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EMIR REFIT: NEW EU AND UK RULES FOR REPORTING DERIVATIVES

New reporting rules will apply to EU and UK counterparties from 2024 for both new and outstanding derivatives transactions. All counterparties will need to consider the impact of these new rules on their reporting systems, reporting agreements and internal procedures for identifying, remediating and notifying regulators of reporting errors.

Key issues:

- New reporting rules for derivatives will apply from 29 April 2024 (EU) and 30 September 2024 (UK).
- Reports for outstanding derivatives must be updated by 26 October 2024 (EU) and 31 March 2025 (UK).
- Significant changes to reporting systems will be required.
- New notification obligations will apply for significant/material reporting issues.
- Reporting agreements, arrangements with counterparties and internal procedures may need to be updated.

What are the current EU/UK reporting rules for derivatives?

Following the financial crisis, the G20 agreed that all over-the-counter (OTC) derivatives should be reported to trade repositories to improve transparency in the derivatives market and enable authorities to monitor the build-up of systemic risk. The EU implemented this commitment through Article 9 of the European Market Infrastructure Regulation (EU EMIR), as amended by a 2019 amending regulation (EMIR REFIT), which the UK retained as part of its 'onshoring' of EU legislation when it left the EU (UK EMIR).

Counterparties established in the EU and the UK must report the details of all OTC and exchange-traded derivative contracts that they conclude, modify or terminate to a trade repository by the end of the next working day. Counterparties which are categorised as financial counterparties (FCs) or non-financial counterparties which exceed one or more clearing thresholds (NFC+s) must also report valuations and collateral exchanges on a daily basis. Detailed content and format requirements for these reports are set out in regulatory technical standards (RTS) and implementing technical standards (ITS).

Responsibility for reporting a derivative contract usually falls on the counterparties to that contract (this is known as 'dual-sided reporting'). However, in some cases, the other counterparty to the trade (or another entity) may be responsible for complying with the reporting obligation that would otherwise fall on a counterparty (this is known as 'mandatory reporting'). The counterparty or other entity responsible for reporting can always delegate reporting to another entity but will still be responsible for any failure to comply with the reporting obligation (this is known as 'delegated reporting').

Why are the reporting rules changing?

Since 2014, the Committee on Payments and Market Infrastructures and the International Organization of Securities Commissions (CPMI-IOSCO) have been looking at ways to facilitate global aggregation of derivatives reporting data. This is considered essential for authorities to have a comprehensive overview of risks in the global derivatives market. CPMI-IOSCO have published guidance to authorities on the harmonisation of the unique product identifier, the unique transaction identifier and on other critical OTC derivatives data elements. Most major derivatives jurisdictions, including the EU and the UK, have committed to updating their derivatives reporting rules over the next few years to ensure alignment with this guidance.

Another key driver for change in the EU and the UK has been continuing data quality issues, caused by uncertainties in the current rules (which have led to counterparties adopting different reporting practices) and by the dual-sided nature of their reporting obligations (which means that two reports for the same transaction must match). The new EU and UK rules aim to address these issues by clarifying existing areas of uncertainty and by imposing stricter reconciliation requirements.

