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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

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GLOSSARY AND LIST OF ABBREVIATIONS USED

Glossary

Central Counterparty (CCP)	A legal person that interposes itself between the counterparties to the contracts traded on one or more financial markets, becoming the buyer to every seller and the seller to every buyer.
Clearing	The process of establishing positions, including the calculation of net obligations, and ensuring that financial instruments, cash, or both, are available to secure the exposures arising from those positions.
Clearing member/direct participant	An undertaking which participates in a CCP and which is responsible for discharging the financial obligations arising from that participation.
Collateral	An asset or third-party commitment that is used by the collateral provider to secure an obligation to the collateral taker. Collateral arrangements may take different legal forms; collateral may be obtained using the method of title transfer or pledge.
Counterparty credit risk	The risk that a counterparty will not settle an obligation for full value, either when due or at any time thereafter. Credit risk includes pre-settlement risk (replacement cost risk) and settlement risk (principal risk).
Credit risk	The risk of a change in value due to actual credit losses deviating from expected credit losses due to the failure to meet contractual debt obligations. Credit risk comprises default and settlement risk. Credit risk can arise on issuers of securities (in the company's investment

	portfolio), debtors (e.g. mortgagors), or counterparties (e.g. on derivative contracts, or deposits) and intermediaries, to whom the company has an exposure.
Margin (initial/variation)	<p>An asset (or third-party commitment) that is accepted by a counterparty to ensure performance on potential obligations to it or cover market movements on unsettled transactions.</p> <p>‘Initial margin’ means margins collected by the CCP to cover potential future exposure to clearing members providing the margin and, where relevant, interoperable CCPs in the interval between the last margin collection and the liquidation of positions following a default of a clearing member or of an interoperable CCP default.</p> <p>‘Variation margin’ means margins collected or paid out to reflect current exposures resulting from actual changes in market price.</p>
Non-Financial Counterparty (NFC)	<p>An undertaking established in the European Union that is not a CCP or a financial counterparty, as defined in Article 2(9) of EMIR. The requirements of EMIR vary depending on the profile of a non-financial counterparty.</p> <p>In determining whether an NFC should be subject to the clearing obligation, EMIR gives consideration to the purpose for which that NFC uses OTC derivative contracts as well as to the size of the exposures that it has in those instruments. NFCs are subject to the clearing obligation and risk mitigation techniques requirements where their positions in non-hedging OTC derivatives exceed certain thresholds defined by ESMA.</p> <p>The thresholds are EUR 1 bn in gross notional value for credit and equity derivatives and EUR 3 bn for interest rate, foreign exchange, and commodity or other derivatives. Once an NFC surpasses one of these thresholds in any asset class, it becomes subject to these requirements across all asset classes. These NFCs are commonly referred to as 'NFC+' as opposed to NFCs below the threshold which are known as 'NFC-'.</p>
OTC	The phrase "over-the-counter" (or OTC) can be used to refer to stocks that trade via a dealer network as opposed to on a regulated market. It also refers to debt securities and other financial instruments such as derivatives, which are traded through a dealer network.
OTC derivative	A derivative contract the execution of which does not take place on a regulated market as within the meaning of Article 4(1)(14) of Directive 2004/39/EC or on a third-country

	market considered as equivalent to a regulated market in accordance with Article 19(6) of Directive 2004/39/EC.
Small Financial Counterparty	Financial counterparty as defined in Category 3 of the existing Commission Delegated Regulations ¹ on the clearing obligation. These are financial counterparties (and certain funds which are classified as non-financial counterparties) belonging to a group whose aggregate positions in OTC derivatives are EUR 8bn or below.

List of abbreviations used

CDS	Credit Default Swaps
CCP	Central Counterparty
CMU	Capital Markets Union
EMIR	'European Markets Infrastructure Regulation', short for: 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
ESA	European Supervisory Authority
ESCB	European System of Central Banks
ESMA	European Securities and Markets Authority
ESRB	European Systemic Risk Board
ETD	Exchange-Traded Derivatives
IRS	Interest Rate Swaps
ISDA	International Swaps and Derivatives Association
NFC	Non-Financial Counterparty
NFC+	A non-financial counterparty whose positions in non-hedging OTC derivatives exceed certain thresholds defined by ESMA and that therefore is subject to the clearing obligation and risk mitigation techniques requirements provided for in EMIR (cf. also Non-Financial Counterparty in the Glossary of this document).
NFC-	A non-financial counterparty whose positions in non-hedging OTC derivatives do not exceed certain thresholds defined by ESMA and that therefore is not subject to the clearing obligation and risk mitigation techniques requirements provided for in EMIR (cf. also Non-Financial Counterparty in the Glossary of this document).

¹ Commission Delegated Regulation (EU) 2015/2205 of 6 August 2015 supplementing Regulation (EU) No 648/2012, OJ L 314, 1.12.2015, p. 13; Commission Delegated Regulation (EU) 2016/592 of 1 March 2016 supplementing Regulation (EU) No 648/2012, OJ L 103, 19.4.2016, p. 5, and Commission Delegated Regulation (EU) 2016/1178 supplementing Regulation (EU) No. 648/2012, OJ L 195, 20.7.2016, p. 3.

OTC	Over The Counter
SFC	Small Financial Counterparty
SFTR	'Securities Financing Transactions Regulation', short for: Regulation (EU) 2015/2365 of the European Parliament and of the Council of 25 November 2015 on transparency of securities financing transactions and of reuse and amending Regulation (EU) No 648/2012.
SIMM	ISDA's proprietary Standard Initial Margin Model for non-cleared derivatives
TR	Trade Repository
VM	Variation Margin

1. INTRODUCTION

In the wake of the financial crisis, the EU adopted in 2012 the European Market Infrastructure Regulation² (EMIR) to address the shortcomings observed in the functioning of the over-the-counter (OTC) derivatives market.

One of the key shortcomings was that regulators lacked information about activity in the OTC derivatives market; 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 OTC transactions across the derivatives market and the interconnectedness of market participants, such losses could pose a broader threat to the financial system³.

These shortcomings led the G20 leaders in 2009 to commit to far-reaching measures to increase the stability of the OTC derivatives market, including that all standardised OTC derivatives contracts should be cleared through central counterparties (CCPs), and that OTC derivatives contracts should be reported to trade repositories (TRs).

EMIR implements the 2009 G20 commitment in the EU. The main objective of EMIR is to reduce systemic risk⁴ by increasing the transparency of the OTC derivatives market, by mitigating the counterparty credit risk and by reducing the operational risk associated with OTC derivatives. To that end, EMIR establishes core requirements on OTC derivatives, CCPs and TRs. They include:

1. Central clearing of standardised OTC derivative contracts;
2. Margin requirements for OTC derivative contracts that are not centrally cleared;

² 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.

³ Commission Staff Working Document Impact Assessment, accompanying document to the proposal for a Regulation of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories. SEC(2010) 1059, available at <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52010SC1058>.

⁴ Systemic risk is defined in Article 2(c) of Regulation (EU) No 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board as “risk of disruption in the financial system with the potential to have serious negative consequences for the internal market and the real economy. All types of financial intermediaries, markets and infrastructure may be potentially systemically important to some degree.”

3. Operational risk mitigation requirements for OTC derivative contracts that are not centrally cleared;
4. Reporting obligations for derivative contracts;
5. Requirements for CCPs; and
6. Requirements for TRs.

EMIR entered into force on 16 August 2012. However, most of the requirements did not immediately become applicable, as EMIR empowered the Commission to adopt secondary legislation specifying the technical practicalities and the phase-in schedule of the core requirements. As a result, the requirements have entered into application in different stages. Some of them, such as mandatory clearing and margin requirements for uncleared derivatives, have either only recently come into operation or will soon start to apply⁵.

In accordance with Article 85(1) of EMIR, the Commission was mandated, by August 2015, to review EMIR and to prepare a general report for submission to the European Parliament and the Council.

From May to August 2015, the Commission carried out an extensive assessment of the rules currently in place to prepare the report and a possible legislative proposal.⁶ The assessment included a public consultation⁷ with more than 170 contributions from a broad range of stakeholders, as well as reports required under Article 85(1) of EMIR from the European Securities and Markets Authority (ESMA), the European Systemic Risk Board (ESRB), and the European System of Central Banks (ESCB). In addition, it was decided to wait to take into account the input to the Call for Evidence on the EU Regulatory framework for financial services⁸ carried out between September 2015 and January 2016, in order to get further evidence on the state of play of EMIR implementation. The assessment also considered replies to this initiative, to the extent they concerned provisions in EMIR.

In November 2016, the Commission adopted the EMIR report⁹. On the one hand, the report indicated 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 risk in the derivatives market and for which there is general support from authorities and market participants. In addition, a comprehensive review of the impact of EMIR is not yet possible since certain core requirements provided for under EMIR have yet to be implemented or completed.

On the other hand, the report pointed to the possibility of amending EMIR in some specific areas so as to **eliminate disproportionate costs and burdens** on certain derivatives counterparties **and to simplify rules** without compromising the objectives of the legislation.

⁵ See Annex 2A for an overall description of the markets regulated by EMIR.

⁶ See Annex 3 for relevant timelines and procedural steps.

⁷ See Annex 4 for a detailed overview of the outcome of the public consultations.

⁸ http://ec.europa.eu/finance/consultations/2015/financial-regulatory-framework-review/index_en.htm.

⁹ 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 COM(2016) 857 final of 23.11.2016. <http://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1480141638729&uri=COM:2016:857:FIN>

The need to eliminate disproportionate costs and burdens to small companies, and to simplify rules without putting financial stability at risk is why the EMIR review was included in the 2016 Commission's Regulatory Fitness and Performance programme (REFIT).¹⁰

As part of REFIT, the Commission assessed the extent to which specific policy requirements in EMIR have met their objectives in an efficient and effective way, while at the same time being coherent, relevant and providing EU added-value. That evaluation fed into the problem definition of the impact assessment and is presented in Annex 5. The evaluation indicates that, even though the impact on the reduction of systemic risk is not yet fully measurable, **EMIR may impose in some targeted areas disproportionate costs and burdens and that certain requirements may be simplified to achieve the objective of financial stability more efficiently.** These areas include: (1) Disproportionate compliance costs for derivatives counterparties that are part of the periphery of the derivatives trading network (e.g. small financials, NFCs, pension funds); (2) Insufficient transparency; and (3) Access to clearing.

This impact assessment report therefore considers the costs and benefits of areas of EMIR where targeted action could ensure fulfilment of the EMIR objectives in a more proportionate, efficient and effective manner.

This impact assessment provides **comprehensive evidence that a reduction of costs and burdens can be achieved hand-in-hand with a simplification of EMIR, without compromising financial stability.** Such evidence includes input received from market participants and various authorities. The feedback that is not addressed in this report will be examined further and considered separately for future action.

2. BACKGROUND AND POLICY CONTEXT

2.1. The over-the-counter (OTC) derivatives market

The European market infrastructure regulation (EMIR) establishes rules on OTC derivatives, central counterparties and trade repositories. The section below provides a definition of each concept.

A derivative is a financial contract linked to the fluctuation in the price of an underlying asset or a basket of assets. Examples of assets on which a derivative contract can be written include equities, commodities or emission allowances. The value of a derivative can also be derived from the value of a market variable (e.g. an interest rate, an exchange rate or a stock index)¹¹.

