



Brussels, 23.11.2016
COM(2016) 857 final

**REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND
THE COUNCIL**

**under Article 85(1) of Regulation (EU) No 648/2012 of the European Parliament and of
the Council of 4 July 2012 on OTC derivatives, central counterparties and trade
repositories.**

1. INTRODUCTION

Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories (EMIR) was published in the Official Journal of the European Union (EU) on 27 July 2012, and entered into force on 16 August 2012.

EMIR responded to the commitment by G20 leaders in September 2009 that: "All standardised OTC derivatives contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end-2012 at latest. OTC derivatives contracts should be reported to trade repositories. Non-centrally cleared contracts should be subject to higher capital requirements¹".

Many derivatives regulators across the globe have also now transposed this commitment into their legislative frameworks.

Prior to the financial crisis of 2007, regulators lacked information about activity in the derivatives markets; this meant that risks could remain unnoticed until they materialised. Moreover, counterparty credit risk between OTC derivative counterparties was often unmitigated, which could lead to losses materialising were one counterparty to default prior to fulfilling its obligations. Due to the high volumes of transactions across these markets and the interconnectedness of the markets' participants, such losses could pose a broader threat to the financial system.

EMIR therefore seeks to promote transparency and standardisation in derivatives markets as well as reduce systemic risk through the application of its core requirements. These are:

- I. Central clearing of standardised OTC derivative contracts;
- II. Margin requirements for OTC derivative contracts that are not centrally cleared;
- III. Operational risk mitigation requirements for OTC derivative contracts that are not centrally cleared²;
- IV. Reporting of all derivative contracts;
- V. Requirements for Central Counterparties (CCPs);
- VI. Requirements for Trade Repositories.

In accordance with Article 85(1) of EMIR, the European Commission is required to review and prepare a general report on EMIR which shall be submitted to the

¹ <http://www.g20.utoronto.ca/2009/2009communique0925.html>

² *Operational risk mitigation requirements* refer to requirements under Article 11(1) of EMIR to value, reconcile and confirm non-cleared OTC derivatives transactions and to compress and reconcile portfolios.

European Parliament and the Council, together with any appropriate proposals. This review will take into account the need to support the European Commission's priority of promoting jobs and growth.

2. STAKEHOLDER INPUT

EMIR applies to almost all users of derivatives³, including any counterparties authorised under Union financial services frameworks, non-financial counterparties ('NFCs') established in the Union as well as CCPs and trade repositories. As a Regulation, it applies directly in all Member States of the Union.

In order to gather stakeholder input for the purposes of the review, the Commission conducted a public consultation on the implementation of EMIR⁴. This consultation took place between 19 May and 13 August 2015 with 172 responses received from a broad range of stakeholders across the EU, as well as third countries.

Additionally, as part of the Call for Evidence consultation⁵ in the framework of the Capital Markets Union initiative which took place between 30 September 2015 and 31 January 2016, 278 respondents raised claims focused on provisions of EMIR. It was decided to wait for the input to this initiative in order to get a fair and balanced representation of the state of play of EMIR implementation and the challenges encountered, and serve as an appropriate basis for a review of EMIR. A detailed summary of the responses to the consultation on the implementation of EMIR is provided in the feedback statement.

A number of reports have also been received from the European Securities and Markets Authority (ESMA) relating to various topics under EMIR, which the Commission has taken into account.

Finally, as part of the review, specific input was received from certain Union bodies and authorities in line with the Commission's mandate to review EMIR under Article 85(1):

- (a) Members of the ESCB (the European System of Central Banks) assessment of the need for any measure to facilitate the access of CCPs to central bank liquidity facilities⁶: In its assessment the ESCB considers that, while competent authorities should continue to examine CCPs' liquidity risk management frameworks, no provisions for central bank liquidity access should be introduced in EMIR. The ESCB considers that this could undermine central

³ Certain Union and third country public bodies may be exempted from EMIR, in accordance with Article 1(4).

⁴ http://ec.europa.eu/finance/consultations/2015/emir-revision/index_en.htm

⁵ http://ec.europa.eu/finance/consultations/2015/financial-regulatory-framework-review/index_en.htm

⁶ Report of the ESCB on the need for any measure to facilitate the access of CCPs to central bank liquidity facilities

bank independence, guaranteed in Article 130 of Treaty of the Functioning of the European Union, and create moral hazard on a large scale. The Commission agrees with the ESCB's assessment.

