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EMIR REFIT ENTERS INTO FORCE ON JUNE 17, 2019 – IMPACTS AND ACTION ITEMS FOR END-USERS

To Our Clients and Friends:

On May 28, 2019, final text was published in the Official Journal of the European Union ("OJEU") for substantive amendments to the European Market Infrastructure Regulation ("EMIR")[1] relating to the clearing obligation, the suspension of the clearing obligation, the reporting requirements, the risk-mitigation techniques for uncleared OTC derivatives contracts, the registration and supervision of trade repositories, and the requirements for trade repositories ("EMIR Refit").[2] EMIR Refit becomes effective on June 17, 2019 (20 days after publication in the OJEU)[3], and most of its provisions will begin applying on that date, while others will be phased in.

Many of the changes of EMIR Refit aim to reduce compliance costs for end-user counterparties that are non-financial counterparties ("NFCs") and smaller financial counterparties ("FCs"). Some of these changes include (i) an exemption from the reporting of intragroup transactions; (ii) an exemption for small FCs from the clearing obligation, (iii) removal of the obligation and legal liability for reporting when an NFC transacts with an FC, and (iv) a determination of the NFC clearing obligation on an asset-class-by-asset-class basis. While these amendments provide relief, end-users should be keenly aware of the nuances of the text of EMIR Refit, the extent to which relief applies, the timing and steps involved in these changes and any notifications which must be filed.

In particular, with the fast-approaching June 17, 2019 implementation date for EMIR Refit, end-users should take note of two immediate action items. The first relates to an end-user's requirement to perform a new calculation to determine whether or not it exceeds the clearing threshold, while the second requires an end-user to file a notification with the relevant national competent authorities ("NCAs") in order to take advantage of an exemption for the reporting of intragroup transactions.

In this alert, we outline some of the key impacts of EMIR Refit on end-users, including the changes to the clearing threshold calculations, the intragroup exemption from reporting and the relief provided to shift responsibility of the reporting obligation from NFCs below the clearing threshold to FCs, as well as the action items resulting from these changes.[4]

I. Changes to Clearing Threshold Calculation – Immediate Action Required

EMIR Refit creates a new regime to determine when an NFC and an FC are subject to the clearing obligation. These determinations will be based on whether the position of an NFC or an FC, as applicable, exceeds the requisite clearing thresholds. In particular, the NFCs and FCs must determine whether their aggregate month-end average position for the previous 12 months across the entire group exceeds any of the thresholds for a particular asset class. If an NFC or FC does not make this calculation

by June 17, 2019, or if it exceeds the calculation, it must notify the European Securities and Markets Authority ("ESMA") and the relevant NCA immediately and such NFC or FC will become subject to the clearing obligation beginning four months following such notifications.[5] Further, NFCs and FCs that are currently subject to the clearing obligation and that remain subject to the clearing obligation under EMIR Refit must still provide notifications to ESMA and the relevant NCA.

A. Impacts on and Action Items for NFCs

Under EMIR Refit, whether an NFC is subject to the clearing obligation is separately determined for each particular asset class for which the clearing threshold is exceeded. Previously, EMIR required that if an NFC exceeded the clearing threshold in one asset class, then all of its OTC derivatives would be subject to the clearing obligation (to the extent the clearing obligation was applicable); *however*, EMIR Refit modifies this "all or nothing" requirement for NFCs. Instead, the clearing obligation under EMIR Refit is determined on an asset-class-by-asset-class basis such that an NFC may exceed the clearing threshold for one asset class and be subject to the clearing obligation for that asset class, but may not be subject to the clearing obligation for other asset classes where the NFC does not exceed the clearing threshold. If an NFC exceeds the clearing obligation in one asset class, it is nonetheless subject to margin requirements for all of its OTC derivatives transactions as the NFC exemption from margin for OTC derivatives remains an "all or nothing" determination.[6]

EMIR Refit changes the way in which the entities calculate their positions by replacing Articles 10(1) and (2) of EMIR (which provided that NFCs are required to determine whether their rolling average position over 30 working days) with new provisions that provide that NFCs may calculate, every 12 months, their aggregate month-end average OTC derivatives positions for the previous 12 months across their entire worldwide group and for each asset class.[7] NFCs would exclude from the calculation transactions that are "objectively measurable as reducing risks related to commercial activity or treasury financing activity" of the NFC or the NFC group (e.g., hedging transactions do not count towards the clearing threshold calculation) but would include intragroup transactions in the calculation.[8] This average position in each asset class must then be compared against the following clearing thresholds[9]:

