

EMIR: illustrative implementation timeline and expected developments

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C L I F F O R D
C H A N C E



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The last stages of the EU's derivatives reforms are now in sight.

Many of the obligations under the EU regulation on OTC derivatives, central counterparties and trade repositories (EMIR) have already come into force and the ESAs are developing the last major regulatory technical standards (RTS) required to implement EMIR:

- ESMA has consulted upon the clearing obligation for certain classes of interest-rate OTC derivatives (IRS), credit OTC derivatives (CDS) and foreign exchange non-deliverable forwards (FX NDF) and, on 1 October 2014, delivered to the Commission final draft RTS on the clearing obligation for IRS. On 18 December 2014, the Commission proposed certain amendments to the final draft RTS and ESMA has until the end of January 2015 to deliver revised draft RTS, in the form of an opinion, to the Commission. It is expected that ESMA will deliver final draft RTS for CDS and FX NDF some time thereafter. Additional consultations are expected as further EU and non-EU CCPs are authorised or recognised under EMIR.
- The ESAs have consulted upon margin requirements for uncleared OTC derivatives, proposing a start date of 1 December 2015 for margining, subject to phase-in of initial margin requirements. The ESAs are expected to publish a second consultation in Q1 2015 before delivering the final draft RTS to the Commission, although there is ongoing international debate as to whether the start date for the margining obligation should be delayed.

There have also been other significant recent developments related to the derivatives reform programme:

- On 24 October 2014, ESMA issued an update of its Q&A on EMIR.
- On 31 October 2014, the Commission adopted equivalence determinations for the regulatory regimes of CCPs in Australia, Hong Kong, Japan and Singapore.
- On 10 November 2014, ESMA published a consultation paper proposing certain amendments to the technical standards on reporting under Art. 9 of EMIR.
- On 19 December 2014, ESMA published a consultation paper on the technical standards required under MiFID2/MiFIR and published its technical advice to the Commission to assist the Commission with its development of delegated acts required under MiFID2/MiFIR.
- The consultation period for responses to ESMA's draft guidelines on the application of C6 and C7 of Annex 1 of MiFID1 closed on 5 January 2015.

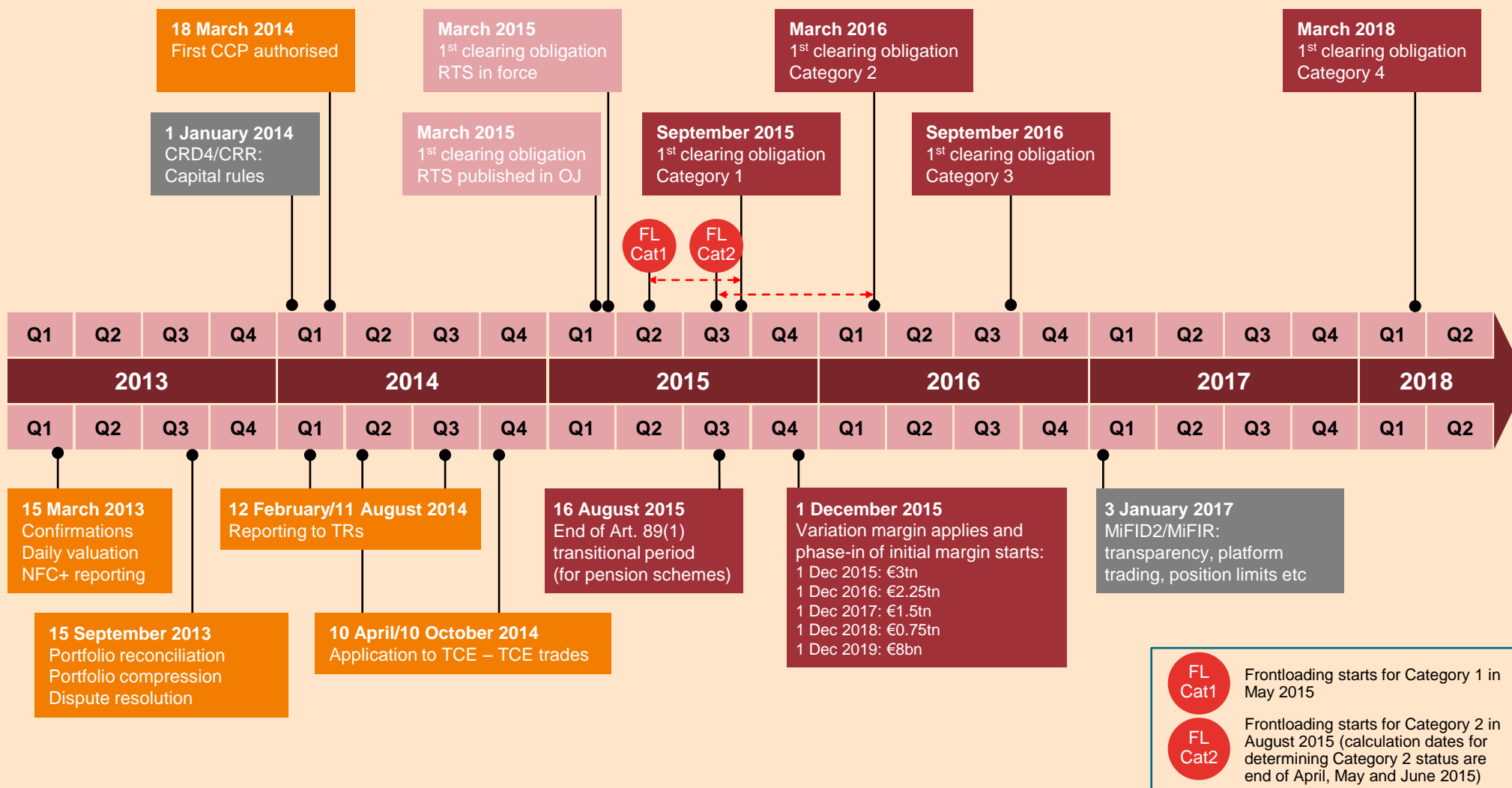
However, there are still a number of steps that need to be taken before EMIR is fully in place and the EU authorities' attention is already turning to the 2015 review of EMIR and possible future amendments.

