EMIR – When are exemptions available for intragroup transactions?

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Contents

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EMIR – When are exemptions available for intragroup transactions?

EMIR provides exemptions from the clearing obligation and the margining obligation for certain intragroup transactions.

These are set out in Article 3 and Articles 4(2) and 11(5) to (11) of the EU regulation on OTC derivatives, central counterparties and trade repositories (EMIR).

However, EMIR does not exempt intragroup transactions from:

- the reporting obligation; or
- the other risk mitigation obligations (timely confirmation, portfolio reconciliation, portfolio compression, dispute resolution, daily valuation).

Intragroup transactions must also be included when computing whether an NFC exceeds the clearing threshold under Article 10 EMIR (unless they are objectively measurable as reducing risks within the meaning of that provision and the related regulatory technical standards).

In this document:

- references to Articles are to Articles of EMIR unless otherwise stated; and
- cross-references in EMIR to the existing Banking and Company Law Directives have been updated to reflect the adoption of the CRR and the Accounting Directive.

See the glossary below for an explanation of other terms used in this document.

The charts below are intended to assist in analysing when the exemptions are available and, if so, the process that must be followed in order to rely on them.

Chart 1 also assists in identifying whether a transaction is an "intragroup transaction" for the purposes of reporting to trade repositories under EMIR. See field 32 of the common data specified in the Commission Delegated Regulation (EU) No. 148/2013.

In relation to the process for relying on the exemptions:

- The UK Financial Conduct Authority has published its forms and process for UK market participants wishing to apply for the exemption from clearing.
- Article 18 of Commission Delegated Regulation (EU) No. 149/2013 sets out the information required from counterparties that wish to apply for the exemption from margining.

This document does not address the application of the exemptions to transactions between:

- members of an institutional protection scheme covered by Article 113(7) CRR (Article 3(2)(b) EMIR) or
- credit institutions permanently affiliated to a central body covered by Article 100(1) CRR (Article 3(2)(c) EMIR).

Chart 1: When is the exemption from clearing available for intragroup transactions?