- (b) ESMA assessment of the systemic importance of the transactions of non-financial firms in OTC derivatives and, in particular, the impact of this Regulation on the use of OTC derivatives by non-financial firms⁷: ESMA concludes that the current hedging approach is not capturing the most significant market players. ESMA suggests removing the hedging exemption and considering the introduction of only a simple threshold to capture the largest market players in terms of volumes. On the basis of ESMA's input, the Commission agrees that for some NFCs the application of the current approach under EMIR could be too overly burdensome considering that it may not reliably reduce systemic risk. The nature of hedging activity is nonetheless a relevant factor when considering the systemic relevance of NFCs because hedging entities are generally not highly leveraged and hold underlying offsetting positions to their OTC derivative contracts.
- (c) ESMA review of the functioning of the supervisory framework for CCPs, including the effectiveness of supervisory colleges, the respective voting modalities laid down in Article 19(3), and the role of ESMA, in particular during the authorisation process for CCPs⁸: ESMA identifies some cases where common approaches should be developed, in particular to the application of the processes envisaged in Article 15 and 49 of EMIR. The feedback from the consultation showed that there was a great interest for clarifying the application of these articles. Supervisory convergence as well as publicly available criteria for the application of these articles will be considered further by European authorities.
- (d) ESMA and ESRB reports on the efficiency of margining requirements to limit procyclicality and the need to define additional intervention capacity in this area⁹: Both authorities made suggestions for improving the treatment of procyclicality. The Commission agrees with the suggestion to increase the transparency of margin requirements, as this is information that clearing members need for effectively managing their exposures and predicting sudden margin changes, but other changes would be premature taking account of the recent application of existing margin and anti-procyclicality requirements and the lack of crystallised failure in margin standards since then.

⁷ EMIR Review Report no.1 - Review on the use of OTC derivatives by non-financial counterparties

⁸ ESMA review of CCP colleges under EMIR

⁹ ESRB Report on the efficiency of margining requirements to limit pro-cyclicality and the need to define additional intervention capacity in this area, ESMA's EMIR Review Report no.2 - Review on the efficiency of margining requirements to limit procyclicality

- (e) ESMA report on the evolution of CCP's policies on collateral margining and securing requirements and their adaptation to the specific activities and risk profiles of their users¹⁰: ESMA concludes that there is, at this stage, no need for a review of the EMIR provisions on collateral margining and securing requirements as the Delegated Regulation n°153/2013 provides sufficient granularity for these requirements.

The input from the diverse authorities shows that EMIR's implementation is achieving its original objectives to promote transparency and standardisation in derivatives markets as well as reduce systemic risk. This input has been duly taken into consideration when drafting this report. However, the Commission notes that in some areas the introduction of significant changes to EMIR would be premature taking account of the recent application of existing requirements and the absence of failure in the application of the relevant standards to date.

3. PURPOSE OF THE REPORT

The Commission is required under 85(1) to produce a report.

It is important to note that certain core requirements provided for under EMIR have yet to be implemented or completed. In particular, at this stage clearing obligations and margin requirements in respect of non-cleared OTC derivatives transactions are not yet fully applicable. In this sense, it is not possible at this stage to review the impact of EMIR comprehensively.

Nevertheless, stakeholders have identified a number of issues relating to the implementation of those requirements which already apply (namely, reporting to trade repositories and operational risk mitigation requirements), as well as issues encountered in preparing for the clearing and margin requirements.

In particular, many stakeholders argue that certain derivatives market participants are facing significant challenges in implementing the requirements such as the reporting and the clearing of some transactions, to an extent that may be considered disproportionate to the objectives of EMIR and which, in some cases, could have an excessive impact on businesses as these requirements would be costly to fulfil compared to the advantages they bring in terms of market transparency and financial stability. Many respondents to the public consultation illustrated their responses by making a comparison to the approaches to regulatory reform that have been taken in other jurisdictions.