The following charts show an updated illustrative implementation timeline for EMIR and a list of some expected developments under EMIR.

The timeline shows when the main obligations for market participants may begin to apply on the basis that:

- the Commission is able to act quickly to adopt and publish the RTS on the clearing obligation for IRS in a form consistent with its amended draft; and
- there is no delay in the start date for margining from that proposed by the ESAs.

EMIR: illustrative implementation timeline



Note: Assumes: (i) ESMA submits revised draft 1st clearing obligation RTS consistent with the Commission's amended draft RTS, the Commission adopts the revised draft RTS without further amendment in February 2015, the Parliament and the Council confirm that they do not object and the RTS are published in the OJ and come into force in March 2015; (ii) the Commission does not extend the Art. 89(1) EMIR transitional period for pension schemes (the Commission may extend this for two years and then a further year); and (iii) the margin RTS are adopted in the form originally proposed by the ESAs for consultation.

EMIR: some expected developments

Q1 2015	EBA to conduct review on the application of the CVA charge to NFCs established in a third country (original deadline 1 January 2015)
	Commission to report on progress on the transfer by pension scheme arrangements of non-cash collateral as variation margin and whether the exemption from the clearing obligation for pension scheme arrangements will be extended under Art. 85(2) EMIR
	ESMA to deliver revised draft RTS on the clearing obligation for IRS to the Commission (expected end January 2015)
	Deadline for responses to ESMA's consultation on the review of technical standards on reporting under Art. 9 EMIR (13 February 2015)
	Deadline for responses to ESMA's consultation on the technical standards required under MiFID2/MiFIR (2 March 2015)
	Publication of the first clearing obligation RTS in the OJ (possibly in March 2015)
	Commission to publish annual report on possible systemic risks and cost implications of interoperability arrangements pursuant to Art. 85(4) EMIR
	ESMA to present annual report on penalties imposed by NCAs pursuant to Art. 85(5) EMIR
	Commission expected to publish further equivalence decisions under Art. 25 EMIR throughout 2015
	Expected authorisation of additional EU CCPs throughout 2015 and first recognition of non-EU CCPs, triggering additional consultations on clearing obligations
Q2 2015	ESAs expected to publish second consultation on draft margin RTS and may deliver final draft margin RTS to the Commission
	Art. 497 CRR transitional period to end on 15 June 2015 unless extended by a further 6 months
Q3 2015	Additional third-country central banks may be added to list of exempted entities in Art. 1(4) EMIR (before first clearing obligation effective)
	NCAs expected to start accepting applications for the intragroup exemption to the clearing obligation (before first clearing obligation effective)
	Commission to publish general report on EMIR implementation pursuant to Art. 85(1) EMIR by 17 August 2015
	ESMA to deliver to the Commission final draft technical standards under MiFID2/MiFIR by 3 July 2015
	ESMA to publish reports under art. 85(3) EMIR in relation to, amongst others, the application of the clearing obligation and the Art. 39 segregation requirements
2016	ESMA to list pension arrangements specifically exempted from the clearing obligation by NCAs (before first clearing obligation effective for Category 2)
2017	Deadline for reporting to TRs pre-existing contracts that were not outstanding on the reporting start date (12 February 2017)

ESMA proposes to impose mandatory clearing on certain classes of IRS, CDS and FX NDF. It does not propose, at this stage, to impose a clearing obligation on interest rate futures and options, equity products or single name credit products.