The purpose of derivatives is to redistribute risk amongst the counterparties to the contract. Derivatives can be used for insuring against risk (hedging) as well as for speculative purposes.

¹⁰ See European Commission, REFIT and the 10 Priorities of the Commission, 25 October 2016. http://ec.europa.eu/atwork/pdf/201621025_refit_scoreboard_summary_en.pdf.

¹¹ See European Commission, "Derivatives Markets", FAQs (<http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/09/314&format=HTML&aged=0&language=EN&guiLanguage=en>).

An OTC derivative is one which is privately negotiated and not traded on a regulated exchange such as regulated markets.

Activities in the area of OTC derivatives are in the trillions. As of end-June 2016, the outstanding notional¹² of OTC derivatives amounted to USD 544.1 trillion, corresponding to 89% of the overall derivatives market¹³. OTC derivatives therefore have a significant impact on the real economy, from mortgages to food prices.

Central counterparties (CCPs) interpose themselves between counterparties to a derivative contract, becoming the buyer to every seller and the seller to every buyer. In doing so, CCPs become the focal point for derivative transactions, linking multiple financial actors, thus increasing market transparency and reducing the risks inherent in derivatives market. Such risks include counterparty risk, liquidity risk and market risk.

Every day CCPs clear thousands of financial transactions in a range of financial instruments including equities, bonds, commodities, derivatives, repos. Before the financial crisis, derivatives traded outside regulated markets were usually not cleared through CCPs.

Trade repositories (TRs) are central data centres that collect and maintain the records of derivative transactions. They play a key role in enhancing the transparency of derivative markets and reducing risks to financial stability.

An overview of the main participants and of the structure of the OTC derivatives market is provided in Annex 2A.

2.2. The G20 reforms of the OTC derivatives market

Derivatives play an important role in the economy, but they also bring certain risks. These risks were highlighted during the 2008 financial crisis, when significant weaknesses in the OTC derivatives markets became evident.

In the run-up to the financial crisis, the use of OTC derivatives had experienced a sharp growth. According to BIS data, notional amounts of all types of OTC contracts stood at USD 683.7 trillion at the end of June 2008, 15% higher than at the end of December 2007¹⁴. The near collapse of Bear Sterns in March 2008, the default of Lehman Brothers on 15 September 2008 and the bail-out of AIG the following day highlighted the shortcomings in the functioning of the OTC derivatives market.

The financial crisis brought the OTC derivatives market to the forefront of regulatory attention. Given the global nature of the OTC derivatives market, the G20 took a leading role in seeking to tackle the shortcomings of that market and in coordinating a policy response. In September 2009 in Pittsburgh, the G20 leaders agreed that "*All standardised*

¹² Notional amounts provide measure of market size and a reference from which contractual payments are determined in derivatives markets.

¹³ See Bank for International Settlements, Triennial Central Bank Survey - OTC derivatives positions at end-June 2016, Table 1, Monetary and Economic Department, 11 December 2016, http://www.bis.org/publ/otc_hy1612/triensurvstatannex.pdf

¹⁴ C.f. Commission Staff Working Document, Impact assessment {SEC(2010) 1059}, http://ec.europa.eu/finance/financial-markets/docs/derivatives/20100915_impact_assessment_en.pdf; BIS: Monetary and Economic Department, OTC derivatives market activity in the first half of 2008, November 2008, http://www.bis.org/publ/otc_hy0811.pdf.

OTC derivatives contracts should be [...] 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 requirements¹⁵.

At European level, EMIR, together with other pieces of EU legislation, implemented the G20's non-binding commitment to increase the stability of the OTC derivatives market. Similar initiatives were undertaken across G20 jurisdictions, such as in certain Asian countries (Hong Kong, Japan, Singapore and South Korea), and in the US via the Dodd-Frank Wall Street Reform and Consumer Protection Act, which was signed into law in July 2010. Today, many derivatives regulators across the globe have transposed this commitment into their legislative frameworks.

2.3. Several international work streams help coordinate the G20 derivatives market reforms under the framework EMIR – the EU rules on OTC derivatives

In response to the financial crisis, the EU adopted EMIR in 2012. Its aims were to (i) increase transparency in the OTC derivatives markets (ii) mitigate counterparty credit risk, and (iii) reduce operational risk.

EMIR establishes core requirements for the OTC derivatives market. In addition to these, EMIR empowered the Commission to adopt delegated acts in accordance with Article 290 of the Treaty on the Functioning of the European Union to spell out the details of some requirements. EMIR also required the European Securities and Markets Authority (ESMA) to draft regulatory technical standards for these delegated acts and carry out appropriate impact assessments.

Therefore, while EMIR entered into force in August 2012, not all of the requirements it sets out already apply. The provisions of EMIR, together with the deadlines included within the different technical standards, imply a phased-in application of the legal framework.

The section below provides an overview of EMIR's main requirements, including their scope and date of entry into application.

2.3.1. Reporting obligations and requirements for TRs

In order to increase transparency, EMIR introduces reporting requirements to make the derivatives market more transparent. The requirements include the following:

- detailed information on each derivative contract has to be reported to trade repositories (TRs) and made available to supervisory authorities;
- TRs have to publish aggregate positions by class of derivatives, for both OTC and listed derivatives; and
- ESMA is responsible for the surveillance of TRs and for granting and withdrawing accreditation.

¹⁵ <http://www.g20.utoronto.ca/2009/2009communique0925.html>

Today, there are six authorised TRs in the EU¹⁶. These TRs provide daily data to over 60 institutions in the EU, which have access to the data pertaining to their respective jurisdiction¹⁷. EMIR grants ESMA and the European Systemic Risk Board (ESRB) with exclusive access to the full EU-wide data.

The scope of the reporting requirement is broad. It applies to all derivatives classes (including credit, commodity, equity, interest rates, foreign exchange and "other") and encompasses trades cleared by CCPs. Both OTC and exchange-traded contracts are covered. Furthermore, the reporting obligation applies to all counterparties. The reporting obligation aims to provide a full picture of the EU derivatives market in order to provide complete and comprehensive information on OTC derivatives positions. The reporting requirement became applicable in February 2014.

2.3.2. Central clearing of standardised OTC derivatives and CCP requirements

EMIR introduced rules to reduce the counterparty credit risk of derivatives contracts. In particular:

- all standardised OTC derivatives contracts must be centrally cleared through CCPs;
- CCPs must comply with stringent prudential, organisational and conduct of business requirements in order to adequately cover their exposures to diverse risks. EMIR also ensures that CCPs are subject to robust supervisory oversight.
- if a contract is not cleared by a CCP, risk mitigation techniques must be applied.

There are currently 17 CCPs that have been authorised to offer services and activities in the Union¹⁸.

The scope of the clearing obligation is far-reaching and includes all financial counterparties¹⁹ and the biggest non-financial counterparties (NFCs). This is because EMIR intends to cover all relevant market participants in order to cover all risks linked to derivatives transactions.

EMIR does however only aim at 'systemic' NFCs: it acknowledges that NFCs use OTC derivative contracts in order to cover themselves against, i.e. hedge, commercial risks directly linked to their commercial or treasury financing activities. NFCs are subject to the clearing obligation where their positions in non-hedging OTC derivatives exceed

¹⁶ Annex 2A provides a list

¹⁷ ESCB, [Occasional Paper Series No11/ September 2016](#), Shedding light on dark markets: First insights from the new EU-wide OTC derivatives dataset.

¹⁸ ESMA, in accordance with Article 88(1) of EMIR, publishes [a list](#) of the CCPs that are authorised to offer services and activities in the Union.

¹⁹ Article 2(8) of EMIR provides a definition of financial counterparty. It refers to an investment firm authorised in accordance with Directive 2004/39/EC, a credit institution authorised in accordance with Directive 2006/48/EC, an insurance undertaking authorised in accordance with Directive 73/239/EEC, an assurance undertaking authorised in accordance with Directive 2002/83/EC, a reinsurance undertaking authorised in accordance with Directive 2005/68/EC, a UCITS and, where relevant, its management company, authorised in accordance with Directive 2009/65/EC, an institution for occupational retirement provision within the meaning of Article 6(a) of Directive 2003/41/EC and an alternative investment fund managed by AIFMs authorised or registered in accordance with Directive 2011/61/EU.

certain thresholds defined in regulatory technical standards²⁰. Once an NFC surpasses one of these thresholds in any asset class, it becomes subject to the clearing obligation across all asset classes. These NFCs are commonly referred to as 'NFC+' as opposed to NFCs below the threshold which are known as 'NFC-'.

The EU has adopted three central clearing determinations, on the basis of draft regulatory technical standards drafted by ESMA, following analysis carried out according to criteria set out in EMIR. The determinations cover two different asset classes: OTC interest rate derivatives – which represent by far the largest segment of OTC outstanding derivatives (80% of global outstanding derivatives)²¹, and OTC credit derivatives (representing 2.2% of global outstanding derivatives)²². Annex 5 provides further details.

Today, the central clearing determination covering OTC interest rate swaps (IRS) related to the Euro, the USD, the Yen, and the British Pound has started to apply to clearing members (as of 21 June 2016) and financial counterparties above the EUR 8 billion threshold (as of 21 December 2016). For other IRS in European currencies (Norwegian Krone, Polish Zloty, and Swedish Krona) and Credit Default Swaps (CDS), the application has started phasing-in as of February 2017 for clearing members. The detailed compliance deadlines for the central clearing determination applying to various asset classes and to different types of counterparties are summarised in Annex 2A.

2.3.3. Risk-mitigation techniques for uncleared OTC derivative contracts

Risk-mitigation techniques (RMT) refer to mechanisms that aim to reduce counterparty credit risk for uncleared OTC derivative transactions, i.e. transactions that are not cleared through a CCP, but traded bilaterally. RMT can include operational obligations on the procedures applying to bilateral transactions (e.g. timely confirmation of a trade, portfolio compression, portfolio reconciliation, and daily valuation). RMT can also refer to requirements that counterparties exchange collateral (margins) when entering into a bilateral transaction in order to protect counterparties from the risk of a potential default of the other counterparty.

Rules on risk-mitigation techniques for OTC derivative contracts not cleared by a CCP started to phase-in in 2013. All uncleared derivatives are subject to requirements on timely confirmation, portfolio reconciliation, portfolio compression, dispute resolution and daily valuation requirements (above a certain portfolio size threshold). The requirements are in line with international standards developed by the International Organization of Securities Commissions (IOSCO), prepared in consultation with the Basel Committee on Banking Supervision (BCBS) and the Committee on Payments and Market Infrastructures (CPMI) and finalised in January 2015²³.

In addition to operational risk-mitigation techniques, the Commission adopted new regulatory technical standards on margin requirements²⁴ in October 2016 to further mitigate risk in bilateral clearing and strengthen the incentive to move to central clearing,

²⁰ The thresholds are EUR 1 bn in gross notional value for credit and equity derivatives and EUR 3 billion for interest rate, foreign exchange, and commodity or other derivatives.

²¹ [OTC derivatives statistics at end-June 2016](#), Statistical release, BIS, November 2016, p. 5.

²² [OTC derivatives statistics at end-June 2016](#), Statistical release, BIS, November 2016.

²³ IOSCO (2015), Risk Mitigation Standards for Non-centrally Cleared OTC Derivatives, January.

