CCPs' risk committees to allow for clients of clearing members to have, not simply a right to be consulted on risk-based decisions on running the CCP (e.g., acceptance of new clearing members and new products for clearing), but to be fully represented on the committees. The Agreed Text provides that CCPs must establish risk committees and that they shall be composed of representatives of CCPs' clearing members, independent members of the board and representatives of clients. None of the groups of representatives shall have a majority in the risk committee.

The CCP shall also have a managing Board and Article 25 provides that "the clients of the clearing members shall be represented in the Board". AIMA believes this will importantly ensure that decisions are made, at all levels, in the interest of the CCP and all of its users.

#### ***i) CCP participation requirements - Article 35***

Article 35 of the Agreed Text remains largely unchanged from the Commission Proposal. Some buy-side firms have expressed a desire to be able to access central clearing directly as a full clearing member. CCPs will be required under the Agreed Text to establish the categories of admissible clearing members upon advice of the CCPs' risk committees. Clearing member criteria shall be risk-based, non-discriminatory, transparent and objective so as to ensure fair and open access to CCPs. Potential clearing members must have sufficient financial resources and operational capacity to meet their obligations and should be able to, for example, participate in the auction of a defaulting clearing member's positions. Clearing members shall be responsible for their clients' adherence with their obligations under OTC derivative contracts.

#### ***j) Segregation and portability - Article 37***

Where clearing members post collateral to a CCP, the CCP shall be required to keep records and distinguish in accounts with the CCP the assets and positions of one clearing member from the assets and positions of other clearing members and from the CCP's own assets. Article 37 in the Agreed Text creates two levels of possible client collateral segregation:

- distinguishing in accounts with the CCP, the assets and positions of the clearing member from those of the clearing member's clients ('omnibus segregation');
- distinguishing in accounts with the CCP, the assets and positions of a client from similar accounts of other clients ('individual client segregation').

Further, clearing members shall be required to keep separate records and accounts enabling it to distinguish in its accounts the assets and positions held for the account of its clients at the CCP from its own. Clearing members must inform clients of the cost of the two different segregation models and the level of protection they provide and clients will be required to confirm in writing their choice of segregation model. For individual client segregation, excess margin (margin over and above the collateral provided for the client's margin requirement), shall also be distinguished in individual accounts at the CCP (unless the client specifically opts out). Clients shall receive preferable capital treatment under the capital requirements

directive where they opt for individual client segregation. A CCP will have distinguished assets and positions in accounts if:

- the assets and positions are recorded in separate accounts;
- the netting of positions recorded on different accounts is prevented; and
- the assets covering the positions recorded in an account are not exposed to losses connected to positions recorded in another account.

***k) Default fund, waterfall, margin and collateral - Articles 39 - 45***

CCPs will be required to impose, call and collect margin from clearing members to cover potential exposures between the date of default of a clearing member up until the liquidation of the positions, covering at least 99% of exposure movements over an appropriate time horizon (to be determined by ESMA in regulatory technical standards). Positions shall be collateralised at least on a daily basis and shall be regularly monitored. CCPs shall call and collect margin on an intraday basis. CCPs shall develop and adopt margin models and parameters for the specific risk characteristics of the products they are cleared. Margin may be calculated with respect to a portfolio of financial instruments, where the methodology is prudent and robust.

Collateral provided to meet a CCP's margin requirements must be highly liquid with minimal credit and market risk and have adequate haircuts to asset values that reflect the potential for their value to decline over the interval between their last revaluation and the time by which they can reasonably be assumed to be liquidated. Acceptable collateral will include cash, government and high-quality corporate bonds and other types of collateral (with appropriate haircuts) specified in regulatory technical standards prepared by ESMA.

Cash posted as collateral will be held either through highly secure arrangements with authorised financial institutions or through the use of the standing deposit facilities of central banks. Securities shall be deposited with operators of securities settlement systems or in highly secure arrangements with authorised financial institutions. A default fund, contributed to by the clearing members, and other financial resources shall be used to protect the CCP from losses not covered by collateral. The default fund shall be of a size that can withstand the default of the largest clearing member (or the combined second and third sized clearing members, if larger than the largest clearing member).

Article 42 specifies the 'default waterfall' of CCPs (i.e., the order of use of resources to cover losses to the CCP resulting from a clearing member default). The order (first-use to last-use) is as follows:

- Margin of the defaulting clearing member;
- The defaulting clearing member's contribution to the default fund;
- Pre-funded resources at the CCP (separate from the CCP's minimum capital);
- The default fund contributions of non-defaulting clearing members; and
- If agreed, additional resources of the non-defaulting clearing members may be called.

Importantly, CCPs are prohibited from using the resources of margin posted by non-defaulting clients to cover the losses arising from a defaulting clearing member.