This report provides a summary of the areas where consultation responses and specific input received from various authorities have shown that action is

¹⁰ EMIR Review Report no.3 - Segregation and portability requirements

necessary to ensure fulfilment of the objectives of EMIR in a more proportionate, efficient and effective manner.

4. PRINCIPAL ISSUES IDENTIFIED

There is general support for the objectives of EMIR of promoting transparency and standardisation in derivatives markets and reducing systemic risk through its core requirements. These core requirements –clearing, margin requirements, reporting, operational risk mitigation requirements and requirements for trade repositories and CCPs – remain integral to achieving the objectives of EMIR, and delivering on its international commitments for regulatory reform.

It is therefore considered that no fundamental change should be made to the nature of the core requirements of EMIR, which are integral to ensuring transparency and mitigating systemic risks in the derivatives markets.

Nonetheless, a number of areas were highlighted where the EMIR requirements could be adjusted without compromising on its overall objectives in order to:

- (i) simplify and increase the efficiency of the requirements; and
- (ii) reduce disproportionate costs and burdens.

4.1. Simplifying and increasing the efficiency of the requirements

Respondents, including CCPs, clearing members, non-financial counterparties, small financials and pension funds, highlighted a number of requirements which could be refined to ensure the smooth functioning of derivatives markets or enable a smoother implementation of the requirements by market participants, without compromising on the objectives of EMIR or introducing additional regulatory burdens.

4.1.1. Introducing a mechanism to suspend the clearing obligation

Both ESMA and the ESRB highlighted the absence of a mechanism under EMIR for the clearing obligation to be suspended promptly, suggesting that this may be necessary to react quickly to dramatic changes in market conditions (e.g. sharp change in volumes cleared or liquidity) and remove or suspend swiftly a clearing obligation where the market situation so requires. Several other respondents also supported the introduction of such a mechanism.

Clearing obligations can be amended or removed through Regulatory Technical Standards ('RTS') but this process can take several months. Furthermore, there are circumstances which could be envisaged where an expedited process to suspend a clearing obligation may be necessary to avoid market disruption. The Commission will therefore propose **a mechanism for suspending a clearing obligation as part of the proposal on the CCP Recovery and Resolution for the purposes of resolution and consider the possibility to broaden the scope of the suspension of a clearing obligation for other appropriate purposes.**

4.1.2. Facilitating the predictability of margin requirements.

Many respondents, notably industry associations and banks noted that, currently, it can be difficult to predict the levels of margin that they will be required to post to CCPs for centrally cleared transactions. These respondents suggested that better information sharing by CCPs to clearing members could address this shortcoming. Both ESMA and the ESRB in their reports on procyclicality and margining requirements also called for greater transparency on margin standards and procyclicality requirements. **Better information sharing could make compliance with margin requirements more efficient for market participants and enable them to better manage their own assets.**

Similarly, with respect to *non-cleared* transactions, some respondents, notably financial institutions, noted the absence of a clear mandate for initial margin models to be endorsed by authorities, which could lead to uncertainty among market participants as to whether their calculations are considered by authorities to be fully compliant with regulations. **A mandate for initial margin models to be endorsed by authorities could promote certainty for market participants and authorities alike.**

4.1.3. Streamlining Trade Reporting

The topic of reporting to trade repositories attracted a significant number of responses from market participants and authorities. Respondents, primarily industry associations and companies, but also public authorities, consultancies, NGOs, and a trade union, suggested that, currently, many reports by the two counterparties pertaining to the same transaction are not accurately matched within trade repositories. This is attributed in part to a lack of clarity around what needs to be reported and how, and to differences in requirements between trade repositories. Further, respondents suggested that requirements could be simplified significantly without losing crucial data, in particular with respect to exchange traded derivatives. Respondents also questioned whether, as a result of the difficulty in submitting accurate data and matching, the data was as reliable and usable as it should be. Finally, respondents questioned the utility of the requirement to report transactions existing prior to the start of the application of the reporting obligation (so called 'backloading') as this data is very challenging to report - it covers derivatives that were concluded before counterparties were in a position to know what information had to be kept and reported - and it is considered as less and less useful as it concerns historical data that is not of critical importance for regulators.