²⁴ [Commission Delegated Regulation \(EU\) 2016/2251 of 4 October 2016](#), OJ L 340, 15.12.2016, p. 9–46.

based on criteria set out in EMIR. These requirements follow international standards developed by the BCBS and IOSCO.

The scope of the margin requirements reflects the one of the clearing obligation and applies to all financial counterparties and 'NFC+'. The margin rules require them to exchange two types of collateral in the form of margins. The first type is variation margin (VM), which is exchanged on a frequent basis and protects counterparties against exposures related to the current market value of their OTC derivative contracts. The second type is initial margin (IM), which is posted at the initiation of a transaction to cover future exposures that could arise from losses on the counterparty's position after it has defaulted. The initial margin requirement applies to financial counterparties and NFC+ above a threshold of EUR 8bn in gross notional amounts of outstanding contracts.

The entry into application of the requirements follows a phase-in schedule, starting on 4 February 2017 for clearing members and as of 1 March 2017 for other counterparties.

2.3.4. Cross-border arrangements

In light of the global nature of the OTC derivatives market, the FSB encourages jurisdictions that have implemented the G20 commitments to provide some capacity to defer in some way to other jurisdictions. This aims to promote safer cross-border OTC derivative transactions and to avoid regulatory arbitrage.

EMIR provides a mechanism for recognising CCPs and trade repositories based outside of the EU. Once recognised, EU and non-EU counterparties may use a non EU-based CCP to meet their clearing obligations and a non EU-based trade repository to report their transactions to. EMIR also empowers the Commission to adopt equivalence decisions for other areas of EMIR, such as reporting, margins for uncleared derivatives and risk mitigation techniques.

2.4. EMIR and the implementation of the G20 OTC derivatives reforms

The FSB regularly monitors the implementation in its 24 member jurisdictions of the OTC derivatives reforms agreed by the G20 in 2009.

In its latest progress report published in August 2016²⁵, the FSB highlights that, as of end-June 2016, the EU had implemented all of the G20 OTC derivatives reforms, except margin requirements for non-centrally cleared derivatives. Since the publication of the FSB progress report however, the EU adopted on 4 October 2016 regulatory standards on margin requirements for uncleared derivatives. This means that the EU has completed the implementation of the G20 OTC derivatives reforms with regard to trade reporting, central clearing and margin requirements.

The FSB is currently focussing on assessing the effects of the OTC derivatives reforms in its 24 member jurisdictions. It is preparing a comprehensive review of the reforms that will feed into the 3rd annual report to the Leaders of the G20, ahead of the G20 summit scheduled for July 2017 in Hamburg under the aegis of the German Presidency.

²⁵ FSB OTC Derivatives Market Reforms - 11th progress report, August 2016. <http://www.fsb.org/wp-content/uploads/OTC-Derivatives-Market-Reforms-Eleventh-Progress-Report.pdf>

In the EU, several authorities have issued publications assessing the progress in delivering on the objectives of EMIR. The ECB published an article in December 2016 concluding that, while gaps remain, *'considerable progress has been made in making OTC derivatives markets more transparent and resilient'*²⁶. The ESRB published a research paper in September 2016 on *'Shedding light on dark markets: First insights from the new EU-wide OTC derivatives dataset'*²⁷, focusing on EMIR's objective to increase transparency in the OTC derivatives market. The paper notes that, *'since the advent of the EMIR reporting obligation in February 2014, data quality has significantly improved'*.

The evaluation presented in Annex 5 concludes that, following the implementation of the core requirements of EMIR, the volume of reported trades has increased. In particular, a substantial share of new OTC derivative transactions (80–100% of new transactions in all asset classes) is estimated to be covered by reporting requirements.

In addition, the evaluation highlights that a substantial share of OTC derivatives is now centrally cleared. As of end-June 2016, on average 62% of the \$544 trillion in outstanding notional amounts reported by dealers was centrally cleared by CCPs across all types of derivative contracts²⁸. In terms of notional amounts, without adjusting for double counting arising from novation, BIS estimated that the volume of cleared OTC transactions at the end of June 2016 totalled USD 337.28 trillion, of which USD 328.5 trillion was attributable to interest rate derivatives and USD 4 trillion to credit OTC derivatives.

2.5. Consistency with other EU policies

²⁹³⁰³¹³² The Commission's proposal for a framework for the recovery and resolution of CCPs³³ aims to ensure that, in the unlikely scenario where CCPs face severe distress or failure, the critical functions of CCPs are preserved while maintaining financial stability and helping to avoid that costs associated with the restructuring and the resolution of failing CCPs fall on taxpayers. The Commission's proposal on the amendment of the CRR³⁴

²⁶ 'Looking back at OTC derivative reforms – objectives, progress and gaps', ECB, 20 December 2016, p. 22.

²⁷ European Systemic Risk Board, Occasional Paper Series No11/September 2016

²⁸ BIS, Statistical release, [OTC derivatives statistics at end-June 2016](#), November 2016.

²⁹ Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU, (OJ L 173, 12.6.2014, p. 349)

³⁰ Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012, (OJ L 173, 12.6.2014, p. 84)

³¹ Proposal for a Regulation of the European Parliament and of the Council on a framework for the recovery and resolution of central counterparties and amending Regulations (EU) No 1095/2010, (EU) No 648/2012, and (EU) 2015/2365, COM(2016) 856 final

³² 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

³³ COM(2016) 856 final.

³⁴ Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 575/2013 as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements and amending Regulation (EU) No 648/2012.

EMIR is also related to the ongoing efforts to establish Capital Markets Union ('CMU'). Efficient and resilient post-trading systems and collateral markets are essential elements for the well-functioning of CMU. Therefore, effective and efficient EMIR rules contribute to achieving the objectives of CMU and of the Jobs and Growth agenda in line with the political priorities of the Commission.

The impact assessment has considered the implications of targeted amendments to specific EMIR rules on these pieces of EU legislation and on the broader Commission's political priorities. Likewise, the impact assessment takes into account, to the extent possible, the expected impact of the Commission's proposals on CCP recovery and Resolution and on the amendment of the CRR on EMIR, as part of a holistic approach.

3. PROBLEM DEFINITION

This section outlines why the scope of the problems identified in the impact assessment is limited, identifies limitations when defining the magnitude of the problems, and explains how the problems have been selected and why targeted action is necessary.

The problems identified in this section draw on the outcome of the evaluation carried out in Annex 5. Those problems include: (1) Disproportionate compliance costs; (2) Insufficient transparency; and (3) Access to clearing.

3.1. Methodology

3.1.1. Selection of relevant issues for the definition of the problems

The main problems and shortcomings assessed in this impact assessment concern areas where the evaluation carried out in Annex 5, as well as input received from various authorities and stakeholders as presented in the EMIR report of November 2016, indicate that targeted action is necessary to ensure fulfilment of the EMIR objectives in a more proportionate, efficient and effective manner.

More specifically, the impact assessment considers the costs and benefits of targeted amendments of specific EMIR rules, including those applying to central clearing and to reporting. While the definition of the problems is targeted, the impact assessment considers the cumulative impact of targeted changes as presented in section 5.

The key element to consider is that, while the implementation of EMIR can now be considered as complete by FSB standards, the application of EMIR remains work in progress five years after its adoption. Certain core EMIR requirements (including clearing obligations and bilateral margin requirements) are yet to enter into application. This has a number of consequences on the availability of data on the costs and benefits of EMIR requirements.

First, while it is not possible to consider the impact of EMIR in its entirety, feedback from stakeholders and public authorities collected during the 2015-2016 public consultations, the evaluation of EMIR in Annex 5, and international monitoring of the G20 OTC derivatives market reforms all indicate that EMIR has positively contributed to promote transparency in derivatives market and mitigate systemic risk through its core requirements. Therefore, 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 market.

Second, the recent application of certain requirements and the absence of failure in the application of the relevant international standards caution against the introduction of significant changes to EMIR. This explains why a number of issues raised by public authorities and stakeholders (see Annex 4 for more detail) are not covered in this impact assessment. For instance, assessing the need to define greater intervention capacity in the area of margin efficiency to limit procyclicality would be premature in light of the recent application of existing margin and anti-procyclicality requirements³⁵ and the lack of evidence concerning any failure in margin rules being at the level of central clearing or bilateral margining³⁶. Other issues raised by stakeholders and authorities, such as the functioning of the supervisory framework for CCPs or cross-border activity, require to be further examined by European authorities at horizontal level as the overall EU financial services supervisory infrastructure and the third-country framework is based on an horizontal Union approach.

Third, under the REFIT framework, priority has been given to issues where targeted action could help alleviate existing burdens without compromising EMIR's objective to increase financial stability. For instance, the recalibration of reporting requirements applying to certain entities could lead to a reduction of compliance costs, while the simplification of reporting requirements could help increase the transparency of the OTC derivatives market more efficiently, without putting financial stability at risk. Priority is also given to requirements where targeted amendments could help either pre-empt significant burdens for specific counterparties or avoid the build-in of risks for financial stability. This concerns the impact that the central clearing obligation for PSAs, due to apply in August 2018, could have on the revenue income of policy holders and on market liquidity. This also includes the expected burdens from the upcoming application of the clearing obligation to NFCs and small financials, as well as the deadline for backloading historic trades which expire in February 2019, according to the recently adopted revised implementing technical standard on trade reporting³⁷.

3.1.2. Limitations when defining the magnitude of the problems

It is important to bear in mind the following limitations when defining the magnitude of the problems.

First, the phased-in application of EMIR core requirements means that there is only a limited amount of evidence available on the impact of the application of the rules. For example, in the specific instance of margin requirements, there is no data available, as margins rules have only recently started to phase-in since February 2017.

Second, while the Commission has received qualitative input and anecdotal evidence from market participants and stakeholders on the impact, as well as the expected impact,

³⁵ See ESRB [Report on the efficiency of margining requirements to limit pro-cyclicality](#) and the need to define additional intervention capacity in this area, July 2015, and [ESMA's EMIR Review Report no.2 - Review on the efficiency of margining requirements to limit procyclicality](#).

³⁶ For further reading on a related topic, see ESRB report on [the macroprudential use of margins and haircuts](#), February 2017.

³⁷ Commission Delegated Regulation (EU) of 19.10.2016, C(2016) 6624 final, and Commission Implementing Regulation (EU) of 26.10.2016, C(2016) 6801 final.

of core EMIR requirements, limited quantitative data is available to measure costs for market participants (such as the IT costs associated with the EMIR reporting requirements). This is for a number of reasons, including because: (i) EMIR was the first regulation seeking to increase transparency in the OTC derivatives market, (ii) the market for OTC derivatives is global and highly interconnected, limiting the relevance of EU-focused data, and (iii) there are concerns with regards to the quality and the usability of the data collected via the EMIR reporting requirement, which this impact assessment considers. Addressing the identified reporting issues will help to improve the availability and quality of data, which can then be used for monitoring the future impact of EMIR.

Third, it is difficult to quantify financial stability as there is still no agreed model for measuring the concept. The assessment of the extent to which specific EMIR requirements have reduced systemic risk raises methodological challenges. These come on top of the data issues mentioned before. The nature of EMIR data requires new tools and innovation in the field of network analysis, statistical physics and certain mathematical concepts. How to assess systemic risk using transaction-based reporting data is an active and open field of research.