Upon the default of a client's clearing member, the CCP shall contractually commit itself to trigger the procedures for the transfer of the assets and positions of the defaulting clearing member's clients to another clearing member designated by all of those clients (or the individual client, where individual client segregation is used), on their request and without the consent of the defaulting clearing member. Another clearing member must have entered into a contractual relationship with the clients (or client) before it can accept those assets and positions. If a transfer to a non-defaulting clearing member is not possible for any reason within a predefined transfer period (specified in the CCP's operating rules), the CCP shall liquidate the assets and positions and return any remaining balances to the clients. Where the clients are not known to the CCP, assets shall be returned to the clearing member for the account of their clients.

***l) Interoperability - Articles 48 - 50***

CCPs will be permitted to enter into interoperability arrangements with parties including other CCPs, trading venues and settlement systems. This permission is subject to a number of risk management requirements

specified in EMIR. Interoperability arrangements may only be rejected or restricted, directly or indirectly, to control any risk arising from that arrangement or access.

***m) Transitional provisions, reports and entry into force of EMIR - Articles 68 - 72***

EMIR shall enter into force 20 days after publication in the official journal of the European Union - this could be expected as early as May 2012. At that point, the level 2 measures will not be expected to be ready or in force and, as such, the key obligations for clients - the clearing and reporting obligations - will not take effect immediately. It is expected that initial CCP and trade repository authorisations will occur in early 2013, at which point the Commission is likely to begin approving classes of OTC derivative contract for CCP clearing and requiring parties to report specified details of all derivatives entered into or novated after entry into force of EMIR or contracts that were outstanding at that date.

Until the regulatory technical standards are introduced (after September 2012) that allow CCPs and trade repositories to seek authorisation or recognition, existing national member state authorisation regimes shall continue to apply. CCPs and trade repositories will have up to six months to seek authorisation at this point.

After entry into force of EMIR, for eligible OTC derivatives where one of the parties is a pension scheme, the Article 3 clearing obligation shall not apply for three years where the contracts are objectively measurable as reducing investment risks directly related to the financial solvency of pension schemes arrangements (defined at Article 2(7a)). Such contracts will remain subject to the risk mitigation requirements of Article 6 as if they were trades not suitable for the clearing obligation. Two years after the entry into force of EMIR, the Commission, in consultation with ESMA and EIOPA, will prepare a report assessing the progress and effort made by CCPs in developing technical solutions for the transfer by pension schemes arrangements of non-cash collateral as variation margin. If no solution has been found, the Commission shall extend the three year exemption from the clearing obligation for a further two years (and by a further one year if subsequent reports show it is necessary).

**5. Next steps and what to expect in level 2**

Once approved by the EP and Council in March, the Agreed Text will be subject to a legal review by jurist linguists who will ensure the text conforms to standards for EU legislation and then translate this into the various languages of the European Union. This process is technical and may take up to three months, meaning that EMIR would come into force 20 days after its publication in the Official Journal (expected in May 2012).

As an Agreed Text is in place, ESMA will now be tasked with preparing approximately 30 draft regulatory technical standards and implementing technical standards. In each case, ESMA will have until 30 September 2012 to prepare these and submit them to the Commission for approval - the standards may be quickly approved or could be subject to revision by the Commission. ESMA and the other European Supervisory Authorities (ESAs) will consult the industry and have already started to do so:

- An ESMA Discussion Paper on clearing, trade repositories and other technical standards (published on 16 February 2012 and requesting comments by 19 March 2012);
- An EBA Discussion Paper on capital requirements for CCPs; (expected to be published in March 2012); and
- A joint Discussion Paper from all three ESAs on uncleared OTC derivatives risk mitigation techniques (expected to be published in March 2012).

Once the feedback from these Discussion Papers is received by the ESAs and digested, the ESAs plan to launch a full ESMA Consultation in June or July 2012. This will provide ESMA sufficient time to take on board feedback ahead of submitting draft regulatory and implementing technical standards to the Commission by 30 September 2012.

The EU has committed at the G20 to implement its clearing and reporting requirements for suitable OTC derivatives by 1 January 2013. Although it is currently unclear, AIMA expects that counterparties are unlikely to be subject to any obligations until sometime in Q2/Q3 2013, given:

- (i) ESMA has until 30 September 2012 to prepare draft technical standards;

- (ii) those standards are needed for effectively application of the clearing and trade reporting obligations;
- (iii) it will take time for the Commission to approve technical standards; and
- (iv) CCPs and trade repositories will not be authorised until six months after technical standards are adopted by the Commission, in accordance with Article 71.

If members have any questions about the Agreed Text, please contact [Jiří Król](#) or [Daniel Measor](#).

February 2012

© The Alternative Investment Management Association Limited (AIMA) 2012