Asset class	**Gross Notional Threshold**
Credit Derivatives	€1 billion
Equity Derivatives	€1 billion
Interest Rate Derivatives	€3 billion
Foreign Exchange Derivatives	€3 billion
Commodity and Other Derivatives	€3 billion

The first calculation must be performed by June 17, 2019 and once a year thereafter. As mentioned above, if an NFC does not calculate its positions it will by default become subject to the clearing

obligation in all asset classes. We note that NFCs that make the calculation and determine that they fall below the clearing threshold in all asset classes, while not required to notify ESMA or their NCA, will nonetheless be required to notify their counterparties. Indeed, ESMA recently updated its EMIR Q&A to explain that a "counterparty should obtain representations from its counterparties detailing their status" and noted that if a representation is not obtained from a counterparty it must be assumed that the counterparty is subject to the clearing obligation.[10]

Four Key Action Items for NFCs

1. Collect the necessary data and calculate OTC derivatives positions by asset class by June 17, 2019 and compare against the clearing thresholds (failure to do so will render the NFC subject to the clearing obligation and margin requirements). NFCs should make such calculation in accordance with the requirements under EMIR Refit and should maintain appropriate documentation of such calculation for audit purposes.

2. Notify ESMA and the relevant NCA (i) if the clearing threshold is breached in one or more asset classes or (ii) if no calculation is performed. In the event the notifying NFC is subject to the clearing obligation, such NFC is required to establish clearing arrangements within four months of the notification.

3. Notify counterparties of clearing status (*i.e.*, whether above or below the threshold) and make any relevant changes to existing documentation.

4. Ensure that reporting fields are consistent with any changes to the NFC's clearing requirements.

Impacts on and Action Items for Small FCs

EMIR Refit enables certain FCs with limited OTC derivatives activities to be excluded from the clearing obligation. Previously, EMIR required all FCs to comply with the relevant clearing requirements regardless of the amount of their activities such that every FC was subject to the clearing obligation. By comparison, the exclusion for FCs is much more limited than the exclusion for NFCs; unlike NFCs, FCs are required to include all OTC derivatives activities in their clearing threshold calculation, including hedging transactions, and FCs maintain the "all or nothing" calculation and do not benefit from the more nuanced asset-class-by-asset-class determination.[11] In all cases, FCs will remain subject to margin requirements on OTC derivatives.[12]

Under EMIR Refit, FCs may calculate, every 12 months, their aggregate month-end average OTC derivatives positions for the previous 12 months across their entire worldwide group and for each asset class. FCs would not exclude any OTC derivatives transactions from these calculations and would include hedging and intragroup transactions for other entities within the FC's group. This average position in each asset class must then be compared against the same clearing thresholds described above for NFCs.

Just like NFCs, FCs must make their first calculation by June 17, 2019 and then each year thereafter. Those FCs that do not make the calculation or that exceed the clearing threshold in one asset

class would be subject to the clearing obligations in all asset classes and must notify ESMA and the relevant NCA immediately. Further, even those FCs that fall below the clearing threshold will be required to notify by their counterparties of their status.

Four Key Action Items for FCs

1. Collect the necessary data and calculate OTC derivatives positions by asset class by June 17, 2019 and annually thereafter (failure to do so will render the FC subject to the clearing obligation). FCs should make such calculation in accordance with the requirements under EMIR Refit and should maintain appropriate documentation of such calculation for audit purposes.

2. Notify ESMA and relevant NCA (i) if the clearing threshold is breached in one or more asset classes or (ii) if no calculation is performed. In the event the notifying FC is subject to the clearing obligation, such FC is required to establish clearing arrangements within four months of the notification.

3. Notify counterparties of clearing status (*i.e.*, whether above or below the threshold) and make any relevant changes to existing documentation.

