

European Market Infrastructure Regulation for Derivatives End-Users – A Shift in Responsibility for Reporting

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EMIR Refit^[1] came into force on 17 June 2019 with the aim of amending the European Market Infrastructure Regulation (“EMIR”)^[2] to address “disproportionate compliance costs, transparency issues and insufficient access to clearing for certain counterparties”^[3]. While most of the changes are already in force, further changes will be implemented with effect from 18 June 2020. These changes will shift responsibility and legal liability as between certain counterparties for the timely and accurate reporting of “over the counter” (“OTC”) derivative contracts.

With a particular focus on corporate end-users of derivatives (such as corporate treasury functions)^[4], this note sets out, and discusses the implications of, these changes for parties to OTC derivative transactions, including the practical steps that should be taken in contemplation of such changes.

What is the reporting obligation?

Under the reporting requirements set out in Article 9 of EMIR, all financial counterparties (“FCs”) and non-financial counterparties (“NFCs”) to derivative contracts are required to report details of any concluded OTC and exchange traded contracts (including any modifications or termination of such contracts) to a European trade repository, by no later than the next business day. European corporate derivatives end-users (which are not regulated under any of the European sectoral financial services legislation, such as MiFID II^[5], AIFMD^[6], etc.) fall into the NFC category.

Under the current rules, each counterparty is responsible for reporting in relation to each in-scope transaction (i.e., dual-sided reporting)^[7]. While reporting can be delegated to the trading counterparty or to a third party service provider, it is not possible for corporate derivative end-users to delegate the regulatory responsibility for the reporting and therefore they remain liable in the event that reporting information is incorrect or transactions are not reported. Consequently, under the current rules it is prudent for end-users to perform periodic monitoring of any reports submitted to a trade repository on their behalf.

What is changing from 18 June 2020 for derivatives end-users?

From 18 June 2020, NFCs who are not subject to the clearing obligation (each an “NFC-”) will no longer be subject to the reporting obligation in relation to OTC derivative contracts, unless they opt to continue to perform their own derivatives reporting^[8]. Where an FC trading counterparty reports on behalf of itself and its NFC- counterparty, the FC will be solely responsible and legally liable for the reporting. For the avoidance of doubt, this applies only in relation to OTC contracts and does not cause a shift in the responsibility for reporting of exchange traded derivatives.

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To ensure the FC has the data it needs to fulfil its reporting obligation, the NFC- must provide to the FC the details relating to the OTC derivative contracts concluded between them, which the FC cannot be reasonably expected to possess. The NFC- bears the responsibility for ensuring that these details are correct.^[9] To facilitate this, FCs are currently reaching out to their clients to request the necessary data and the execution of a new reporting agreement. In addition to this data, we are also seeing FCs requesting a range of other data from their NFC- clients, including:

- whether the NFC- intends to report for themselves;
- whether the NFC- will be in scope of EU-EMIR reporting or the on-shored UK-EMIR reporting regime after the transition period ends following the UK's withdrawal from the EU;
- the trade repository used by the NFC-; and
- whether the FC will report lifecycle events on contracts entered into before 18 June 2020.

With respect to specific data required to be reported under Regulation (EU) 2017/104, the NFC- would be expected to provide the following details to its FC counterparties:

- Field 1.2 (Reporting counterparty ID – e.g., the counterparty's Legal Entity Identifier ("**LEI**"));
- Field 1.6 (Corporate sector of the counterparty);
- Field 1.7 (Nature of the counterparty);
- Field 1.8 (Broker ID – if unknown by FC);
- Field 1.10 (Clearing Member – if unknown by FC);
- Field 1.11 (Type of ID of the beneficiary – if the beneficiary is different from the NFC-);
- Field 1.12 (Beneficiary ID – if beneficiary is different from the NFC-);
- Field 1.13 (Trading capacity);
- Field 1.15 (Directly linked to commercial activity or treasury financing); and
- Field 1.16 (Clearing threshold).

It is important to note that while Fields 1.2, 1.6, 1.7 and 1.16 are static fields which can be provided to the FC one time and updated immediately when they change, the other fields are specific to each OTC derivatives contract and therefore must be provided to the FC for each such contract.^[10] Importantly, the NFC- will retain the responsibility for ensuring it has a valid LEI at all times and to provide such information to its FC counterparties. If the NFC- has not timely renewed its LEI, the FC will not be able to successfully report the OTC derivatives contract data to the European trade repository on behalf of the NFC-.^[11]

What happens if my counterparty is not in the EU?

Under current rules, where an NFC- trades with a counterparty that is established outside of the EU (*i.e.*, it is a third-country entity) the NFC- is required to take steps to report its side of the transaction to a European trade repository. EMIR Refit establishes a mechanism whereby the NFC- would no longer need to report the transaction itself where certain conditions are fulfilled, including where the legal regime for reporting in the jurisdiction where the trading counterparty is established has been declared equivalent under EMIR.^[12] Currently, there are no equivalency decisions related to reporting and therefore when an NFC- transacts with any third-country entity, including a third-country FC, it must continue to report (or delegate reporting to its counterparty or a third party) the data for any OTC derivative contracts (and lifecycle / termination events) to a European

trade repository in the same way as it does today.

