OTC derivatives, central counterparties and trade repositories (EMIR, European Market Infrastructure Regulation)

2010/0250(COD) - 05/07/2011 - Text adopted by Parliament, partial vote at 1st reading/single reading

The European Parliament amended, at first reading of the ordinary legislative procedure, the proposal for a regulation of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories.

The vote on the legislative resolution has been postponed to a later date.

Subject matter of the Regulation: Parliament clarifies that the Regulation lays down uniform requirements for derivative contracts, specific provisions to improve the transparency and risk management of the OTC derivatives market as well as uniform requirements for the performance of activities of CCPs and trade repositories.

In order to ensure the uniform application of the Regulation, the European Securities and Markets Authority (ESMA) shall develop draft regulatory technical standards laying down guidelines for the interpretation and application, for the purposes of this Regulation, of Directive 2004/39/EC. ESMA shall submit drafts for these regulatory technical standards to the Commission by 30 June 2012.

The clearing obligations of this Regulation shall not apply to the Bank for International Settlements. Further derogations from this Regulation shall require the adoption of a specific regulation of the European Parliament and of the Council drawn up on the basis of international standards and equivalent Union sectoral rules.

Strengthening the role of ESMA: Members state that the three European Supervisory Authorities have a crucial role to play in safeguarding the stability of the financial sector. It is therefore essential to continuously ensure that the development of their work is a matter of high political priority and that they are adequately resourced.

In view of its pivotal role, ESMA should decide, after consulting the Commission and the European Systemic Risk Board whether a class of derivatives meets the eligibility criteria, whether the clearing obligation should be applied and from when the clearing obligation should take effect, including, where appropriate, any 'phase-in' implementation standards.

In determining whether a class of derivatives is to be subject to clearing requirements, ESMA should aim for a reduction in systemic risk and avoidance of systemic repercussions. This includes taking into account in the assessment factors: such as the future date from which the clearing obligation takes effect, the interconnectedness of the relevant class of derivative in the market, the level of contractual and economic standardisation of contracts, the effect on the performance and competitiveness of EU companies in the global markets, the operational and risk management ability of CCPs to handle the volume and obligations of this directive, the degree of settlement risk and counterparty credit risk and the impact of cost on the real economy and investment in particular.

The Commission and ESMA should ensure that mandatory clearing arrangements also protect investors.

As part of the preparation for the establishment of technical guidelines and regulatory technical standards, and in particular when setting the clearing threshold for non-financial counterparties under this Regulation, ESMA should organise public hearings of market participants.

Members consider that it is imperative that ESMA should be involved in the authorisation and supervisory process. ESMA should involve other competent authorities in the Member States concerned in the work of preparing recommendations and decisions.

For the purpose of the clearing obligation, ESMA shall establish and manage a public register. The register shall be publicly available on ESMA's website.

Clearing obligations: Members consider that OTC derivatives contracts entered into before the date from which the clearing obligation takes effect for that class of derivatives are exempted from the clearing obligation. That clearing obligation shall apply to all OTC derivative contracts which, following publication of ESMA decision are classified as derivatives eligible for the clearing obligation. There shall be no clearing obligation in the case of derivative contracts between subsidiary undertakings of the same parent company or between a parent company and a subsidiary undertaking.

Validity of transactions: in general, the obligations under this Regulation should apply only to future transactions, thereby making a smooth transition possible and enhancing the stability of the system while reducing the need for subsequent adjustments. In that connection, clearing and reporting obligations should be dealt with in different ways. Whilst a retrospective clearing obligation is hardly feasible on legal grounds, given the need for post-collateralisation, the same is not true of a retrospective reporting obligation. In this case, on the basis of the results of an impact study, and using rules tailored to classes of derivatives, technical requirements and remaining periods to maturity, a retrospective reporting obligation could be laid down.

Pension funds: pension funds as defined in Directive 2003/41/EC on the activities and supervision of institutions for occupational retirement provision with a risk-averse risk-profile and that use derivates to hedge their pension liability risks should be made subject to the reporting obligations and the risk-mitigation techniques for OTC derivative contracts not cleared by a CCP as laid down in this Regulation. Those pensions should not, however, be subject to the clearing obligation in order to avoid disproportionate costs for pensioners.

Institutions for occupational retirement provision as defined in Directive 2003/41/EC:institutions for occupational retirement provision or arrangements offering similar level of risk mitigation and recognised under national law for the purpose of retirement provision using derivative contracts that are objectively measurable as reducing risks directly related to the solvency of the institution that operate a pension scheme should be subject to the provisions for bilateral collateralisation as set out in this Regulation to be reviewed in 2014.