Many respondents noted improvements that could be made at the level of trade repositories to make data aggregation more efficient, notably through the use of common methodologies by Union trade repositories. Further, ESMA suggested that fines for trade repositories may need to be increased in order to ensure effective supervision.

Promoting transparency by streamlining reporting requirements in certain areas and enhancing the functioning of trade repositories is essential to fully achieve

the objectives of EMIR. Thus, it is considered that further assessment of the current rules should be undertaken to take specific actions to achieve that goal. This can also help reduce the compliance burden for market participants.

Further, certain third country authorities face legal challenges in executing the arrangements (i.e. conclusion of an international agreement) currently required under EMIR for mutual access to data held in trade repositories. **Alternative methods for providing access to third country authorities of trade repositories' data that provide appropriate safeguards should therefore be explored.**

4.2 Reducing disproportionate costs and burdens

4.2.1. Scope of transactions

Responses pointed to a number of areas where the scope of transactions covered by requirements could be considered unnecessary in achieving the objectives of EMIR.

In particular, it was questioned whether the requirement to clear contracts entered into before the clearing obligation enters into force (so called 'frontloading') is proportionate given the limited number of contracts that this will capture as it is a temporary measure by nature, balanced against the difficulties and uncertainty of applying clearing obligations retrospectively. Companies and industry associations questioned whether it is proportionate to apply operational risk mitigation requirements to intragroup transactions, given that these transactions are undertaken within the same corporate groups where coordination between the counterparties is inherent in the nature of the transactions.

It is appropriate to review to what extent transactions entered into before the clearing obligation enters into force and intragroup transactions should remain in scope of the relevant requirements.

4.2.2. Scope of entities

a) Non-Financial Counterparties (NFCs)

With respect to the scope of counterparties covered by EMIR requirements, respondents noted that non-financial counterparties (NFCs) face significant challenges in meeting requirements, in particular reporting requirements, due to limited resources and experience. Taking the significance of these challenges into account, many non-financial counterparties questioned whether such counterparties pose systemic risk to a degree that justifies continued application of EMIR requirements. Respondents also noted that EMIR appears to be more stringent with respect to NFCs than many similar regulatory regimes in third countries.

Therefore, it is appropriate to assess whether adjustments should be made to the scope of core requirements under EMIR in order to address the challenges faced by NFCs.

Such adjustments could include removing legal obligations for NFCs to fulfil operational risk mitigation requirements and simplifying the reporting of their transactions. However, such transactions should not be exempt from these requirements entirely in order to preserve the application of the core EMIR objectives in terms of financial stability. Options should be explored to consider whether a) financial counterparties should report derivatives data on behalf of NFCs, b) financial counterparties, but not NFCs, should ensure that operational risk mitigation requirements are applied for transactions with NFCs and c) NFCs should be exempted from reporting their intragroup transactions.

Additionally, in its report on this topic, ESMA provided new insights into the activities of NFCs following the introduction of the EMIR reporting requirements. It is apparent from ESMA's findings that NFCs may be finding the hedging exemption difficult to monitor and apply in practice. This could result in inconsistent regulatory treatment of NFCs across the Union. It is also apparent from the data available that NFCs have a low level of interconnectedness with the financial system as they transact with very few counterparties across the markets; an average of 1-2 per entity compared with financial counterparties which have an average of 31 counterparties per entity.

On the basis of ESMA's input, it can be concluded that some NFCs are finding the application of the current approach under EMIR burdensome and that it may not substantially reduce systemic risk. However, it is considered that the nature of hedging activity is nonetheless a relevant factor when considering the systemic relevance of NFCs, as entities that hedge are generally not highly leveraged and hold underlying offsetting positions to their OTC derivative contracts.

Therefore, taking into account the limited interconnectedness of NFCs that existing data reveals to exist in the financial system, further consideration should also be given to whether any NFCs, or only some of them based on the volume and type of activity in derivatives markets, should be captured by clearing and margin requirements.