With these limitations in mind, the definition of the magnitude of the problem draws on the data collected by ESMA, ESRB, ESCB, responses to the public consultations, where stakeholders and authorities have provided evidence regarding the problems at stake, and targeted market intelligence. It also draws on data relating to other EU measures that establish similar requirements to EMIR. For example, based on preliminary, non-public findings in the Commission project on financial data standardisation³⁸, it seems that the EMIR reporting requirements may be at least as burdensome³⁹ as reporting requirements under CRR/CRD IV. In relation to the latter, the Commission has assessed the proportionality of the reporting burden in a 2009 study and found that smaller reporting entities are strongly disproportionately impacted by compliance cost related to reporting obligations.

Where there is no data available at EU level, the impact assessment draws on evidence provided by the Financial Stability Board (FSB) and the Bank of International Settlements (BIS) stemming from the monitoring of the G20 reforms of the OTC derivatives reform. While such evidence is useful because of the global nature of the OTC derivatives market and the comparability of certain rules in other jurisdictions, it should, however, be noted that the participant scope of mandatory central clearing requirements in EMIR is farther-reaching than in the legal and regulatory frameworks adopted in other jurisdictions.⁴⁰

³⁸ See Communication from the Commission on the Call for Evidence - EU regulatory framework for financial services, COM/2016/0855 of 23.11.2016, and the related Staff Working Document.

<http://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1481281099294&uri=CELEX:52016DC0855>

³⁹ EMIR, if anything, exhibits a similar, or stronger, non-linear cost structure with respect to the size of the reporting entity.

⁴⁰ C.f. FSB, *OTC Derivatives Market Reforms - Eleventh Progress Report on Implementation*, 26 August 2016, Appendix I, <http://www.fsb.org/wp-content/uploads/OTC-Derivatives-Market-Reforms-Eleventh-Progress-Report.pdf>.

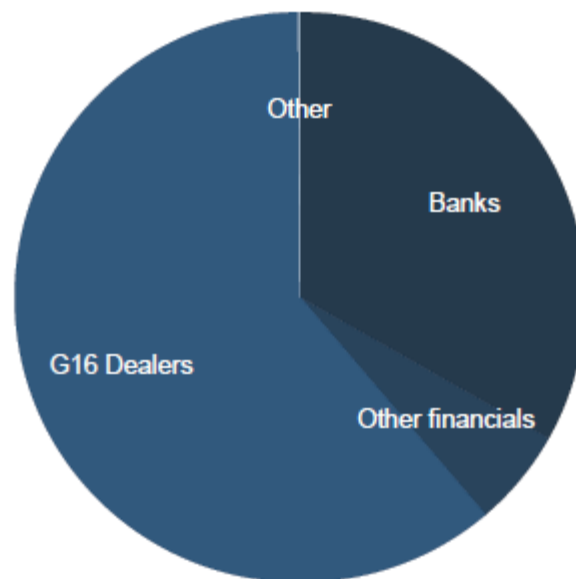
3.1.3. The relevance of the network structure when defining the magnitude of the problems

When defining the magnitude of the problems, it is also necessary to consider the relative systemic risk profile of the counterparties covered by EMIR. Two aspects can help in that process: i) the size of the portfolio of OTC derivatives entered into by a counterparty and ii) the degree of 'interconnectedness' of a counterparty with other counterparties. On the second point, it is useful to take into account the network structure of the OTC derivatives market because there are some indications that market participants at the periphery of the market seem to present a relatively lower systemic risk for financial stability.

Figure 1 below provides a sense of the relative share of various market participants in cleared OTC derivative contracts, on the basis of an analysis carried out by the ESRB. It highlights that 'G16 dealers'⁴¹, which include mainly clearing members, represent a substantial share of this market, followed by banks. By comparison, other financials as well as non-financial counterparties, represent a smaller share.

⁴¹ This chart includes only trades which are centrally cleared. The group of G16 dealers includes Bank of America, Barclays, BNP Paribas, Citigroup, Crédit Agricole, Credit Suisse, Deutsche Bank, Goldman Sachs, HSBC, JPMorgan Chase, Morgan Stanley, Nomura, Royal Bank of Scotland, Société Générale, UBS, and Wells Fargo.

Figure 1 – Share of total notional of centrally cleared contracts by type of market participant (DTCC OTC interest rate derivatives dataset, based on the 02/11/15 trade state report)

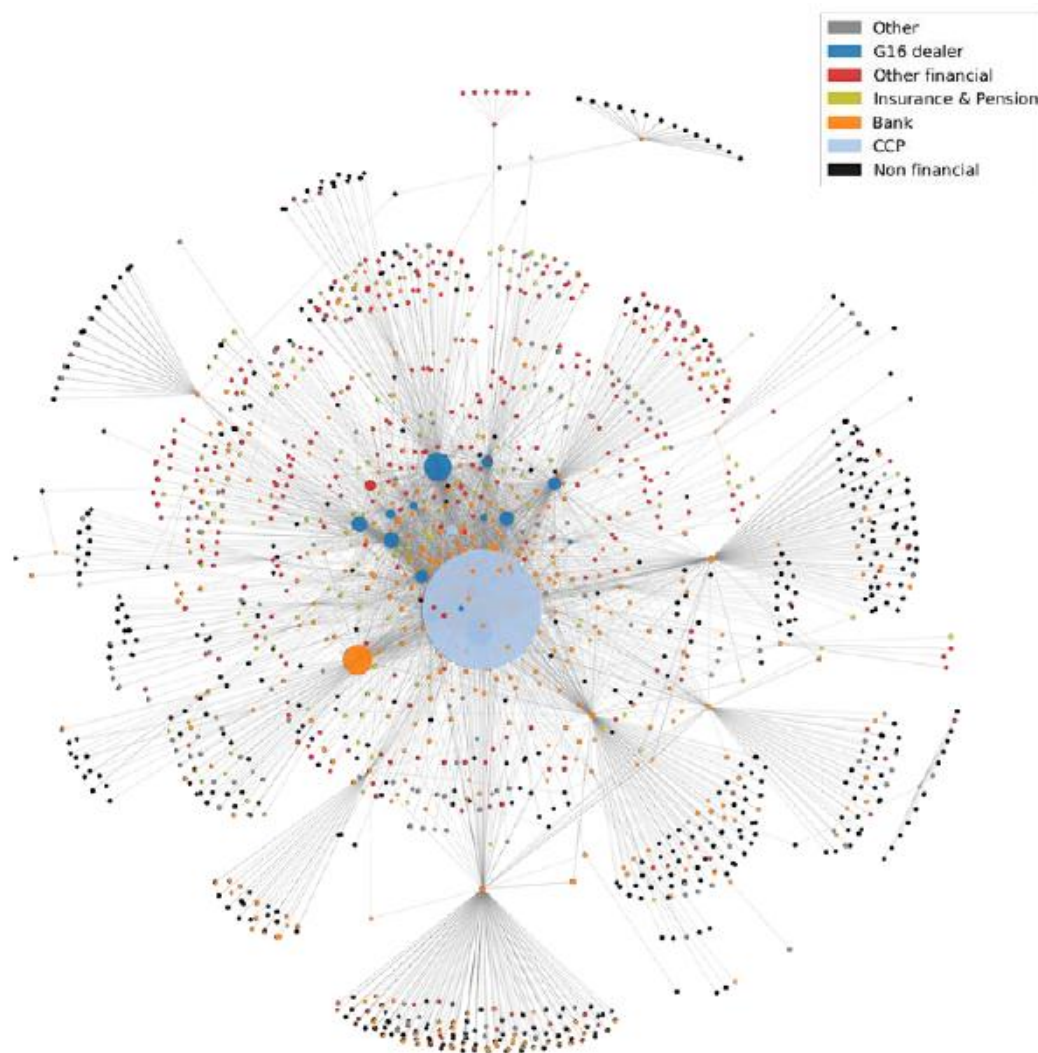


Source: European Systemic Risk Board, Occasional Paper Series No11/September 2016

The ESRB has also illustrated in a recent paper published in September 2016 the network structure of the market through the visualisation of the outstanding bilateral IRS positions. This provides a sense of “who trades with whom” and of the degree of interconnectedness between market participants active in the IRS market.

Figure 2 below illustrates that CCPs, clearing members (referred to as G16 dealers), and banks, which appear in the core of the chart, are connected to a large number of counterparties, with many connections between them, suggesting a high degree of systemic risk. By contrast, counterparties in the periphery, including NFCs and other financials, tend to be connected to only one intermediary, suggesting limited systemic risk.

Figure 2 Network of gross notional links between counterparties in a subset of the interest rate swap (IRS) market



Source: Jorge Abad, Jorge Abad, Iñaki Aldasoro, Christoph Aymanns, Marco D’Errico, Linda Fache Rousová, Peter Hoffmann, Sam Langfield, Martin Neychev, Tarik Roukny, Shedding light on dark markets: First insights from the new EU-wide OTC derivatives dataset, ESRB, Occasional Paper Series No 11, September 2016, p. 18.

3.2. Disproportionate prudential and transparency requirements

Stakeholders have highlighted a number of cases where the rules set out in EMIR may impose compliance costs on certain market participants that outweigh prudential benefits. These concern: (i) the scope of entities subject to the requirements set out in EMIR; and (ii) the scope of transactions covered by reporting requirements..

3.2.1. Mandatory clearing and risk-mitigation techniques

This section assesses the application of the mandatory clearing and margin requirements to the following counterparties: (1) Pension Scheme Arrangements; (2) Non-Financial

Counterparties (NFCs); and (3) small financials, hereafter referred to as Small Financial Counterparties (SFCs).

Table 1 below provides a summary of the scope of the clearing and bilateral margin requirements in EMIR, as described in section 2:

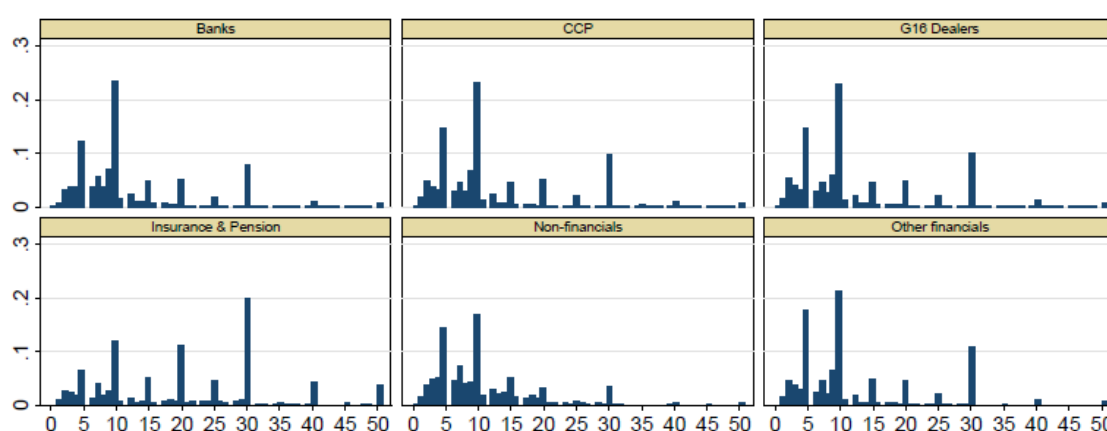
Table 1: Scope of EMIR clearing and margin requirements

	FC (including SFCs)	PSAs	NFC+	NFCs-
Clearing obligation	Yes	Transitional exemption	Yes	No
Operational risk- mitigation techniques for uncleared OTC derivatives	Yes	Yes	Yes	Yes (except daily valuation)
Variation Margin requirements	Yes	Yes	Yes	No
Initial Margin requirements (when OTC derivatives uncleared activities are above EUR 8bn in gross notional outstanding amounts)	Yes	Yes	Yes	No
Reporting of all derivative contracts	Yes (including backloading, ETDs, IGTs and double- sided reporting)	Yes (including backloading, ETDs, IGTs and double- sided reporting)	Yes (including backloading, ETDs, IGTs and double- sided reporting)	Yes (including backloading, ETDs, IGTs and double- sided reporting)

3.2.1.1. Pension Scheme Arrangements ('PSAs')

Pension Scheme Arrangements⁴² typically enter into derivative transactions to protect their long-term liabilities to current and future pensioners against complex market risks (including interest rate and inflation volatility). PSAs therefore tend to have a preference for derivatives with longer maturities than other counterparties. Figure 3 below illustrates that PSAs, together with insurers, are disproportionately extensive users of Interest Rate Derivatives (IRS) with original maturities of 20, 40 and 50 years. Indeed, about 20% of IRSs with at least one counterparty as an insurer or pension fund have a maturity of 30 years, compared with a global average of less than 10%⁴³. This also reflects the specific mandates governing the investment management and risk taking of PSAs, as compared to other financial counterparties.