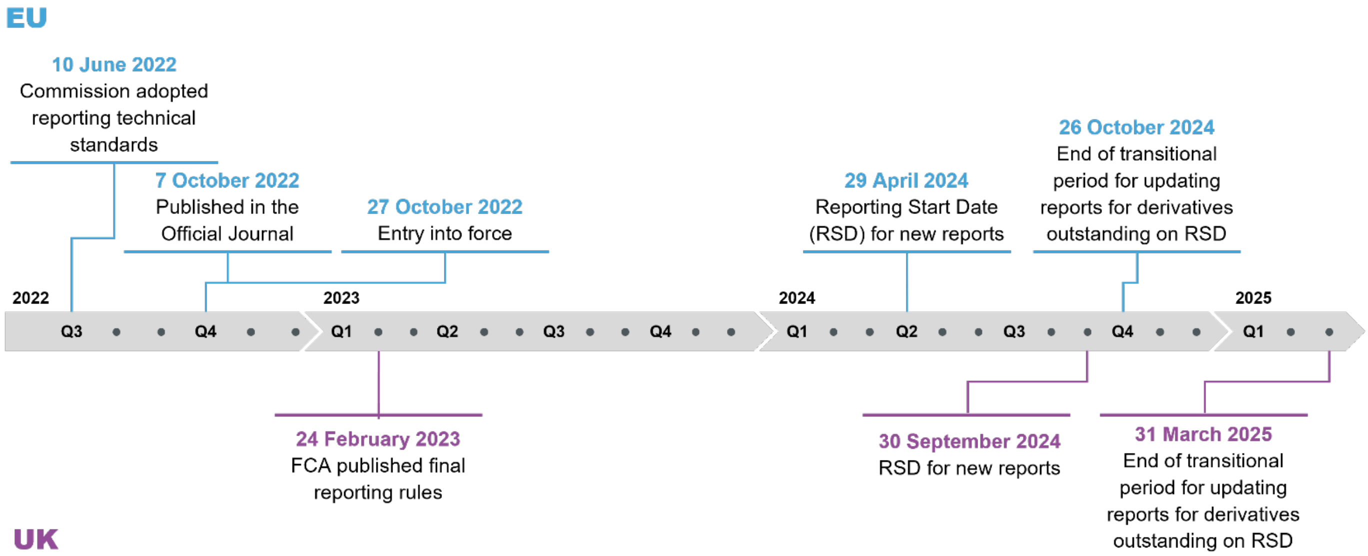
Where are the new reporting rules set out?

In 2022, the European Commission adopted new RTS and ITS which will repeal and replace the current RTS and ITS on reporting. The European Securities and Markets Authority (ESMA) has also published validation rules and reporting instructions for EU counterparties and trade repositories.

In 2023, the Financial Conduct Authority (FCA) and the Bank of England adopted standards instruments which will revoke the current RTS and ITS on reporting as they apply in the UK and replace them with new UK technical standards. The FCA has also published validation rules and XML schemas to support the implementation of the new UK requirements.

ESMA has published new reporting guidelines to clarify the new EU reporting rules and provide practical guidance on their implementation. EU entities will also need to consider any guidance published by their national competent authority (NCA). For example, the Commission de Surveillance du Secteur Financier (CSSF) has published expectations for Luxembourg market participants, stressing that firms should be ready by the end of the implementation period and any failure to accurately report after this date will be a breach of the reporting obligation. This suggests limited regulatory forbearance during the early days of the new reporting requirements. The FCA has not yet published guidance for UK entities on the new reporting requirements but it has indicated that it will consult on a supporting guidance document in due course.

When do the new rules apply?



Counterparties or other entities responsible for reporting (reporting entities) will need to comply with the new rules from 29 April 2024 in the EU and from 30 September 2024 in the UK (reflecting the later publication of the final UK rules). After the reporting start date, all new reports (including for modifications and terminations of derivatives entered into before the reporting start date) will need to comply with the new requirements.

The reporting start dates in the EU and the UK give reporting entities an 18-month implementation period and fall on a Monday to allow for a weekend switch-over for reporting systems. Whilst the FCA did receive requests from firms to align the UK start date with the EU one, the FCA preferred to give UK reporting entities the full 18-months to prepare. Therefore, entities which report under both regimes will have a five-month period during which they will need to comply with the new EU regime and the old UK regime.

Under both the new EU and UK rules, reporting entities will need to update reports for any derivatives outstanding on the reporting start date to ensure that these comply with the new requirements. This is different to the approach adopted in 2017 when re-reporting was not required as part of the last major update of the EU reporting rules. EU reporting entities will have until 26 October 2024 to make these updates and UK reporting entities will have until 31 March 2025. Despite this extra time, the process of updating existing reports may be challenging for firms, especially in relation to data points not captured by existing reporting systems.