Such consideration should take into account the fact that some NFCs may be reclassified when MIFID II is implemented.

b) Small Financial Counterparties

In addition to the difficulties faced by NFCs, small financials and industry associations and some public authorities noted that when undertaking limited derivatives activity they were facing significant challenges in establishing the access to clearing necessary to meet upcoming clearing obligations. Respondents considered this was principally due to leverage ratio requirements anticipated by clearing

members under the Capital Requirements Regulation¹¹, which are perceived as having the potential to make client clearing services too costly for them to offer. Another obstacle noted by respondents was a lack of both flexibility and certainty around segregation and portability options. Respondents pointed out challenges in applying these requirements in particular as they might be difficult to implement in certain Member States' due to domestic insolvency laws. Finally, several respondents suggested that, even if the obstacles mentioned could be resolved, some small financial counterparties subject to clearing requirements undertake such limited activity in OTC derivatives that it is not commercially viable for them to establish clearing solutions. **Action to address the obstacles to client clearing should be considered.**

c) Pension Scheme Arrangements

Pension scheme arrangements are currently exempt from clearing under EMIR through a Commission Delegated Regulation¹². This exemption will expire on 16 August 2017 at the latest and can be prolonged for one additional year through another delegated act by the European Commission. As described in the Report from the Commission assessing the progress and effort made by CCPs in developing technical solutions for the transfer by pension scheme arrangements of non-cash collateral as variation margins, as well as the need for any measures to facilitate such solution¹³, clearing solutions for pension scheme arrangements to post non-cash assets as variation margin are however unlikely to be available in the foreseeable future. Once the temporary clearing exemption currently provided for under EMIR expires, pension scheme arrangements will be faced with either (i) relying on repo markets for collateral transformation, or (ii) increasing their cash holdings relative to their non-cash asset holdings. The first scenario may not provide a robust solution in times of market volatility and a strain on capacity of the repo markets could pose liquidity and stability threats to those markets more broadly. The second scenario would have a negative impact on retirement incomes of beneficiaries of the pension scheme

¹¹ Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, OJ L 176 of 27.6.2013

¹² Commission Delegated Regulation (EU) 2015/1515 of 5 June 2015 amending Regulation (EU) No 648/2012 of the European Parliament and of the Council as regards the extension of the transitional periods related to pension scheme arrangements, OJ L 239 of 15.9.2015

¹³ Report from the Commission to the European Parliament and the Council under Article 85(2) of Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories, assessing the progress and effort made by CCPs in developing technical solutions for the transfer by pension scheme arrangements of non-cash collateral as variation margins, as well as the need for any measures to facilitate such solution (COM(2015)39 final of 3.2.2015)

arrangements, estimated by the baseline study¹⁴ ordered by the European Commission to be up to 3.66% across the EU over 20-40 years¹⁵.

An assessment should be made as to whether the current exemption could be prolonged or made permanent without compromising on EMIR's objective of reducing systemic risk as pension scheme arrangements would still be subject to bilateral margin requirements for OTC transactions that are not centrally cleared that mitigate systemic risks.

5. CONCLUSIONS

There does not seem to be a need for fundamental changes to be made to the nature of the core requirements of EMIR, which are integral to ensuring transparency and mitigating systemic risks in the derivatives markets.

Nevertheless, having analysed the input received as part of the EMIR Review process and the Call for Evidence, action should be considered to address the issues identified in this report.

In particular, further assessment is needed in order to determine how to alleviate the challenges identified to allow for a streamlined application of EMIR that could remove excessive regulatory burdens on market participants and enable smoother implementation of the requirements, whilst ensuring that the objectives of EMIR are nonetheless fulfilled. This process should carefully consider the international principles in the derivatives markets field in order to ensure an efficient functioning of global markets. In addition, this initiative would support the Commission's Better Regulation agenda by eliminating unnecessary costs that are currently carried by companies and that could release funds for investing.

The Commission will propose a legislative review of EMIR in 2017, in the framework of REFIT that will be accompanied by an impact assessment which will consider the various issues at stake in more depth. As part of this review the Commission will also assess the relevant technical standards linked to EMIR.

Finally, the Commission is also proposing a legislation on CCP recovery and resolution that deals with elements that are not covered by EMIR, such as recovery planning, resolution planning, and removing impediments to resolvability for CCPs so that their financial distress can be dealt with effectively by authorities without unduly creating financial stability or placing public funds at risk.

¹⁴ Baseline report on solutions for the posting of non-cash collateral to central counterparties by pension scheme arrangements - 25 July 2014.

¹⁵ *ibid.*