Figure 3. Frequency distribution of original maturity across counterparty type⁴⁴
(DTCC OTC interest rate derivatives dataset based on the 02/11/15 trade state report)



Source: European Systemic Risk Board, *Occasional Paper Series No11/September 2016*

As significant users of derivatives, PSAs are subject to several EMIR requirements that aim to mitigate related systemic risks, including the obligation to report trades and to mitigate counterparty risk in non-centrally cleared OTC derivatives.

However, EMIR recognises that PSAs have *structural* difficulties in clearing OTC derivatives through CCPs, as CCPs tend to accept only cash collateral for variation margin (VM), which allows for a rapid liquidation in the event of a default. The results of the latest available Margin Survey of the International Swaps and Derivatives

⁴² PSAs are defined in Article 2(10) of EMIR as: "Institutions for occupational retirement provision under Article 6(a) of Directive 2003/41/EC; Occupational retirement provision businesses as defined under Article 3 of Directive 2003/41/EC; Occupational retirement provision businesses of life insurers covered by Directive 2002/83/EC; and Any other authorised and supervised entity operating nationally whose main objective is to provide retirement benefits".

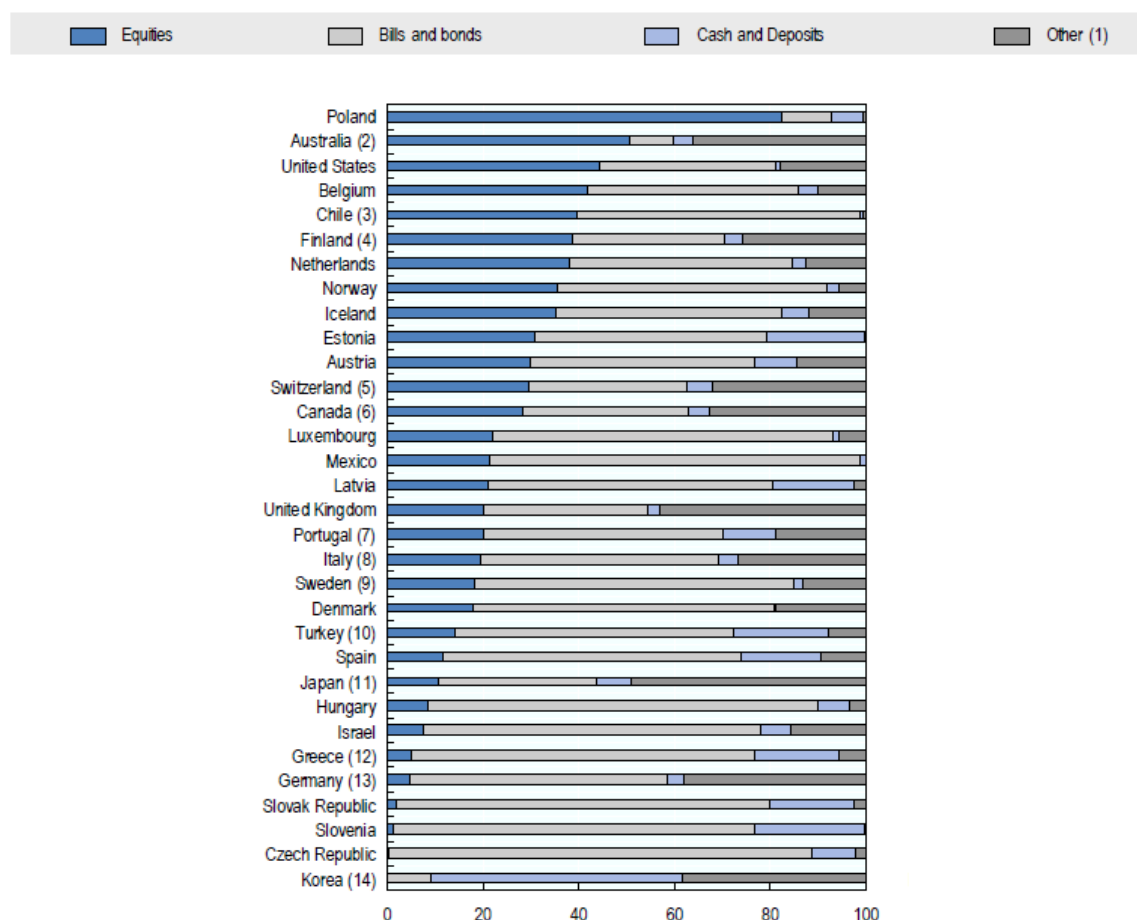
⁴³ ESRB, [Occasional Paper Series No11/ September 2016](#), Shedding light on dark markets: First insights from the new EU-wide OTC derivatives dataset, p. 14. The group of G16 dealers includes Bank of America, Barclays, BNP Paribas, Citigroup, Crédit Agricole, Credit Suisse, Deutsche Bank, Goldman Sachs, HSBC, JPMorgan Chase, Morgan Stanley, Nomura, Royal Bank of Scotland, Société Générale, UBS, and Wells Fargo.

⁴⁴ The horizontal axis represents maturities, while the vertical axis represents the proportion of IRSs involving at least one of the counterparties considered in each of the charts (e.g. insurance and pension funds).

Association ('ISDA')⁴⁵ highlights the dominance of cash, which accounts for 99.4% of the amount delivered to meet variation margin against cleared derivative transactions in House Trades and 100% in client clearing (as of December 2014).

PSAs generally hold limited amounts of cash, as they invest in higher yielding assets to enhance returns for pensioners. PSAs mainly hold cash for the purpose of provisioning for cash-flows within the schemes themselves (see Figure 4).

Figure 4. Pension fund asset allocation in selected OECD countries, 2015 (as a percentage of total investment)



Source: OECD Global Pension Statistics, October 2016

If PSAs were to reduce their holdings of non-cash assets in order to meet cash collateral requirements this would have a detrimental impact on future pension benefits. Recital 26 of EMIR acknowledges this risk, which a baseline study prepared for the Commission also highlighted in 2014.⁴⁶ According to the modelling in this study, which assumed that PSAs would create a cash buffer of between 80% and 100% of the maximum expected variation margin call under a 100 basis points increase in interest rates, the aggregate variation margin call would be EUR 204–255 billion for EU PSAs (see table below). This compares to the estimated annual cost of the current bilateral arrangements of about

⁴⁵ [ISDA Margin Survey 2015](#), August 2015.

⁴⁶ Europe Economics and Bourse Consult, *Baseline report on solutions for the posting of non-cash collateral to central counterparties by pension scheme arrangements*, p. 10 – 25, July 2014.

EUR 43 million, and of EMIR (with the exemption) of EUR 52 million. The baseline study estimated the cumulated reduction in the retirement income of future pensioners to be a up to 3.66% across the EU over 40 years⁴⁷.

Figure 5. Total annual costs of PSAs posting cash variation margin (without the exemption)

	Cash buffer (Cbn)			Total annual cost (Cbn)		
EU28 impact (100bps)	204.3	-	255.4	2.3	-	2.9
EU28 impact (historic)	109.6	-	137.1	1.3	-	1.6
EU28 impact (EBA)	301.3	-	376.6	3.4	-	4.2
EU28 impact (US Fed Adverse)	336.3	-	420.3	3.8	-	4.7

Source: Europe Economics and Bourse Consult study, July 2014

Furthermore, in response to the Commission's Call for Evidence, one industry association gave an example of a large German pension fund with more than EUR 10bn in assets under management that would have had to hold between 0.5% and 1.0% of total assets in cash in the last 5 to 10 years to meet the variation margin call related to central clearing instead of investing this amount in higher-yielding assets.⁴⁸

The FSB also highlighted in a recent report that requirements to post cash for variation margin represent a challenge for counterparties that do not hold much cash, such as some pension funds⁴⁹.

Taking into account these difficulties, Article 89(1) of EMIR provides a temporary clearing exemption for PSAs meeting certain conditions⁵⁰. There are approximately 15000 PSAs benefiting from the clearing exemption in the EU. Nearly all the PSAs are institutions for occupational retirement provision as defined under Article 2(10)(a) and (b) of EMIR, which automatically qualify for the exemption.⁵¹ The remainder includes 22 PSAs referred to in Article 2(10)(c) or (d) of EMIR, which have been granted an exemption by ESMA, as they encounter difficulties in meeting the variation margin requirements in accordance with Article 89(2)⁵². The PSAs benefiting from the exemption include life insurance undertakings,⁵³ provided that all corresponding assets

⁴⁷ Ibid, p. 68.

⁴⁸ PensionsEurope's contribution to the Call for Evidence.

⁴⁹ FSB, OTC Derivatives Market Reforms, Eleventh Progress Report on Implementation, 26 August 2016.

⁵⁰ Article 89(1) and (2) of EMIR. The exemption shall apply only to OTC derivatives that are objectively measurable as reducing investment risks directly relating to the financial solvency of pension scheme arrangements and where the PSA encounters difficulties in meeting the VM requirements.

⁵¹ C.f. EIOPA public register <https://eiopa.europa.eu/publications/register-of-institutions-for-occupational-retirement-provision>

⁵² Data based on the list that was last updated in August 2016, available on ESMA's website at: https://www.esma.europa.eu/sites/default/files/library/list_of_exempted_pension_schemes.pdf.

⁵³ Recital (27) of EMIR highlights the need to provide for a level playing field for all PSAs. In addition to institutions for occupational retirement provision registered in accordance with Directive 2003/41/EC, Recital (28) of EMIR specifies that the derogation should also apply to occupational retirement provision businesses of life insurance undertakings.

and liabilities are ring-fenced, managed and organised separately, without any possibility of transfer.