The development of RTS on the clearing obligation for IRS is the most advanced, with the Commission recently proposing amendments to the final draft RTS submitted by ESMA. The amended draft RTS envisage the following phase-in of the clearing obligation and application of the frontloading obligation.

Phase-in of the clearing obligation

The amended draft RTS would apply the clearing obligation subject to a phase-in, based upon the categories of counterparties:

- **6 month phase-in period for Category 1 counterparties:** counterparties which, on the date of entry into force of the RTS, are clearing members for at least one of the classes of OTC derivatives listed in Annex 1 of the RTS, of at least one of the CCPs authorised before that date to clear at least one of the classes of OTC derivatives listed in Annex 1 of the RTS.
- **12 month phase-in period for Category 2 counterparties:** FCs and NFC+ AIFs which are not included in Category 1 which belong to a group whose aggregate month-end average notional amount of non-centrally cleared derivatives for [3 months following publication of the RTS in the OJ, excluding the month of publication] is above EUR 8 billion.
- **18 month phase-in period for Category 3 counterparties:** FCs and NFC+ AIFs which are not included in Category 1 or 2.
- **3 year phase-in period for Category 4 counterparties:** NFC+ not included in Category 1, 2 or 3.

The longest phase-in period will apply where the counterparties to a contract fall into different categories.

Application of the frontloading obligation

The amended draft RTS provide for a more limited application of the frontloading obligation than envisaged in Art. 4(1)(b)(ii) of EMIR:

- **No frontloading for NFC+:** contracts where at least one counterparty is an NFC+ (in any Category) are not subject to frontloading.
- **No frontloading for Category 3:** the minimum remaining maturity (MRM) for contracts entered into with Category 3 counterparties has been set at the maximum maturity of each class subject to the clearing obligation.
- **Frontloading applies for Category 1 and Category 2:**
 - The frontloading period for FCs in Category 1 begins two months after the RTS enter into force and begins for FCs in Category 2 five months after the RTS enter into force.
 - Contracts entered into or novated after the relevant start date and before the end of the relevant phase-in period will be subject to frontloading if they have a MRM higher than 6 months at the end of the phase-in period.

Phase-in of margin requirements

The ESAs consulted on proposals for draft RTS for the margining of uncleared OTC derivatives broadly in line with the final policy framework published by BCBS-IOSCO in September 2013. However, there is ongoing international debate as to whether the start date for the margining obligation should be delayed.

Variation margin (VM)

- Requirement to collect VM applies from 1 December 2015.
- Zero threshold for transfer of VM.*

Initial margin (IM)

- Requirement to collect IM phased in from 1 December 2015.
- IM must be collected on gross basis and segregated (without rehypothecation).
- FCs may agree with their FC or NFC counterparties on a margin threshold of €50m covering all IM to be exchanged between consolidated groups.*

Scope

- Requirements to collect margin apply to FCs and NFC+s.
- FCs/NFC+s may agree not to collect VM or IM from NFCs under EMIR clearing threshold and counterparties exempt from EMIR.†
- Counterparties may agree not to collect IM for physically settled foreign exchange forwards/swaps (or exchange of principal on currency swaps).

Rules apply prospectively

- Margin requirements apply to new transactions entered into after the specified dates.

* Counterparties may agree a minimum transfer amount of €500,000 covering all VM and IM.

† The draft RTS contemplate that FCs/NFC+s would be required to collect VM and IM from all non-EU counterparties.

Phase-in timetable for initial margin	
From 1 December:	Trigger level for consolidated groups
2015	€3 trillion
2016	€2.25 trillion
2017	€1.5 trillion
2018	€0.75 trillion
2019 onwards	€8 billion

Note: A counterparty is required to collect initial margin where both counterparties belong to consolidated groups having total gross notional values of uncleared OTC derivatives (including foreign exchange forwards/swaps) over the trigger level.

Core definitions

Derivatives: Derivatives covered by the Markets in Financial Instruments Directive (MiFID).