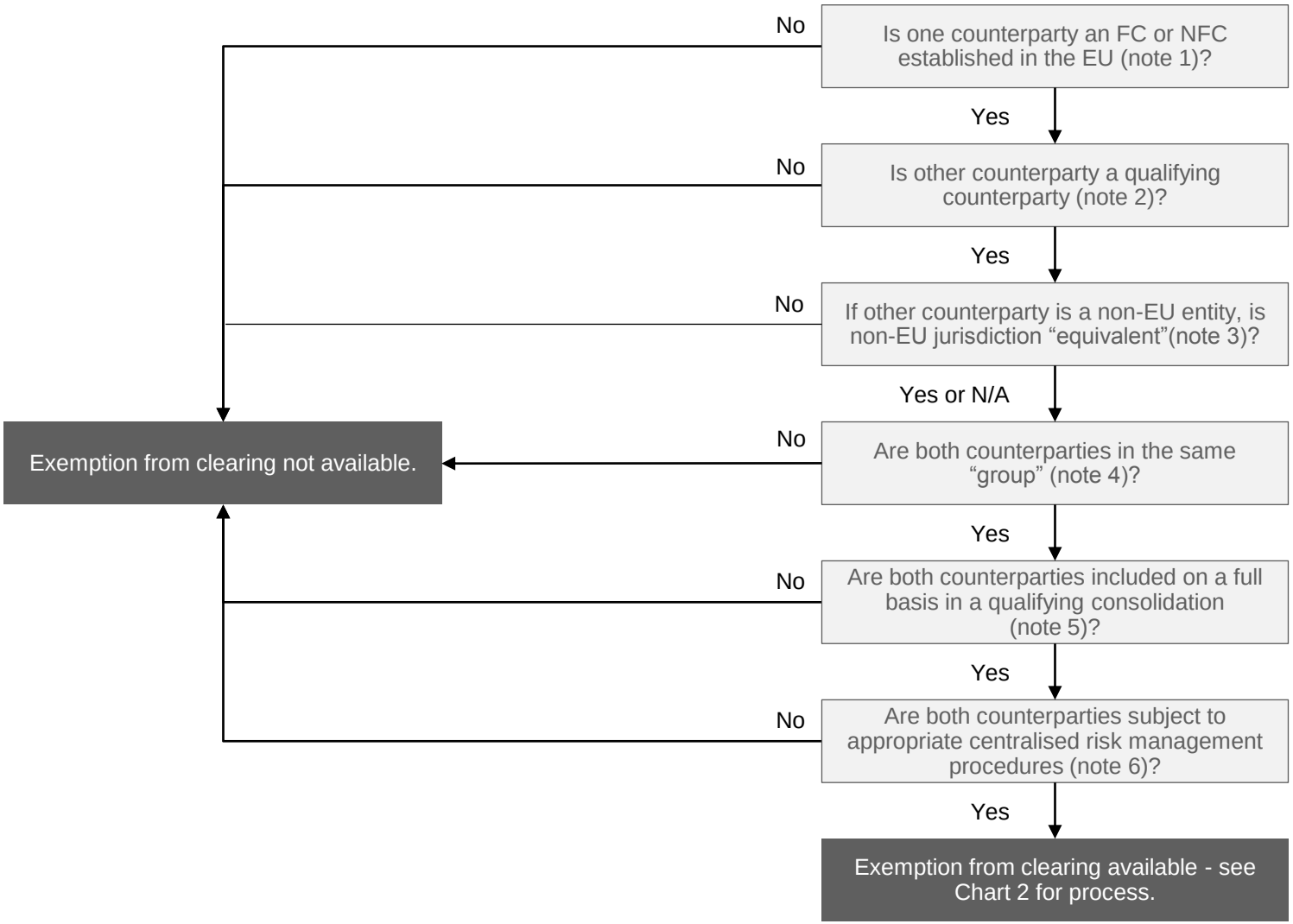

Chart 2: What is the process for relying on the exemption from clearing?

First counterparty	Second counterparty	Process
FC or NFC established in EU	**FC or NFC established in EU**	■ Both counterparties must notify their respective competent authorities not less than 30 calendar days before the use of the exemption ■ Competent authorities may object to the use of the exemption before or after the expiry of the 30 day period ■ ESMA may mediate if the competent authorities disagree ■ See Article 4(2)(a)
FC or NFC established in EU	**Third country entity that would be FC or NFC if established in EU (or an FC established outside the EU)**	■ Counterparty established in the EU must notify its competent authority before the use of the exemption ■ May use the exemption if its competent authority has authorised the application of the exemption within 30 calendar days of the notification ■ Competent authority must notify ESMA of decision ■ See Article 4(2)(b)

Chart 3: When is the exemption from margining available for intragroup transactions?