The exemption was agreed explicitly in order to provide time for CCPs to develop technical solutions to accept non-cash collateral. As viable technical solutions failed to emerge, the Commission, in accordance with Article 85(2) of EMIR, extended this exemption by two years in 2015. A Commission Report issued in February 2015⁵⁴ assessed the progress and effort made by CCPs in developing technical solutions for the transfer by PSAs of non-cash collateral as variation margin. The Report fulfilled the mandate set out in Article 85(2) of EMIR and was based on the baseline study referred to above. The Report found that CCPs had not made sufficient progress in developing appropriate technical solutions. Only one CCP had started developing a repurchase (repo) transaction clearing service that could address the needs of PSAs to use non-cash assets. The Report, however, highlighted that certain important questions remained, as to the viability of such a collateral transformation service. In particular, it considered that the bilateral repo markets did not appear to hold sufficient liquidity to withstand the needs of PSAs in stressed scenarios. Based on an analysis of the EU government bond markets, the baseline study underpinning the Report highlighted that the aggregate variation margin call for a 100 basis point move (amounting to EUR 204-255 billion for EU PSAs, as per above) would exceed the apparent daily capacity of the relevant bilateral repo markets. Similarly, respondents to the EMIR consultation expressed concerns that in stressed market scenarios, PSAs would face a substantial liquidity risk as they might not be able to raise enough cash to meet their variation margin calls.

On this basis, on 20 December 2016, the Commission adopted a delegated act⁵⁵ to prolong the exemption by an additional and final year, until August 2018. Under the current legal framework, the transitional exemption cannot be further extended. However, as indicated by respondents to the EMIR consultation and to the Call for Evidence, viable CCP clearing solutions for PSAs continue to be insufficient. Recent comments received during the public feedback period on the draft delegated act, which took place in November 2016, made a similar point. Four business associations expressed support for the extension by a further year of the clearing exemption for PSAs and highlighted the negative consequences of not doing so. Therefore, there is a genuine risk that in August 2018 PSAs could be subject to the clearing obligation without a technical solution to post non-cash variation margins, which would generate disproportionate damage to the returns of (future) pensioners.

While PSAs benefit from an exemption from central clearing, they are however subject to bilateral margin requirements applying to uncleared OTC derivatives. The objective of these requirements is to mitigate the risk of a counterparty credit default in the absence of clearing via a CCP, as well as to provide an incentive towards central clearing. The application of these requirements will be phased in from March 2017, including requirements for PSAs' margin.⁵⁶

⁵⁴ [Commission Report](#) assessing the progress and effort made by CCPs in developing technical solutions for the transfer by PSAs of non-cash collateral as variation margin, as well as the need for any measures to facilitate such solution (COM(2015)39 final of 3.2.2015).

⁵⁵ [Commission Delegated Regulation C\(2016\)8542](#) of 20 December 2016.

⁵⁶ [Commission Delegated Regulation \(EU\) 2016/2251 of 4 October 2016](#), OJ L 340, 15.12.2016, p. 9–46.

3.2.1.2. Non-Financial Counterparties ('NFCs')

The scope of clearing and bilateral margin requirements is far-reaching and includes all financial counterparties and the biggest non-financial counterparties (NFCs). This is because EMIR intends to cover all relevant market participants in order to cover all risks linked to derivatives transactions.

EMIR does however only aim at 'systemic' NFCs: it acknowledges that NFCs use OTC derivative contracts in order to cover themselves against commercial risks directly linked to their commercial or treasury financing activities. Consequently, in determining whether an NFC should be subject to the clearing obligation, EMIR gives consideration to the purpose for which that NFC uses OTC derivative contracts, as well as to the size of the exposures that it has in those instruments.⁵⁷ NFCs are subject to the clearing obligation and risk mitigation techniques requirements where their positions in non-hedging OTC derivatives exceed certain thresholds defined in a regulatory technical standard. The thresholds are EUR 1 bn in gross notional value for credit and equity derivatives and EUR 3 bn for interest rate, foreign exchange, and commodity or other derivatives⁵⁸. Once an NFC surpasses one of these thresholds in any asset class, it becomes subject to these requirements across all asset classes. These NFCs are commonly referred to as 'NFC+' as opposed to NFCs below the threshold which are known as 'NFC-'.

The public consultations identified several problems in applying the EMIR requirements to NFCs. First, significant problems emerged in relation to the application of the hedging/non-hedging distinction. NFCs pointed out the difficulty of classifying transactions as 'hedging' or not, as the definition of hedging is not in line with accounting rules and differs in their interpretation between regulators. These problems were also confirmed by ESMA,⁵⁹ which concluded that many NFCs do not seem to apply the hedging/non-hedging distinction because many counterparties classify 100% of their trades either as hedging or as non-hedging. Those counterparties have not developed systems to monitor the hedging or non-hedging nature of their transactions.⁶⁰ These systems generate compliance costs. ESMA estimated at EUR 50 000 on-off plus EUR 40 000 on-going per year and per counterparty to monitor trades⁶¹. However, as a result of diverging regulatory practices and application of the hedging definition, NFCs that undertake similar activities and which hold comparable OTC derivative portfolios end-up qualifying either above or below the threshold, leading to an unlevelled playing field. Some industry participants and authorities also drew attention to the difficulty for market participants to determine which of their non-financial counterparties are above or below the clearing threshold.

More generally, NFCs also highlighted the operational challenges with EMIR requirements and stated that the transaction costs associated with OTC derivative trading,

⁵⁷ See Article 10 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.

⁵⁸ <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:052:0011:0024:EN:PDF>

⁵⁹ https://www.esma.europa.eu/sites/default/files/library/2015/11/esma-2015-1251_-_emir_review_report_no.1_on_non_financial_firms.pdf

⁶⁰ ESMA, *EMIR Review report n°1 – Review on the use of OTC derivatives by non-financial counterparties*, https://www.esma.europa.eu/sites/default/files/library/2015/11/esma-2015-1251_-_emir_review_report_no.1_on_non_financial_firms.pdf.

⁶¹ See impact assessment accompanying the draft RTS on EMIR submitted by ESMA to the European Commission on 27 September 2012 (ESMA/2012/600 Annex VIII).

whether hedging or not, had increased. Due to a sizeable cost increase for non-centrally cleared transactions,⁶² they argue that EMIR has reduced incentives to engage in derivative transactions, including hedging transactions. In particular, some NFCs pointed out the lack of available cash and eligible collateral to cover their derivatives activities in line with EMIR rules. Non-financial counterparties that are active in derivatives markets are numerous (64 295), and represent 72% of all counterparties.⁶³ However, it is important to contrast the number of NFCs active in derivatives markets with the volume of their OTC derivative positions and their degree of interconnectedness in order to appreciate the risks NFCs may pose for financial stability.

According to ESMA data, only 2% of the notional value of the OTC derivatives markets is made up of NFC activity. This accounts for EUR 9.5 trillion outstanding volumes as measured by notional amount out of a grand total of EUR 608 trillion, including both financial counterparties and non-financial counterparties⁶⁴. ESMA also indicates that on average, NFCs have portfolios of around 30 trades, representing EUR 150mn of notional. This compares to portfolios of 1,000 trades representing EUR 25,000mn of notional for financial counterparties. Therefore, the positions of NFCs in the OTC derivatives market appear to be very limited when compared to the group of financial counterparties. In addition, NFCs tend to transact with less than 6 other market participants, which suggests not only a lack of interconnectedness across the system, as far as NFCs are involved, but also a lower level of risk than financial counterparties' risk (as the latter hold much larger volumes of derivatives and have a far higher level of interconnectedness). This lower degree of interconnectedness can be illustrated by Figure 2 in section 3.1.3, which provides a picture of the network structure of the OTC derivatives market in the IRS segment. It highlights that non-financials generally tend to sit at the periphery of the market, while CCPs, clearing members and banks appear at the core, with many connections between them. This shows that non-financial counterparties present a relatively lower systemic risk for financial stability.

There is also a need to consider the distribution of OTC derivative positions within NFCs, in order to provide a more nuanced approach of the risk profile of non-financials. When it comes to NFCs subject to clearing and margin requirements (or NFC+), ESMA identifies 43 groups corresponding to the definition of NFC+, which include 424 counterparties⁶⁵. While the number of groups is limited, ESMA indicates that, as an order of magnitude, the typical portfolio size of a group of NFC+ is about five times bigger than the average portfolio of FCs in terms of trade count and 1.5 times bigger in terms of notional amount. Nevertheless, when considering the relative share of their OTC derivatives positions, these NFCs+ represent a notional value of 16% of NFCs notional amount, which is equivalent to 0.32% of the total notional amount. The systemic relevance of most of the NFCs is therefore very limited. ESMA concluded that the only asset classes in which NFCs may have some systemic relevance, measured as the number

⁶² Deloitte estimated the annual cost of OTC derivatives reform at EUR 15.5 billion annually (EUR 2.5 billion for centrally cleared transactions and EUR 13 billion for OTC transactions), but no detail estimate is provided for the share of costs taken up by NFCs. See <https://www2.deloitte.com/content/dam/Deloitte/uk/Documents/financial-services/deloitte-uk-fs-otc-derivatives-april-14.pdf>.

⁶³ ESMA, *EMIR Review report n°1 – Review of the use of OTC derivatives by non-financial counterparties*, https://www.esma.europa.eu/sites/default/files/library/2015/11/esma-2015-1251_-_emir_review_report_no.1_on_non_financial_firms.pdf.

⁶⁴ *Ibid*, Table 2, p. 8.

⁶⁵ *Ibid*, Table 6, p. 11.

of contracts (trade counts) or as the number of counterparties, are the commodity and other⁶⁶ asset classes and the FX asset classes.⁶⁷

Concerning the impact of other regulatory developments, the MiFID II framework aims at reclassifying large non-financial commodities traders as financial counterparties. MiFID II⁶⁸ puts in place an 'ancillary activity test' that determines how much non-hedging (or speculative) commodity derivative or emission allowances derivative trading non-financial firms can conduct before this activity is no longer deemed 'ancillary to the main business' of the firm and the firm be obliged to seek a MiFID authorisation. Two thresholds will be used in MiFID: one based on the value of contracts traded by the firm as a percentage of the overall EU market size for that commodity derivative or emission allowance derivative, and one based on whether commodity derivative or emission allowance derivatives make up more than 10% of the firm's business. Hence the largest NFCs active on commodity derivative or emission allowance derivative markets will need to seek a MiFID authorisation. This development will lead the largest NFCs to being subject to the clearing obligation under EMIR, limiting EMIR clearing thresholds to a residual tool for picking up 'systemic' NFCs. However, it should be noted that the MiFID thresholds operate differently from the EMIR ones in two important respects: first, both MiFID thresholds are percentage-based, rather than absolute numerical values as in the case of EMIR. Second, they only apply to commodity derivatives and emission allowances derivatives (for which, as noted above, the EMIR threshold is EUR 3 billion).

Furthermore, according to the FSB report on *OTC Derivatives Market Reforms - Eleventh Progress Report on Implementation* of August 2016, the EMIR scope is much broader than the scope of OTC derivatives regulations in the majority of non-EU jurisdictions. NFCs are not subject to mandatory clearing in other major third countries with important derivatives markets (e.g. US, Japan, Canada, Australia, HK, Republic of Korea, Singapore) as they consider that these counterparties do not bring systemic risk to the financial system. This situation risks creating an un-level playing field at the international level and puts EU NFCs in a less favourable position than their competitors established in third countries, especially for groups with ties in third countries and when the same type of derivatives are traded within and outside the EU.