OTC derivatives: Derivatives not executed on a regulated market or equivalent non-EU market.

FC (financial counterparty): An investment firm, credit institution, insurance/reinsurance undertaking, UCITS/UCITS manager, pension scheme and alternative investment fund managed by an alternative investment fund manager, in each case where authorised or registered in accordance with the relevant EU directive.

NFC (non-financial counterparty): An undertaking established in the EU which is not a financial counterparty or CCP.

NFC+: A non-financial counterparty whose positions in OTC derivatives (excluding hedging positions) exceed a specified clearing threshold.

TCE (third country entity): an entity not established in the EU that would be subject to the relevant EMIR obligation if established in the EU.

CCPs (central counterparties): EMIR provides for the authorisation of EU CCPs and the recognition of non-EU CCPs, including CCPs clearing OTC and exchange traded derivatives and securities and other transactions.

TRs (trade repositories): EMIR provides for the registration of EU TRs and the recognition of non-EU TRs for reporting purposes.

Main obligations

Clearing obligation: FCs and NFC+s must clear OTC derivative contracts which are declared subject to the clearing obligation through an authorised/recognised CCP when they trade with each other or with TCEs.

TR reporting: Counterparties must report all their OTC and exchange traded derivative transactions to registered/recognised TRs or to ESMA.

NFC+ notification: NFCs must immediately notify the competent authority if their and their non-financial affiliates' positions in OTC derivatives (excluding hedging positions) exceed the specified clearing threshold.

Risk mitigation rules for uncleared OTC derivatives:

- **Confirmations:** FCs and NFCs must confirm transactions by set deadlines (and FCs must have procedures for monthly reporting of unconfirmed transactions).
- **Portfolio reconciliation/compression:** FCs and NFCs must agree processes for regular portfolio reconciliation with counterparties and have processes to address portfolio compression opportunities.
- **Dispute resolution:** FCs and NFCs must agree procedures for identification, recording, monitoring and resolution of disputes (and FCs must report on unresolved disputes).
- **Daily valuation:** FCs and NFC+s must carry out daily mark-to-market or, where market conditions prevent this, mark-to-model valuation.
- **Margin:** FCs and NFC+s must have procedures for the exchange of collateral.
- **Capital:** FCs must have appropriate capital for uncollateralised risks.

TCE-TCE trades: The clearing and risk mitigation rules apply to certain trades between TCEs as specified in the RTS.

Clearing members: Clearing members of CCPs are subject to certain segregation, disclosure and other obligations.

Detailed key

Obligation	EMIR	Adopted RTS/ITS	Applies to ¹	Dealing with ¹	Product	Comment
Frontloading	Art. 4(1)(b)(ii)	Draft RTS	FC ²	FC, TCE ²	OTCD	OTCD entered into after a CCP is authorised may later become subject to mandatory clearing
Clearing obligation	Art. 4	Draft RTS	FC, NFC+ ²	FC, NFC+, TCE ²	OTCD	Consultation proposes phase-in for clearing obligation
TR reporting	Art. 9	RTS/ITS on TR reporting	FC, all NFCs ³	Any	OTCD and ETD	Applies from 12 February 2014 (reporting of valuations/collateral from 11 August 2014)
NFC+ notification	Art. 10	Rec. 17-25, Arts. 10 and 11 RTS	NFC+	Any	OTCD	Obligation to notify competent authority immediately if over clearing threshold applies from 15 March 2013
Confirmations	Art. 11(1)	Rec. 26-27, Arts. 1(c) and 12 RTS	FC, all NFCs	FC, all NFCs, TCE ⁴	Uncleared OTCD ⁵	Applies from 15 March 2013, subject to a compliance schedule expiring 31 August 2014
Portfolio reconciliation	Art. 11(1)	Rec. 28-29, Art. 13 RTS	FC, all NFCs	FC, all NFCs, TCE ⁴	Uncleared OTCD ⁵	Applies from 15 September 2013
Portfolio compression	Art. 11(1)	Rec. 30, Art. 14 RTS	FC, all NFCs	FC, all NFCs, TCE ⁴	Uncleared OTCD ⁵	Applies from 15 September 2013. Only where ≥ 500 open contracts with counterparty
Dispute resolution	Art. 11(1)	Rec. 31, Art. 15 RTS	FC, all NFCs	FC, all NFCs, TCE ⁴	Uncleared OTCD ⁵	Applies from 15 September 2013
Daily valuation	Art. 11(2)	Rec. 32-34, Arts. 16 and 17 RTS	FC, NFC+	Any	Uncleared OTCD ⁵	Applies from 15 March 2013
Margining	Art. 11(3)	Consultation proposal	FC, NFC+	TBD	Uncleared OTCD ⁵	Proposed to apply from 1 December 2015, in line with BCBS-IOSCO framework, subject to phase-in
Clearing member obligations	Arts. 37(3), 38(1), 39(4)-(7)	n/a	CCP clearing members	n/a	Cleared transactions	