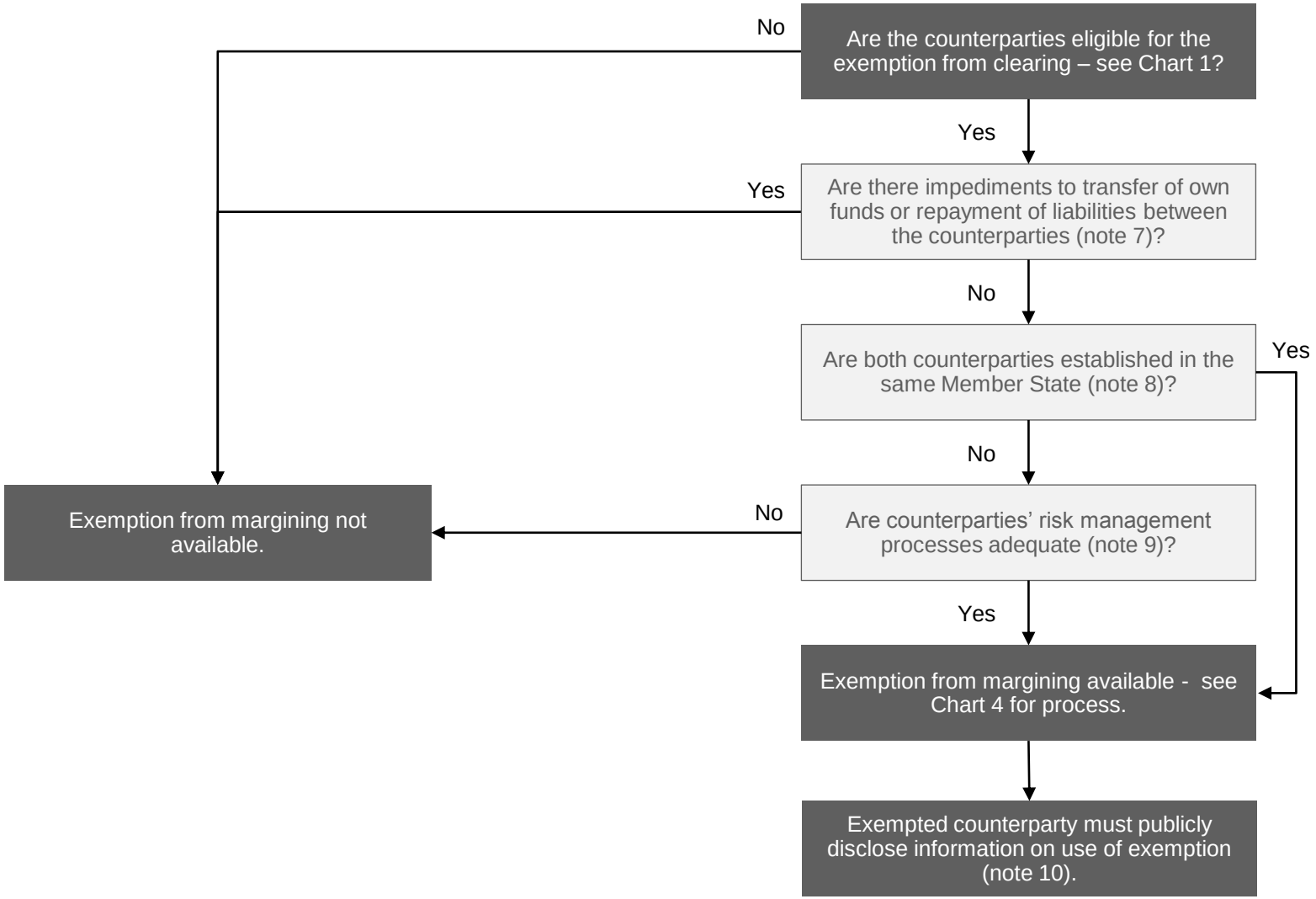

Chart 4: What is the process for relying on the exemption from margining?

First counterparty	Second counterparty	Process
FC or NFC established in EU	Counterparty established in same Member State	■ No process required ■ See Article 11(5)
FC established in EU	FC, financial holding company, financial institution or ancillary services undertaking established in a different Member State	■ Counterparties must apply for exemption ■ Exemption only available on the basis of a positive decision of both competent authorities (provision only applies if second counterparty is subject to "appropriate prudential requirements") ■ ESMA may mediate if the competent authorities do not reach a positive decision within 30 calendar days of application for exemption ■ See Article 11(6) (note the overlap with Article 11(10) where counterparties are an FC and an NFC)
NFC established in EU	NFC established in a different Member State	■ Counterparties must notify their respective competent authorities of their intention to apply the exemption ■ Exemption valid unless either of the competent authorities does not agree on fulfilment of conditions specified in Article 11(7) (a) and (b) within three months of notification ■ See Article 11(7)
FC established in EU	FC, financial holding company, financial institution, ancillary services undertaking or NFC established outside EU	■ Requires a positive decision by the relevant competent authority responsible for supervising the counterparty established in the EU ■ See Article11(8) (this may also apply where the counterparty established in the EU is a financial holding company, financial institution, ancillary services undertaking or other NFC and the counterparty established outside the EU is an FC).
NFC established in EU	Any counterparty established outside EU	■ NFC must notify its competent authority of its intention to apply the exemption ■ Exemption valid unless competent authority does not agree on fulfilment of conditions specified in Article 11(9) (a) and (b) within three months of notification ■ Article 11(9)
NFC established in EU	FC established in a different Member State	■ Requires a positive decision by the relevant competent authority responsible for supervising the FC ■ That competent authority must notify the competent authority of the NFC+ of its decision ■ Exemption valid unless competent authority does not agree on fulfilment t of conditions specified in Article 11(10) (a) and (b): if there is disagreement ESMA may mediate ■ Article 11(10) (note the overlap with Article 11(6) where counterparties are an FC and an NFC)

Notes

1 One counterparty must be an FC or NFC established in the EU

The clearing and margining exemptions are only available where one counterparty is established in the EU (see Article 4(2)(a) and (b) and Article 11(5) to (10)). Thus, the exemptions are not available where both counterparties are established in a third country even though the clearing and margining obligation can apply in some circumstances to transactions between such counterparties (see e.g. Article 4(1)(a)(v) and Article 11(12)).