As a result, keeping in mind the objective of EMIR to capture and address the systemic risks of derivatives transactions, it would appear that the EU framework currently covers at least some NFCs which present very limited systemic risk to the financial system as has already been recognised in other global jurisdictions. Furthermore, the inclusion of such non-systemic entities under EMIR's requirements is both costly and impractical for some of them to apply, particularly in light of the obstacles that smaller market participants face in accessing central clearing, as further described in section 3.4.

⁶⁶ In its analysis ESMA commingled the data for "Commodity Derivatives" with that for "Other Derivatives".

⁶⁷ https://www.esma.europa.eu/sites/default/files/library/2015/11/esma-2015-1251_-_emir_review_report_no.1_on_non_financial_firms.pdf, p. 17.

⁶⁸ Directive 2014/65/EU of 15 May 2014 on market in financial instruments (MiFID) Article 2(1)(j) specified by ESMA RTS 20 (mandate in Article 2(4)).

3.2.1.3. Small Financial Counterparties ('SFCs')

As presented in Table 1, the scope of the EMIR clearing obligation captures all financial counterparties⁶⁹ irrespective of their size and of their volume of OTC derivatives activity. Trading associations⁷⁰, as well as associations that typically represent small banks⁷¹, argued that the costs generated by the clearing obligation were disproportionate in light of the limited systemic risk posed by smaller financial counterparties. They also explained that the clearing obligation creates considerable implementation issues for these smaller financial counterparties, notably because of the difficulties smaller market participants, including very small financials, face with regards to access to clearing⁷². This concerns financial counterparties with small derivatives portfolios, for instance small banks, that need to conclude interest rate swaps to cover their activities (i.e. interest rate swaps to cover their mortgage loan portfolio) or small funds that want to cover risks linked to their portfolios (i.e. foreign exchange risk).

EMIR does not differentiate between (very) small and larger financial counterparties. It is therefore challenging to provide a clear difference of what would represent a small financial counterparty. Lacking a common definition, and in order to provide an order of magnitude, this impact assessment considers Small Financial Counterparties (SFCs) as financial counterparties defined as Category 3 counterparties under the existing Commission Delegated Regulations on the clearing obligation. These are financial counterparties (and certain funds which are classified as non-financial counterparties) belonging to a group whose aggregate positions in OTC derivatives are EUR 8bn or below.⁷³

Direct access to a CCP implies costs and risks that at least some of those SFCs are not in a position to bear: to be a direct participant in a CCP, firms are required to put in place specific infrastructures and dedicate a large amount of resources that smaller financial counterparties do not necessarily have at their disposal.⁷⁴ But even if the small financial counterparties would overcome these problems, this would not necessarily mean that (all) CCPs were in a position to accept smaller participants as clearing members for infrastructure or risk management reasons.

For these small financial counterparties, it is therefore necessary to become the client of a clearing member, or to establish indirect clearing arrangements. However, ESMA confirmed in a consultation paper that Category 3 counterparties, i.e. those with the smallest level of activity in OTC derivatives, are facing important difficulties in preparing the arrangements with clearing members that are necessary for clearing the contracts. First, in relation to client clearing, recent evidence suggests that clearing members find little incentives to develop extensively their client clearing offer because of cost issues, and even more so for clients with limited activity in OTC derivatives.

⁶⁹ Article 4(1)(a)(i) of EMIR.

⁷⁰ E.g. Association for Financial Markets in Europe (AFME) and the International Swaps and Derivatives Association (ISDA).

⁷¹ E.g. European Association of Co-operative Banks (EACB),

⁷² See section 3.4.

⁷³ Commission Delegated Regulation (EU) 2015/2205 of 6 August 2015 supplementing Regulation (EU) No 648/2012, OJ L 314, 1.12.2015, p. 13; Commission Delegated Regulation (EU) 2016/592 of 1 March 2016 supplementing Regulation (EU) No 648/2012, OJ L 103, 19.4.2016, p. 5, and Commission Delegated Regulation (EU) 2016/1178 supplementing Regulation (EU) No. 648/2012, OJ L 195, 20.7.2016, p. 3.

⁷⁴ For membership requirements see para. 3.3.

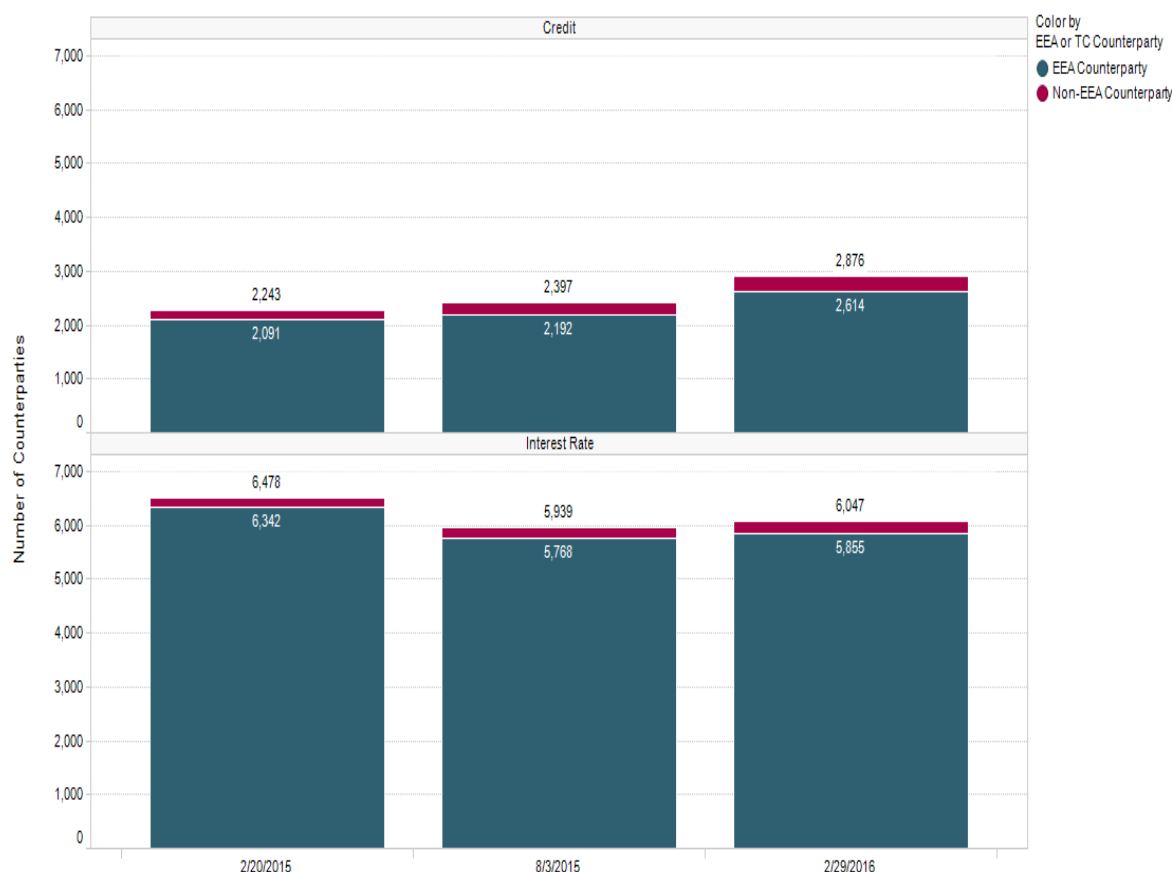
Estimates by ISDA reported by the Financial Times suggest that many clearing members are setting minimum revenues or clearing fees that range from EUR 95 000 to EUR 265 000 according to current exchange rates⁷⁵. This may be a significant fixed cost for a small financial counterparty with a very limited volume of OTC derivatives activity. Second, in relation to indirect clearing arrangements, ESMA indicated that counterparties are currently unable to access CCPs by becoming an indirect client of a clearing member, because of the scarcity of the offer. These obstacles to central clearing are dealt with further in the separate section on 'insufficient access to clearing' that deals with factors impacting the offer of such services (Section 3.4). The important constraints and costs for SFCs to have access to clearing services risk forcing them to cease some of their activities. This risk, as well as the high costs, may however not be justified by the added value achieved for regulatory purposes.

Taking into account the costs and administrative burden that the clearing obligation represents, there is a need to appreciate the degree of systemic risk that these SFCs pose, by considering both (i) the volume of their OTC derivatives activity and (ii) their level of interactions with other counterparties. On the first point, ESMA presented in 2016 extensive data in a consultation paper on the clearing obligation for financial counterparties with a limited volume of activity⁷⁶. ESMA assessed the activity of financial counterparties in OTC derivatives asset classes already subject to a clearing obligation, using data from European trade repositories, on three different dates covering a timespan of one year: 20 February 2015, 3 August 2015 and 29 February 2016. As shown in Figure 6, ESMA established that around 6 000 European financial counterparties were active in the OTC interest rate asset class, the number being relatively stable on the three dates of the study, whereas in the OTC credit asset class the number of active European financial counterparties oscillated between around 2 000 in February 2015 and 2 800 one year later.

Figure 6. Number of counterparties per asset class (credit and interest rate asset class)

⁷⁵ Philip Stafford, OTC markets, Derivatives 'Big Bang' catches market off guard, Financial Times, 02.02.2017, <https://www.ft.com/content/086ec02a-e6fc-11e6-967b-c88452263daf>

⁷⁶ See ESMA, *Consultation Paper on the clearing obligation for financial counterparties with a limited volume of activity*, 13 July 2016, ESMA/2016/1125, https://www.esma.europa.eu/sites/default/files/library/2016-1125_cp_on_clearing_obligation_for_financial_counterparties.pdf

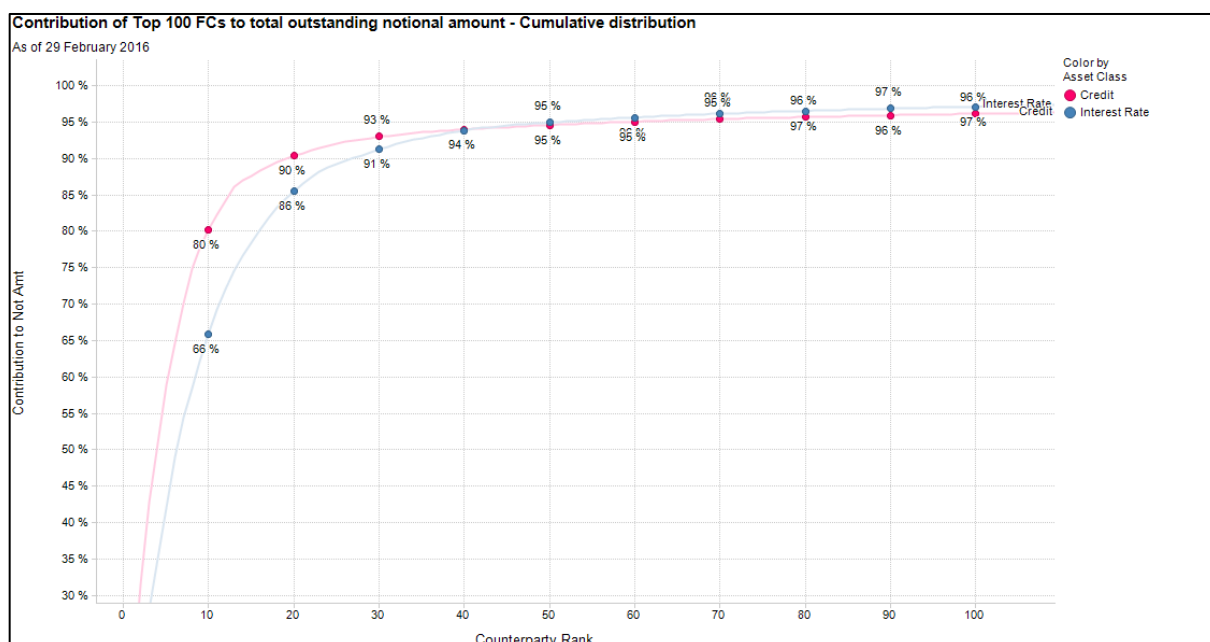


Source: European Securities and Markets Authority⁷⁷

The ESMA paper highlights that the distribution of trades among financial counterparties is highly concentrated, i.e. a relatively small number of the largest financial counterparties account for an important share of the total market. Figure 7 below highlights the asymmetric distribution of trades both in the interest rate and the credit asset classes. Based on the trades outstanding on 29 February 2016, the largest 50 counterparties accounted for 95% of the credit and interest rate OTC derivative volume; and the largest 100 counterparties accounted for 96%-97% of the credit and interest rate OTC derivative volume, measured by outstanding notional amounts.