From the perspective of certain NFC-s, the lack of equivalence determinations for reporting is sub-optimal because the NFC- must retain the legal liability for reporting certain transactions beyond 18 June.

What happens if my counterparty is not an FC?

EMIR Refit's changes to Article 9 of EMIR only shift the reporting responsibility from an NFC- to an FC. In the event that an NFC- transacts an OTC derivative contract with another NFC (whether established in the EU or a third-country NFC), the NFC- would retain the responsibility and legal liability to report the data for such OTC derivative contract to a European trade repository. In other words, EMIR Refit does not address NFC to NFC transactions and therefore the same EMIR dual-sided reporting rules would continue to apply for OTC derivatives contracts entered into between NFCs.

What about transactions entered into before 18 June 2020?

The change discussed above not only applies to new OTC derivative transactions concluded between NFC-s and FCs after 18 June 2020, but also to the modifications or terminations of OTC derivative contracts existing before that date (unless the parties contractually agree that the responsibility of the FC will be limited to the new OTC derivative contracts only).

This raises some operational difficulties which counterparties to trades will need to work through in advance of 18 June. For example, if two counterparties to a transaction have each reported to a different European trade repository under the current rules, in order for the FC to report lifecycle and termination events, either the NFC- will need to transfer the contract to the FC's trade repository using the porting mechanism under EMIR Refit or, where operationally feasible, the FC may continue to report to the trade repository used by the NFC-.^[13]

Use of the porting mechanism has also thrown up certain operational issues. In particular, prior to porting trades between trade repositories, the Unique Trade Identifiers ("UTI") originally reported by the NFC- and FC for each trade must match. If this is not the case, it will not be possible for the FC to successfully report post-trade events because the existing position will have a UTI that differs from that recognised by the FC. Therefore, where the UTI of existing positions (as reported by the NFC- and FC counterparties) do not match, such positions must be corrected before porting between trade repositories. This is another area where counterparties need to work together.

What happens if I change NFC classification?

Where an NFC which is above the clearing threshold in one or more asset classes ("NFC+") becomes an NFC-, its FC counterparties become immediately responsible for reporting on behalf of the NFC- in respect of both new and lifecycle events. However, in order to facilitate the assumption of reporting by the FC, it is incumbent upon the NFC client to inform the FC of its change in classification.^[14] Similarly, an NFC- reclassified as an NFC+ would become liable for its own reporting from the date on which the NFC calculates that its classification has changed. There would be no way for the FC to know of the reclassification in the absence of such notification.

[1] Regulation (EU) 2019/834.

[2] Regulation (EU) No 648/2012.

[3] See Press Release, Capital markets union: Council adopts updated rules for

financial derivative products and clearing, *available at*
<https://www.consilium.europa.eu/en/press/press-releases/2019/05/14/capital-markets-union-council-adopts-updated-rules-for-financial-derivative-products-and-clearing/>

[4] Given this focus, this bulletin does not provide detail on the prospective transfer in reporting responsibility and liability from alternative investment funds and undertakings for collective investment in transferable securities to their managers.

[5] Directive 2014/65/EU

[6] Directive 2011/65/EU

[7] We note that EMIR's dual-sided reporting regime differs from the derivatives reporting regimes of other jurisdictions (e.g., CFTC) which maintain a single-reporting regime where the legal liability for reporting lies with only one counterparty to the OTC derivative contract.

[8] An NFC- might opt to continue to do its own reporting where, for example, it has invested in building a reporting system and ongoing maintenance costs of operating such a system are not significant.

[9] See Article 9(1a) of EMIR as amended by EMIR Refit.

[10] See ESMA Questions and Answers, Implementation of the Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories (EMIR) (updated 28 May 2020) ("**ESMA Q&A**"), TR Question and Answer 54(a), available at https://www.esma.europa.eu/sites/default/files/library/esma70-1861941480-52_qa_on_emi_r_implementation.pdf.

[11] See ESMA Q&A, TR Question and Answer 54(b).

[12] Article 9(1a) of EMIR as amended by EMIR Refit provides that the NFC- would not retain the legal liability for reporting under Article 9 of EMIR when transacting with a third-country FC if the following conditions are met: (a) the third-country entity would be an FC if it were established in the EU; (b) the legal reporting regime to which the third-country FC is subject has been declared equivalent pursuant to Article 13 of EMIR; and (c) the third-country FC has reported the information pursuant to the third-country legal regime for reporting to a trade repository that has granted the entities referred to in Article 81(3) of EMIR direct and immediate access to the data.

[13] See ESMA Q&A, TR Question and Answer 54(d).

[14] See ESMA Q&A, TR Question and Answer 54(c).

Gibson Dunn's lawyers are available to assist in addressing any questions you may have regarding these developments. Please contact the Gibson Dunn lawyer with whom you usually work in the firm's Financial Institutions and Derivatives practice groups, or any of the following:

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