In these circumstances, the clearing and margining obligations each only applies where the EU counterparty is an FC or NFC+ (See Article 4(1) and 11(3)).

2 Other counterparty must be a qualifying counterparty

Where the first counterparty is an FC, the other counterparty must be:

- An FC, a financial holding company, a financial institution or an ancillary services undertaking subject to appropriate prudential requirements (Article 3(2)(a)(ii));
- An NFC (Article 3(2)(d)) which is expressed to include an NFC established in a third country (this presumably refers to a third country entity which would be an NFC if it was established in the EU, since the definition of NFC is limited to undertakings established in the EU).

Where the first counterparty is an NFC, there is no limit on the category of qualifying counterparties (Article 3(1)).

The terms financial holding company, financial institution and ancillary services undertaking are defined in Article 2(17), (18) and (19) EMIR.

There is no guidance as to what would be considered be "appropriate prudential requirements" for these purposes. However, this requirement is likely to be similar to the requirement under the CRR that institutions seeking to 0% risk weight certain exposures to affiliates can only do so if, among other things, the other counterparty is an institution, a financial institution or an ancillary services undertaking "subject to appropriate prudential requirements" (Article 113(6)(a) CRR).

Recital 38 states that "if a contract is considered to be an intragroup transaction in respect of one counterparty, then it should also be considered an intragroup transaction in respect of the other counterparty". This indicates that the exemption from the margining obligation should be available where an FC enters into a transaction with an NFC which is not a financial holding company, financial institution or ancillary services undertaking covered by Article 11(6) because Article 11(10) should apply (even though Article 11(6) does not apply to intragroup transactions between an FC and NFCs generally).

This requirement might mean that the exemptions from clearing and margining are not available where:

- Two FCs are party to a transaction and one or both of them are not subject to "appropriate prudential requirements" (as it is not clear that all FCs would be considered subject to appropriate prudential requirements for these purposes, e.g. in the case of fund entities).
- An FC is a party to a transaction with a non-EU entity which is not an FC (but which would be an FC if established in the EU) where the non-EU entity is an entity that is not a financial holding company, a financial institution or an ancillary services undertaking (such as an insurance company) or that is not subject to appropriate prudential requirements.

Notes (continued)

3 If other counterparty a non-EU entity, relevant non-EU jurisdiction must be "equivalent"

If the other counterparty is established outside the EU, the jurisdiction in which it is established must be one for which the Commission has adopted an implementing act under Article 13(2). See Article 3(1) and 3(2)(a)(i) and (d) (although the wording of Article 3(2)(a)(i) is unclear). ESMA has confirmed this requirement in its Q&A (OTC Question 6(b)).

Under Article 13(2), the Commission can adopt implementing acts declaring that the legal, supervisory and enforcement arrangements of a third country:

- Are equivalent to the EMIR requirements on clearing, reporting, NFCs and risk mitigation;
- Ensure protection of professional secrecy equivalent to EMIR; and
- Are being effectively applied and enforced in "an equitable and non-distortive manner" to ensure effective supervision and enforcement in the third country.

The Commission has not yet made any determinations under Article 13(2), but ESMA has advised the Commission to allow transactions between EU and US entities of the same group to benefit from the intragroup exemption, even though ESMA considered that the US regime for clearing, reporting, NFCs and risk mitigation to be only partially equivalent to EMIR.

4 Both counterparties must be in the same "group"

EMIR defines a "group" as the group of undertakings consisting of a parent undertaking and its subsidiaries within the meaning of Article 22(1) to (5) of the Accounting Directive. A group may be headed by a parent undertaking which has its head office outside the EU (see Article 3(3)). This group is co-extensive with the group that is relevant for the purposes of the calculation of the clearing threshold under Article 10, except that it is not limited to non-financial entities. The group may be broader or narrower than the group that is consolidated for regulatory or accounting purposes.