The obligation to update existing reports falls on entities subject to the reporting obligation, i.e., counterparties to derivative contracts or the entities responsible for reporting on their behalf under mandatory reporting. In particular, this means that FCs which are responsible for reporting on behalf of non-financial counterparties which do not exceed any of the clearing thresholds (NFC-s) will need to update reports for these NFC-s. Reporting entities which delegate reporting to a third party will need to confirm if that third party is able and willing to update reports for them as this may not be addressed in existing delegated reporting agreements.

What are the key changes to the reporting rules?

Content and format of reports

The number of reportable fields will significantly increase from 129 to 203 in the EU and to 204 in the UK (although some fields will only be required for specific asset classes, contract types or post-trade events). This increase is largely driven by the desire to ensure alignment with the CPMI-IOSCO standards.

To ensure consistency of reporting, reporting entities must submit reports using a common XML template based on ISO 20022 standards (the same format used for transaction reporting under the Markets in Financial Instruments Regulation and the Securities Financing Transactions Regulation). This standardisation is intended to enhance the automation of reporting, reduce data quality issues and contribute to easier reconciliation of reports, thereby decreasing the need for burdensome follow-up processes to resolve reconciliation breaks.

These changes will require significant modifications to reporting systems and the development of internal policies and procedures setting out firms' approaches to completing the revised reporting fields (a process which is likely to require both operational and legal input).

Notification of significant or material reporting issues

The new EU and UK reporting rules both introduce new requirements for reporting entities to notify regulators of certain reporting issues. Currently, questions regarding the need for an entity to notify its regulator of reporting errors are decided on the basis of national notification requirements, which often vary by jurisdiction and counterparty type. This patchwork approach has led to concerns that regulators may not be aware of certain types of reporting issues, especially those which do not result in rejected reports or reconciliation failures which regulators can become aware of through information they receive directly from trade repositories.

Although the new EU and UK reporting rules both introduce a notification requirement, the EU requirement is much more prescriptive and metric-based.

Under the new EU rules, a reporting entity must notify:

- any misreporting caused by flaws in the reporting systems that would affect a significant number of reports;
- any reporting obstacle preventing the report submitting entity from sending reports to a trade repository within the reporting deadline; or
- any significant issue resulting in reporting errors that would not cause rejection by a trade repository.

The ESMA reporting guidelines contain metrics and thresholds that reporting entities must use to assess the significance of a reporting error.

Under the new EU rules, if a notification is required, the reporting entity must notify its NCA and, if different (e.g., because of the mandatory reporting regime), the NCA of the reporting counterparty. The notification must be made promptly, as soon the reporting entity becomes aware of the notifiable event and must at least indicate the type of error or omission, the date of the occurrence, scope of the affected reports, reasons for the errors or omissions, steps taken to resolve the issue and the timeline for resolution of the issue and corrections. ESMA has published a notification template that NCAs may opt to use. For example, the CSSF has confirmed that it will implement the template. Both ESMA and the CSSF have stated that all stakeholders must be ready to promptly identify and assess reporting issues to determine what (if any) notifications are required and to make any required notifications quicky.

In contrast, under the new UK rules, the reporting entity must notify the FCA (or, in the case of central counterparties, the Bank of England) of any material errors or omissions in its reporting as soon as it becomes aware of them. The UK reporting rules do not specify the meaning of 'material' in this context and, unlike ESMA, the FCA will not provide further guidance on this point. The FCA has said that it is for reporting entities to judge what is material in a given situation, taking into account their own particular circumstances and the circumstances of the error, but that, if reporting entities are in doubt as to the materiality of a given error, they should be conservative and notify the FCA or the Bank of England (as applicable).