1. Art. 1 EMIR exempts certain entities from EMIR obligations. Where one party is established in a non-EU state, counterparties are deemed to fulfil the clearing, NFC+ notification, reporting and risk mitigation obligations if the Commission determines non-EU state has “equivalent” regulatory framework (Art.13 EMIR). The clearing obligation and the risk mitigation obligations in Art.11.also apply to certain transactions between TCEs which have a direct, substantial and foreseeable effect in the EU or necessary to prevent evasion as specified in RTS.
2. There are transitional exemptions for certain pension funds (Arts.85(2) and 89(1) and (2) EMIR). ESMA has indicated that frontloading does not apply to NFC+s.
3. The TR reporting obligation is expressed to apply to “counterparties”. ESMA’s Q&A indicate that the obligation only applies to FCs and NFCs.
4. Although some of the provisions of the RTS implementing Art. 11(1) EMIR are expressed to be restricted to transactions concluded between FCs/NFCs, ESMA has stated that they apply to transactions between FCs/NFCs and TCEs.
5. The heading to Art. 11 EMIR indicates that it applies to uncleared OTCD, although some of its provisions and the related RTS might appear to have broader scope.

- **CCP:** central counterparty
- **CDS:** credit OTC derivatives
- **Commission:** the European Commission
- **Clearing obligation:** requirement to clear at a CCP all OTC derivative contracts pertaining to a class of OTC derivatives that has been declared subject to the clearing obligation in accordance with the procedure in Art. 5(2) EMIR
- **Council:** the Council of the European Union
- **CRD4/CRR:** the Capital Requirements Directive and Regulation implementing Basel III in the EU
- **Derivative:** as defined in EMIR, i.e. a financial instrument as set out in points (4) to (10) Section C, Annex 1, MiFID, as implemented by the MiFID implementing regulation
- **EMIR:** the EU regulation on OTC derivatives, central counterparties and trade repositories
- **ESA:** European Supervisory Authority (i.e. EBA, EIOPA or ESMA)
- **ESMA:** European Securities and Markets Authority
- **ETD:** exchange traded derivatives
- **EU:** European Union
- **FC:** financial counterparty as defined in EMIR, i.e. an investment firm, credit institution, insurance/reinsurance undertaking, UCITS, pension scheme and alternative investment fund managed by an alternative investment fund manager, in each case where authorised or registered in accordance with the relevant EU directive
- **Frontloading:** the obligation under Art. 4(1)(b)(ii) of EMIR to clear OTC derivatives (pertaining to a class of OTC derivatives that has been declared subject to the clearing obligation) that are entered into after the notification referred to in Art. 5(1) EMIR and before the date of application of the clearing obligation
- **FX NDF:** foreign exchange non-deliverable forwards
- **IRS:** interest-rate OTC derivatives
- **MiFID:** the EU Markets in Financial Instruments Directive
- **MiFID2 and MiFIR:** the EU directive and regulation repealing and replacing MiFID
- **MRM:** minimum remaining maturity as referred to in Art. 4(1)(b)(ii) EMIR
- **NCA:** the national authority designated by a Member State as responsible for carrying out functions under an EU regulation or directive
- **NFC:** non-financial counterparty as defined in EMIR, i.e. an undertaking established in the EU which is not a financial counterparty or a CCP
- **NFC+:** a non-financial counterparty whose positions in OTC derivatives (excluding positions reducing risks directly relating to commercial or treasury financing activity) exceed the clearing threshold
- **OJ:** Official Journal
- **OTC derivative:** over-the-counter derivative as defined in EMIR, i.e. a derivative executed outside a regulated market or equivalent non-EU market
- **Parliament:** the European Parliament
- **RTS:** regulatory technical standards proposed by an ESA and adopted by the Commission under powers conferred by an EU regulation or directive
- **TCE:** third country entity
- **TR:** trade repository
- **UCITS:** undertaking for collective investment in transferable securities as defined in Art. 1(2) UCITS Directive
- **UCITS Directive:** 4th directive on undertakings for collective investment in transferable securities

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Regulatory reforms – charting a new course



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