4. Ensure that reporting fields are consistent with any changes to the FC's clearing requirements.

II. Exemption from Intragroup Transaction Reporting – Immediate Action Required

Under the current reporting requirements in Article 9 of EMIR, all counterparties subject to EMIR are required to report their intragroup transactions (*i.e.*, inter-affiliate transactions) to a trade repository. However, effective June 17, 2019, EMIR Refit provides relief to NFCs from the requirement to report these intragroup transactions in certain circumstances. Specifically, EMIR Refit provides an exemption from the reporting of derivatives contracts "within the same group where at least one of the counterparties is [an NFC] or would be qualified as [an NFC] if it were established in the [EU]" subject to the following criteria:

1. Both counterparties are included in the same consolidation on a full basis;

2. Both counterparties are subject to appropriate centralized risk evaluation, measurement and control procedures; and

3. The parent undertaking is not an FC.[13]

While this intragroup exemption from reporting is likely to provide significant relief to NFCs (particularly the global nature of the exemption), it is important to note that the exemption is not self-executing and that notification to the relevant NCA is required. Specifically, the text requires counterparties wishing to take advantage of the exemption to "notify their competent authorities of their intention to apply the exemption."[14] The text further explains that "[t]he exemption shall be valid unless the notified competent authorities do not agree upon the fulfilment of the conditions [of such exemption] within three months of the date of notification."[15]

The language as drafted lacks some clarity as to how such notification to an NCA may be achieved in order to perfect this intragroup exemption. For example, it is not clear what form the notification must take, whether it can cover multiple entities and whether a notification for one jurisdiction on behalf of the group may be recognized in another jurisdiction. Further, while EMIR Refit creates a notification requirement and not an "approval" requirement, market participants must determine whether they seek to take advantage of the intragroup exemption upon notification to the NCA(s) or choose to wait until the three-month NCA response period lapses.

NCAs may have different views and requirements with respect to what is required of this notification, but a multinational corporation with affiliates in multiple EU countries may be required to notify the NCA of each jurisdiction in which an affiliate seeking to rely on the intragroup exemption is located. Accordingly, any counterparty seeking to take advantage of the intragroup exemption should review whether its NCA has provided guidance regarding the notification and/or reach out to its NCA to review with the applicable notification requirements for purposes of claiming the intragroup exemption.[16]

Key Action Item for NFCs

Those NFCs that wish to rely on the intragroup exemption from reporting must notify their relevant NCAs that they intend to rely on the exemption in order for such exemption to be available (following such notification(s), the intragroup exemption will apply unless the NCA responds three months to inform the NCA that it does not agree that the conditions for the intragroup exemption are met).

III. Changes to Reporting Obligation for NFCs Below the Clearing Threshold ("NFC-s")

Article 9 of EMIR currently provides a dual-sided reporting regime where all parties subject to EMIR must report the details of their OTC derivatives to a trade repository. EMIR Refit seeks to ease these reporting burdens for NFC-s by providing that FCs will be "solely responsible and legally liable" for reporting contracts concluded with an NFC- on behalf of both counterparties, as well as for ensuring the accuracy of the details so reported.[17] In other words, EMIR Refit does not create a single-sided reporting regime, but rather modifies its existing dual-sided reporting regime such that the FC will be responsible for reporting data for itself and for the NFC- where the NFC- retains no legal liability for the reporting of such data or the accuracy of the details of such data.[18] NFC-s are responsible for providing the FC that is reporting the data with the details of the contracts that the FC "cannot be reasonably expected to possess" and the NFC- will remain responsible for the accuracy of that information.[19]

EMIR Refit notably does not extend this reporting relief to OTC derivatives between an NFC- and a third-country counterparty that would be an FC if established in the EU (a "third-country FC"), unless the third-country reporting regime has been deemed equivalent and the third-country FC has reported the relevant transactions under such equivalent regime. These restrictions on third-country FCs are particularly important given that the United States has not been deemed an equivalent regime and counterparties domiciled in the United Kingdom will become third-country FCs following the United Kingdom's expected exit from the EU later this year.[20]

Additionally, EMIR Refit provides NFC-s that have already invested in a reporting system with the option to opt out of this new regime and continue to report the details of their contracts that have been executed with FCs in the same manner as they report under EMIR, rather than having the FC counterparty report on behalf of the NFC-, by informing the FC that they would like to do so.[21]

Unlike the intragroup exemption and the changes to the clearing obligation, these changes to the reporting obligation do not come into force until June 18, 2020.

Three Key Action Items for NFC-s

1. NFC-s should identify which of their counterparties are FCs in order to determine the counterparty relationships that will benefit from this relief and those where the NFC- will retain the reporting obligation (this will help to identify where delegated reporting agreements can be terminated and where they should remain in place).

2. Provide information to FC counterparties that they cannot reasonably be expected to possess (FCs will likely reach out for this information (e.g., whether a transactions is a hedging transaction)).

3. NFC-s that wish to opt out of the new reporting regime and continue to report the details of their OTC derivatives should notify their FC counterparties as soon as possible.