The new UK notification obligation is likely to have a limited impact on regulated reporting entities as they are already subject to broad notification obligations (such as FCA Principle 11). However, the impact may be larger for unregulated reporting entities as they are not currently subject to an obligation to notify reporting breaches to the FCA (although some may have been self-reporting breaches voluntarily). Both regulated and unregulated UK reporting entities should use the existing processes of the FCA and the Bank of England for notifying errors and omissions (e.g., the FCA's UK EMIR breach notification form).

The new EU notification obligation raises several issues for both regulated and unregulated entities. In particular:

- A reporting entity may need to make notifications to multiple NCAs (following different notification procedures), including those with whom it does not have a direct relationship. For example, an FC which undertakes mandatory reporting on behalf of its NFC- clients may need to make notifications to its own NCA and the NCAs of all or some of its NFC- clients.
- Reporting entities will need to adopt internal policies and procedures to determine when a reporting issue affects a significant number of reports or transactions. These will need to reflect the metrics and thresholds set out in the ESMA reporting guidelines. Reporting entities will also need to ensure that their processes allow them to quickly draw upon the necessary data to allow them to assess if the relevant metrics and thresholds have been met.
- Entities subject to mandatory reporting will need to consider what information they will provide to their clients when a notifiable issue arises and when this information will be provided. Clients may wish to be informed of notifications that will be made to their NCAs before these notifications are made or as soon as possible thereafter.
- Entities which delegate reporting to a third party (and, therefore, retain responsibility for accurate reporting) will need to consider what information they will require from the third party to ensure that they are able to comply with the notification obligation. It may be particularly difficult for firms to obtain this type of information from third parties established outside the EU (although non-EU firms providing delegated reporting services to EU clients may be willing to provide this information in order to remain competitive with EU firms

or because they are subject to similar obligations in their home jurisdiction, e.g., UK FCs).

- Reporting entities (especially regulated entities) will also need to consider how this new notification obligation interacts with other notification obligations that may apply to them at a national level.

Reconciliation processes and sharing information about data quality issues

Reporting entities and report submitting entities (if different) will need to have arrangements to take account of feedback received from trade repositories regarding reconciliation breaks (i.e., where two reports of the same trade do not match). The UK reporting rules also provide that any reconciliation breaks must be resolved where possible, as soon as practicably possible. The ESMA reporting guidelines also set out expectations for reconciliation breaks to be corrected.

In response to requests from market participants for guidance on acceptable arrangements and expected timeframes for remediation, the FCA has said that it does not seek to be overly prescriptive on timelines (recognising that the severity and drivers of reconciliation breaks will differ) and that it does not intend to provide guidance on the arrangements that reporting entities and report submitting entities may wish to put into place. It is for these entities to assess what is appropriate for their particular circumstances and business. Similarly, the ESMA reporting guidelines do not prescribe specific arrangements or timeframes.

Whilst this obligation specifically relates to reconciliation processes, the ESMA reporting guidelines set out broader expectations for the sharing of information about data quality issues. EU entities will need to consider these expectations and assess if they already have access to this information or if they will need to put in place new arrangements to obtain this information (either directly from trade repositories where this is possible or from the entities who report on their behalf). The ESMA guidelines also stress that even NFC-s which rely on mandatory reporting should have access to the information reported on their behalf. The guidelines suggest that FCs should consider whether to provide NFC-s on a regular basis (e.g., monthly) with information about their outstanding contracts. This type of information sharing is unlikely to be covered by existing reporting agreements.

Information to be provided by NFC-s to FCs

The new EU and UK reporting rules specify the information which NFC-s must provide to FCs in a mandatory reporting context. This largely reflects existing ESMA guidance, but with modifications to ensure consistency with the revised reporting fields. The new reporting rules provide that FCs must put in place arrangements to ensure that this information is provided on a timely basis. ESMA has confirmed that these arrangements can provide for the reporting of predefined standard values for all trades unless the NFC- advises otherwise for a particular transaction.