Non-financial counterparties: non-financial counterparties should explain the use of derivatives through their annual report or other appropriate means. The clearing threshold for non-financial counterparties is a very important figure for all market participants. Both qualitative and quantitative criteria should be assessed and given a suitable weighting when the clearing threshold is set. In that connection, appropriate

efforts should be made to standardise OTC contracts to a considerable extent and to recognise the importance of risk mitigation for non-financial counterparties in the context of their normal business activity.

SME exemption: with a view to exempting small and medium-sized enterprises (SMEs) from the clearing obligation, consideration should also be given to sector-specific OTC clearing thresholds based on the total volume of contracts concluded by an undertaking. In addition, ESMA should examine whether a de minimis rule might be introduced for SMEs in connection with the reporting obligation.

Reporting obligation: the Regulation provides for mandatory reporting requirements. Moreover, a retrospective reporting obligation is needed, to the largest possible extent, for both financial counterparties and non-financial counterparties over the threshold, in order to provide ESMA with comparative data. If such retrospective reporting is not feasible for any classes of OTC derivatives, an appropriate justification should be provided to the respective trade repository.

Penalties: there should be effective, proportionate and dissuasive penalties with regard to the clearing and reporting obligations. Member States should enforce those penalties in a manner that does not reduce the effectiveness of those rules. Member States should ensure that the penalties imposed are publicly disclosed and that assessment reports on the effectiveness of existing rules are published at regular intervals.

Agreements with supervisory authorities of third countries: in view of the global nature of financial markets, agreements with CCPs established in third countries on the provision of clearing services within the Union are necessary according to the Parliament. Such agreements should cover the authorisation by ESMA and the competent authority of the Member State in which the CCP concerned intends to provide clearing services of authorisation of a CCP established in a third country or the granting by the Commission of an exemption from the authorisation conditions and procedure, provided that the Commission has recognised the legal and supervisory framework of that third country as equivalent to the Union framework and that the requisite conditions are met.

Central counterparties (CCP): a CCP shall have a permanent and available initial capital of at least EUR 10 million to be authorised pursuant to the text. The draft Regulation states that CCPs should have robust governance arrangements, senior management of good repute and independent members on its board, irrespective of its ownership structure. At least one third and no less than two members of the board should be independent members. Those independent members should not act as independent members in more than one other CCP. Their remuneration should not be linked in any way with the performance of the CCP. Outsourcing of functions should be approved by the risk committee of the CCP.

Parliament feels that the development of a highly robust risk management should remain the primary objective of a CCP. However, it may adapt its features to the specific activities and risk profiles of the clients of the clearing members, and if deemed appropriate, may include in the scope of the highly liquid assets accepted as collateral at least cash and government bonds subject to adequate haircuts. CCPs? risk management strategies should be sound, and should not transfer risk to the taxpayer..

Interoperability arrangements: given the additional complexities involved in an interoperability arrangement between CCPs clearing OTC derivative contracts, it is appropriate at this stage to require a grace period of three years between receiving clearing authorisation for derivatives and eligibility to apply for authorisation for interoperability as well as to restrict the scope of subsequent interoperability arrangements to cash securities. However, by 30 September 2014, ESMA should submit a report to the Commission on whether and when an extension of that scope to other financial instruments would be appropriate.

Maintenance of website by ESMA: Members require ESMA to maintain a website which provides the following information:(a) contracts eligible for the clearing obligation; (b) CCPs authorised to offer services or activities in the Union that are a legal person established in the Union, and the services or activities which they are authorised to provide or perform, including the classes of financial instruments covered by their authorisation; (c) penalties imposed for breaches of the Regulation; (d) CCPs authorised to offer services or activities in the Union established in a third country, and the services or activities which they are authorised to provide or perform, including the classes of financial instruments covered by their authorisation; (e) trade repositories authorised to offer services or activities in the Union;(g) penalties and fines imposed (h) the public register referred to in the Regulation.

Delegated acts: in defining the delegated acts, the Commission should make use of the expertise of the relevant ESAs (ESMA, EBA and EIOPA). In view of the expertise of ESMA regarding issues concerning securities and securities markets, ESMA should play a central role in advising the Commission on the preparation of the delegated acts. However, where appropriate, ESMA should consult EBA and EIOPA. In order to ensure uniform conditions for the implementation of this Regulation, implementing powers should be conferred on the Commission. Those powers should be exercised in accordance with Regulation (EU) No 182/2011 of the European Parliament and of the Council laying down the rules and general principles concerning mechanisms for control by the Member States of the Commission's exercise of implementing powers.