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

[2] Regulation (EU) No 2019/834 of the European Parliament and Council of 20 May 2019 amending Regulation (EU) No 648/2012 as regards the clearing obligation, the suspension of the clearing obligation, the reporting requirements, the risk-mitigation techniques for OTC derivatives contracts not cleared by a central counterparty, the registration and supervision of trade repositories and the requirements for trade repositories.

[3] In 2015, the European Commission conducted a comprehensive review of the EMIR to help to reduce disproportionate costs and burdens imposed by EMIR and simplify rules without putting financial stability at risk. This review included, among other things, the European Commission's Public Consultation on the Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories and their broader Call for Evidence on the European Union ("EU") regulatory framework for financial services. *See* Public Consultation on Regulation (EU) No 648/2012 on OTC Derivatives, Central Counterparties and Trade Repositories; *see also* Call for Evidence, EU Regulatory Framework for Financial Services. Following this review, on May 4, 2017, the European Commission proposed amendments to EMIR in the context of its Regulatory Fitness and Performance (Refit) program. The EU Council published its compromise text on December 11, 2017 and ECON Committee report was adopted by EU Parliament on May 16, 2018. The EU Council and EU Parliament reached political agreement on EMIR Refit on February 5, 2019. Following that, Parliament's ECON Committee

approved the text, it was approved in plenary, adopted by EU Council and ultimately signed on May 20, 2019.

[4] EMIR Refit also (i) extends the definition of "financial counterparties" to include EU alternative investment funds (AIFs) and their EU alternative investment fund managers (AIFMs); (ii) ends the frontloading requirement; (iii) ends the backloading requirement; (iv) provides power for ESMA and the European Commission to suspend the clearing and derivatives trading obligation; (v) extends the clearing exemption for risk-reducing transactions of pension schemes for two additional years with the ability to extend further; (vi) creates an obligation to provide clearing services on fair, reasonable, non-discriminatory and transparent terms (FRANDT); and (vii) requires regulators to validate risk management procedures for the exchange of collateral.

[5] *See* ESMA Public Statement, Implementation of the new EMIR Refit regime for the clearing obligation for financial and non-financial counterparties, March 28, 2019, available at https://www.esma.europa.eu/sites/default/files/library/esma70-151-2181_public_statement_on_refit_implementation_of_co_regime_for_fcs_and_nfcs.pdf.

[6] Recital (8) of EMIR Refit explains that "[NFCs] should nonetheless remain subject to the requirement to exchange collateral where any of the clearing thresholds is exceeded."

[7] Article 1(8)(a) of EMIR Refit.

[8] Article 10(1) of Commission Delegated Regulation (EU) No 149/2013.

[9] The clearing thresholds are defined under Article 11 of Commission Delegated Regulation (EU) No 149/2013.

[10] ESMA, Questions and Answers, Implementation of the Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories (EMIR), pp. 21-22 (May 28, 2019).

[11] Article 1(3) of EMIR Refit.

[12] Recital (7) of EMIR Refit explains that "small financial counterparties should be exempted from the clearing obligation, but they should remain subject to the requirement to exchange collateral to mitigate any systemic risk."

[13] Article 1(7)(a) of EMIR Refit.

[14] *Id.*

[15] *Id.*

[16] We note that some NCAs have provided guidance or forms on how notification of the reliance on the intragroup exemption should be submitted while others have not. *See, e.g.*, EMIR: FCA Notification

for an Intragroup Exemption from Reporting, available at https://www.fca.org.uk/publication/forms/emir-reporting-exemption-form.pdf.

[17] Article 1(7)(b) of EMIR Refit.

[18] While many NFC-s currently delegate the reporting responsibility to their counterparties, under EMIR delegated reporting the NFC-s retain the legal liability to report and for the accuracy of the data that is reported by the counterparties on the NFC-'s behalf.

[19] *Id.*

[20] For example, if an NFC- were to transact with an EU bank, the NFC- would no longer have a reporting obligation; however, if the NFC- were to transact with a US-based bank, the NFC- would retain the reporting obligation and delegated reporting would likely be desired.

[21] It should be noted that if an NFC- decides to opt-out of the new EMIR Refit reporting regime, it will retain the legal liability for reporting the OTC derivatives data as well as the liability for ensuring the accuracy of such data.

The following Gibson Dunn lawyers assisted in preparing this client update: Jeffrey Steiner and Erica Cushing.

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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