The new EU and UK rules will require FCs to maintain arrangements with the NFC-s for which they report for those NFC-s to:

- renew their Legal Entity Identifiers (LEIs) regularly;
- inform the FC on a timely basis about any change to the NFC's status as this will affect the allocation of responsibility for reporting; and

- notify the FC of its decision to start reporting OTC derivatives itself (instead of relying on the FC). The FC's arrangements must ensure that this notification is done in writing or by other equivalent electronic means at least 10 working days before the date on which the NFC- wishes to start reporting itself.

Existing reporting agreements may adequately address the above requirements. However, the new reporting rules will also require FCs to put in place arrangements with any NFC- clients which report for themselves to ensure the timely notification by these NFC-s should they decide to cease reporting for themselves. These arrangements must ensure the NFC- notifies the FC in writing or other equivalent electronic means at least 10 working days before the date on which the NFC- wishes to cease reporting for itself. Given that FCs will not have reporting agreements in place with these NFC- clients, FCs will need to consider how to implement these arrangements (e.g., through contractual arrangements or one-way notices). FCs will also need to have appropriate internal procedures to ensure that they can start reporting immediately after the end of the 10-working day notification period.

Requirement to keep LEIs renewed

The new EU and UK reporting rules maintain the requirement for parties to be identified in reports by LEIs. Whilst counterparties generally obtain LEIs, some fail to keep these renewed. This can cause trade repositories to reject reports. To address this issue, the new reporting rules require reporting entities to keep their LEIs renewed.

In a mandatory reporting context, the FCA has confirmed that whilst NFC-s are responsible for renewing their LEIs, an NFC- and an FC may put in place arrangements for the FC to renew the NFC-'s LEI. This statement is helpful for firms which may have been concerned about whether such arrangements are compliant with inducements rules. The ESMA guidelines are not as explicit on this point but do confirm that FCs can, for example, liaise with their NFC- clients to ensure that the NFC- renews its LEI.

Conditions to report at position level

Under the new EU and UK reporting rules, counterparties wishing to use position level reporting will need to agree this with their counterparties. Whilst existing ESMA guidance already stressed the need for reporting at position level to be done consistently by both counterparties, the guidance did not expressly require a bilateral agreement. Under the new rules, counterparties will need to report at trade level and will only be permitted to report at position level where both counterparties agree to do so. Firms will need to consider how they will seek to agree and evidence this with their counterparties.

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What are the key differences between the new EU and UK reporting rules?

As discussed above, the new EU and UK reporting rules have different reporting start dates and differing notification obligations for significant or material reporting errors. The new EU and UK reporting fields are predominantly aligned, with the main differences being:

- The UK reporting rules include an additional (but optional) reporting field for the identification of an execution agent.
- The 'intragroup' field in the UK reporting rules must be completed with 'TRUE' where the transaction meets the definition of an intragroup transaction in Article 3 of UK EMIR or fails to meet that definition only because its counterparty is established in a non-equivalent third country. The same field in the EU reporting rules must be completed with 'TRUE' only where the transaction meets the definition of an intragroup transaction in Article 3 of EU EMIR, which currently requires a third country counterparty to be established in an equivalent jurisdiction. However, the European Commission's current legislative proposal for amendments to EU EMIR (EU EMIR 3.0) envisages the removal of the equivalence condition.
- Only the UK reporting rules include TONAR as an option for completing fields relating to floating rates.

There are also some differences between the EU and UK validation rules, which firms will need to factor in when building their reporting systems. The FCA has published a worksheet setting out these differences and its reasons for diverging from the EU approach.

Will there be further changes?

The European Systemic Risk Board (ESRB) has recommended that there should be changes to EU EMIR to further improve the quality of reported data. The ESRB's recommendations include the mandatory appointment of an officer responsible for reporting and the extension of the reporting obligation to non-EU subsidiaries of EU groups. The ESRB has requested that EU legislators take account of these recommendations when considering the EU EMIR 3.0 legislative proposal.

At this time, there is no indication that the new UK reporting rules will be further revised. However, it is possible that changes may be proposed as part of the process of revoking and replacing retained EU law under the Financial Services and Markets Bill.