5 Both counterparties must be included on a full basis in a qualifying consolidation

Either of the following are regarded as qualifying consolidations under Article 3(3):

- Qualifying accounting consolidation: consolidation under –
  - The Accounting Directive or IFRS as adopted in the EU;
  - For groups with a non-EU parent, a non-EU GAAP determined to be equivalent to IFRS or permitted to be used under Regulation (EC) No. 1596/2007: this covers IFRS (if the accounts include a note in the prescribed terms) and US, Japanese, PRC, Canadian, Korean and (until 2015) Indian GAAP (Commission Decision 2008/961, as amended).
- Qualifying regulatory consolidation: consolidated supervision under –
  - The CRR;
  - For groups with a non-EU parent, a non-EU regime for consolidated supervision verified as equivalent to consolidated supervision under the CRR pursuant to Article 127 CRD4.

Both counterparties must be included in the qualifying consolidation on a full basis (proportional consolidation or equity accounting treatment may not be sufficient).

Notes (continued)

6 Both counterparties must be subject to appropriate centralised risk management procedures

The definition of intragroup transaction requires that both parties be subject to "appropriate centralised risk evaluation, measurement and control procedures". No guidance is provided as to what is required for these purposes. However, this requirement is likely to be similar to the requirement under the CRR that institutions seeking to 0% risk weight certain exposures to affiliates can only do so if, among other things, the two counterparties are subject to the "same risk evaluation, measurement and control procedures as the institution" (Article 113(6)(c) CRR).

7 There must be no impediments to transfer of own funds or repayment of liabilities between the counterparties

The margining exemption imposes the additional condition that "there is no current or foreseen practical or legal impediment to the prompt transfer of own funds or repayment of liabilities between the counterparties" (Article 11(5) to (10)). This is similar to the corresponding condition for 0% risk weighting under CRR (see Article 113(6)(e) CRR). Again, there is no guidance on this for these purposes, but the UK regulators have given guidance on the corresponding requirement (based on the 0% risk weighting criteria) for the formation of a core UK group for large exposures purposes (see BIPRU 10.8A.6G).

8 Both counterparties are established in same Member State

If both counterparties are established in the same Member State there are no further conditions to be satisfied for the margining exemption(see Article 11(5)).

9 Both counterparties must have adequate risk management procedures

Where the counterparties are established in different member states or one is established outside the EU, then it is a requirement of the margining exemption that "the risk management procedures of the counterparties are adequately sound, robust and consistent with the complexity of the derivative transactions" (see Article 11(6) to (10)).

10 Exempted counterparty must disclose information on use of exemption from margining

The counterparty of an intragroup transaction which has been exempted from the margining requirements must publicly disclose information on the exemption from margining (see Article 11(11)). The information to be disclosed is set out in Article 20 of Commission Delegated Regulation (EC) No. 149/2013:

- The legal counterparties to the transactions including their Legal Entity Identifiers (LEIs);
- The relationship between the counterparties;
- Whether the exemption is full or partial;
- The notional aggregate amount of the OTC derivative contracts for which the exemption applies.

This likely means that the parties will need to make updated disclosures as the aggregated notional amount of exempted transactions changes.

Glossary

- **Accounting Directive:** the 2013 EU Directive replacing the 7th Company Law Directive
- **Clearing threshold:** the threshold size of derivatives positions specified for the purposes of determining whether a non-financial counterparty is subject to the clearing requirement under EMIR
- **Commission:** the European Commission
- **Competent authority:** the national authority designated by a Member State as responsible for carrying out functions under an EU regulation or directive
- **CRD4 and 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
- **ESMA:** European Securities and Markets Authority
- **EU:** European Union
- **FC:** financial counterparty as defined in EMIR, i.e. an investment firm, credit institution, insurance/reinsurance undertaking, UCITS, pension scheme or alternative investment fund managed by an alternative investment manager, in each case where authorised or registered in accordance with the relevant EU directive
- **GAAP:** Generally Accepted Accounting Principles
- **IFRS:** International Financial Reporting Standards
- **Member State:** member state of the EU
- **MiFID:** the EU Markets in Financial Instruments 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 central counterparty
- **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
- **OTC derivative:** over-the-counter derivative as defined in EMIR, i.e. a derivative executed outside a regulated market (as defined in MiFID) or equivalent non-EU market
- **Third country:** a country outside the EU

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