For more information, please see:

- The new EU reporting RTS here.
- The new EU reporting ITS here.
- ESMA's reporting guidelines, validation rules and reporting instructions here.
- The new UK technical standards, validation rules and XML schemes here.

What should firms do to comply with the new reporting rules?

Firms which report directly to trade repositories

These firms will need to:

- Make significant changes to their reporting systems to continue to report directly and will need to prepare for a weekend switch-over before the reporting start date.
- If they report to both EU and UK trade repositories, prepare to report under significantly different reporting rules between 29 April 2024 and 30 September 2024 due to the different reporting start dates in the EU and the UK.
- Analyse the new and modified fields to understand how they should be populated, a process which will likely require operational and legal input and engagement with industry working groups.
- Develop a strategy for updating reports of outstanding derivatives, including collating all the necessary data.

Some firms which report directly to trade repositories today may wish to consider whether to continue doing so in light of the changes that will be required to reporting systems. It may be feasible for some firms to rely solely on delegated reporting arrangements.

Firms which report on behalf of others

Firms which report on behalf of others, either under mandatory reporting or delegated reporting arrangements, will need to consider:

- If they require any information from clients under mandatory reporting arrangements in order to update reports for outstanding derivatives.
- If they will update reports for outstanding derivatives for clients under delegated reporting arrangements.
- If they will need to make any updates to mandatory reporting or delegated reporting agreements to reflect the new reporting rules or enhanced regulatory expectations.

Firms which rely on others to report on their behalf

These firms will need to:

- Satisfy themselves that their service-provider under a delegated reporting arrangement will be able to report in compliance with the new requirements or switch service-provider.
- Check whether their service-provider under a delegated reporting arrangement is willing and able to update reports for outstanding derivatives.
- Consider whether it is necessary to update the terms of mandatory or delegated reporting agreements and/or respond to requests from service-providers to amend the terms of these agreements.

All firms

All firms which are subject to the reporting rules or which report on behalf of others will need to consider:

- How they will comply with the new notification obligation for significant or material reporting issues (as applicable) and how this interacts with other obligations, either under contractual agreements or under existing national notification regimes.

- How they will comply with the new requirements and enhanced regulatory expectations regarding the monitoring and correction of reporting issues, including utilising the additional information that trade repositories will be required to provide.

- Whether they wish to report on a position level and, if so, agree and record this agreement with their counterparties.

Groups which operate in both the EU and the UK or firms which have cross-border reporting arrangements should consider the impact of both the new EU and UK rules on their reporting arrangements.

CONTACTS

Stephanie Peacock
Senior Associate

T +44 207006 4387
E stephanie.peacock
@cliffordchance.com

Caroline Dawson
Partner

T +44 207006 4355
E caroline.dawson
@cliffordchance.com

Maria Luisa Alonso
Counsel
T +34 91 590 7541
E marialuisa.alonso
@cliffordchance.com

Chris Bates
Consultant

T +44 207006 1041
E chris.bates
@cliffordchance.com

Marc Benzler
Partner

T +49 69 7199 3304
E marc.benzler
@cliffordchance.com

Lucio Bonavitacola
Partner

T +39 02 8063 4238
E lucio.bonavitacola
@cliffordchance.com

Michael Brown
Partner

T +44 207006 8359
E michael.brown
@cliffordchance.com

Yolanda Ghita-Blujdescu
Senior Associate

T +352 48 50 50 489
E yolanda.ghita-blujdescu
@cliffordchance.com

Hélène Kouyaté
Counsel

T +33 1 4405 5226
E helene.kouyate
@cliffordchance.com

Paul Lenihan
Senior Associate

T +44 207006 4622
E paul.lenihan
@cliffordchance.com

Marc Mehlen
Partner

T +352 48 50 50 305
E marc.mehlen
@cliffordchance.com

Will Winterton
Partner

T +44 2070064386
E will.winterton
@cliffordchance.com