Figure 7: Contribution of Top 100 FCs to outstanding notional amount

⁷⁷ https://www.esma.europa.eu/sites/default/files/library/2016-1125_cp_on_clearing_obligation_for_financial_counterparties.pdf



Source: European Securities and Markets Authority⁷⁸

Both the interest rate derivative and the credit derivative markets show important levels of concentration on a small number of large counterparties. For example in the interest rate derivative asset class, 490 counterparties (the ones with portfolios of OTC interest rate derivatives above EUR 5bn) represent 99.4% of the activity, while only accounting for 8.4% of the total number of financial counterparties⁷⁹. Looking at different categories of counterparties, clearing members represent 94.5% of the volume and 1.2% of the number of counterparties, other counterparties with individual portfolios above EUR 8bn represent 4.4% of the volume and 4.5% of the number of counterparties and counterparties with individual portfolios below EUR 8bn represent only 1.1% of the volume but 94.3% of the number of counterparties⁸⁰.

Similarly, in the credit derivative asset class, less than 400 counterparties (the ones with portfolios of OTC credit derivatives above EUR 500mn) represent 98.6% of the activity, and 14.5% in terms of number of counterparties⁸¹. Conversely, this means that an important number of counterparties account for only a small fraction of the total volume. Analysing this in more detail, clearing members represent 85.6% of the volume and 0.7% of the number of counterparties, other counterparties with individual portfolios above EUR 8bn represent 9.3% of the volume and 5.9% of the number of counterparties and counterparties with individual portfolios below EUR 8bn represent only 5.1% of the volume but 93.5% of the number of counterparties⁸².

Additional tables and charts illustrating this are included in Annex 2B.

⁷⁸ https://www.esma.europa.eu/sites/default/files/library/2016-1125_cp_on_clearing_obligation_for_financial_counterparties.pdf

⁷⁹ See ESMA, Consultation Paper on the clearing obligation for financial counterparties with a limited volume of activity, 13 July 2016, Table 1, p. 13. ESMA/2016/1125, https://www.esma.europa.eu/sites/default/files/library/2016-1125_cp_on_clearing_obligation_for_financial_counterparties.pdf

⁸⁰ *Ibid*, Figure 5, p. 20.

⁸¹ *Ibid*, Table 2, p. 14.

⁸² *Ibid*, Figure 6, p. 20.

The asymmetry in the distribution of trades was one of the justifications for the adoption of a phased-in implementation schedule for the clearing obligation, i.e. starting with the few but most active counterparties (clearing members) and adding progressively an increasing number of less active counterparties (see also the impact assessments of the first two final reports on the clearing obligation on interest rate swaps (IRS)⁸³ and credit default swaps (CDS)⁸⁴). In November 2016, based on the data presented above ESMA proposed to delay the application of the clearing obligations for small financials (category 3 counterparties)⁸⁵ by two additional years with regard to the clearing obligation for OTC interest rate derivatives denominated in EUR, GBP, JPY, and USD and the shorter delay of about 1 year and 4 month with regard to the clearing obligations for OTC index credit default swaps and OTC interest rate derivatives denominated in NOK, PLN and SEK (all until June 2019) due to the disproportionate burden or impossibility for these counterparties to use central clearing in 2017.

Finally, with regard to the degree of interconnectedness of SFCs, it is necessary to take into account the network structure of the OTC derivatives market, as presented in Figure 2 of section 3.1.3, which focuses on the interactions between market participants active in the IRS market. Figure 2 shows that the category 'other financials', which does not include the largest Financial Counterparties such as clearing members and banks, do not sit at the core of the market. This suggests that SFCs tend to be connected to fewer intermediaries than larger FCs, suggesting a relatively lower systemic risk for financial stability.

3.2.2. Scope of EMIR reporting requirements

In the public consultation, stakeholders characterised a number of different aspects of the existing reporting requirements under EMIR as excessively burdensome.

3.2.2.1. The backloading obligation⁸⁶

According to Article 9(1) of EMIR, counterparties are required to report their derivative contracts which: (a) were entered into before 16 August 2012 and remain outstanding on that date; (b) are entered into on or after 16 August 2012.

Article 9(6)(b) empowers ESMA to “develop draft implementing technical standards specifying the date by which derivative contracts are to be reported, including any phase-in for contracts entered into before the reporting obligation applies”. These

⁸³ ESMA, *Final Report, Draft technical standards on the Clearing Obligation – Interest Rate OTC Derivatives*, 1 October 2014, ESMA/2014/1184, https://www.esma.europa.eu/sites/default/files/library/2015/11/esma-2014-1184_final_report_clearing_obligation_irs.pdf

⁸⁴ ESMA, *Final Report, Draft technical standards on the Clearing Obligation – Credit Derivatives*, ESMA/2015/1481, 1 October 2015, https://www.esma.europa.eu/sites/default/files/library/2015/11/2015-1481_final_report_clearing_obligation_index_cds.pdf

⁸⁵ For the purpose of applying the clearing obligation for different classes of OTC derivatives, counterparties have been divided in four categories that are defined in regulatory technical standards. See, for instance, Article 2 of Commission Delegated Regulation (EU) 2016/592 of 1 March 2016 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on the clearing obligation.

⁸⁶ The term 'backloading' is used to refer to the obligation of reporting historical trades, i.e. derivative transactions concluded before the start of the reporting obligation in February 2014.

implementing technical standards (ITS) were adopted by means of Commission Implementing Regulation (EU) No 1247/2012 of 19 December 2012. In addition to setting out a start date for the reporting obligation (which depended on certain conditions being fulfilled, but became effective on 12 February 2014), the ITS put in place a 3 year phase-in for the reporting of contracts entered into between the date referred to in Article 9 of EMIR and the start of the reporting obligation, and which were no longer outstanding on the latter date. In other words, 'historic' contracts were to be reported by 12 February 2017 at the latest. The main reason for this phase-in period was to avoid a huge number of trades being reported shortly before the start of the reporting obligation. The revised ITS adopted by the Commission on 26 October 2016 extended this deadline for a further 2 years, until 12 February 2019.

The requirement to report historic trades was intended to give regulators a complete overview of the derivative markets since the entry into force of EMIR by providing them with relevant historic reference data and thus enable regulators to obtain a picture of potential ongoing risks and exposures. This has however not happened for several reasons. Firstly, in practical terms, this requirement is virtually impossible to fulfil. For example, there are very high failure rates due to the lack of certain reporting elements which were not required at that time or to the lack of a requirement to use the Legal Entity Identifier (LEI) prior to the start of the reporting obligation. As such, the quality and therefore the added value of the generated data is very low compared to the burden it generates, which implies that there is a high likelihood that this data will remain unused.⁸⁷ The provision of such inaccurate and low quality data therefore will not enable regulators identify risks and thus achieve what it was originally designed to do. Secondly, the fact that the data will remain unused is made even more likely by the fact that backloaded data will, for the most part, be quite old and will therefore be of less use than more recent data. Quite a few historical transactions will have already expired and with them, the corresponding exposures and risks. Furthermore, some of the non-expired historic trades are reported in any case, as modifications to the original contract made after the start of the reporting obligation need to be – and are – reported according to the rules for new trades. Therefore, the number of historic trades which remain unreported is likely to be only a fraction of all historic trades falling within the scope of this requirement.

For the above reasons, respondents to the public consultation (primarily companies and industry associations, but also non-governmental associations and public authorities) considered the 'backloading' requirement as very problematic and burdensome while bringing virtually no added value. This view was also shared by ESMA, which based its assessment on a limited number of trades which have already been backloaded.

3.2.2.2. Reporting of intragroup transactions

Intragroup transactions are defined in Article 3 of EMIR as OTC derivative contracts entered into with another counterparty which is part of the same group. With the exception of certain risk-mitigation techniques, from which intragroup transactions are exempt under certain conditions, all other EMIR requirements currently apply to intragroup trades in the same way as they do to all other transactions.

⁸⁷ ESMA, *EMIR Review Report no.4*, ESMA's input as part of the Commission consultation on the EMIR Review, https://www.esma.europa.eu/sites/default/files/library/2015/11/esma-2015-1254_-_emir_review_report_no.4_on_other_issues.pdf

Intragroup derivative transactions are usually carried out to hedge against certain market risks or aggregate such risks at the level of the group. Their number is usually quite large – according to one source⁸⁸, the volume of IGTs entered into by companies on an annual basis varies between approximately 28 000 and more than 120 000 trades. However in practice, in most cases these large volumes of intragroup trades result in significantly fewer external trades after netting. This is illustrated by the table below.

Figure 8 - Relation between internal/external derivatives; annual reporting costs (2015)

Relation between internal / external derivatives; annual reporting costs (2015)

Company	Annual revenue (bn. Euro)	Internal / external derivatives	Annual reporting costs (Euro in thousands)
1	150	18%	200
2	71	46%	50
3	65	61%	500
4	60	n.a.	50
5	46	n.a.	150
6	32	100%	20
7	22	50%	25
8	21	20%	30

Source: Deutsches Aktieninstitut e.V.

In another case, 122 000 intragroup trades netted down to just over 16 000 external trades. This is in line with other data which indicated that the inclusion of IGTs in the reporting requirement can result in as much as a threefold increase in the number of transactions which need to be reported.

As can be deduced from the above, in most cases, intragroup trades do not have a significant impact on the risk profile of the group as a whole. Given this nature of intragroup transactions, there is reason to believe that such trades have a more limited impact on systemic risk than trades between different groups or companies. The requirement to report these transactions can be considered particularly burdensome for smaller counterparties and in particular NFCs, whose intragroup trades represent only an insignificant proportion of the market. Reflecting these concerns, some jurisdictions (notably the CFTC in the United States) have excluded NFCs and small financials from the requirement to report their intragroup transactions.

Many respondents to the public consultation (including companies, industry associations, trade associations, public authorities and others) confirmed this view by asserting that the obligation to report intragroup transactions is unnecessary as these transactions carry very little systemic risk, while it is highly burdensome (due to the potentially very significant volumes of such trades but also to the fact that every entity in the group needs to be assigned a LEI) and potentially even harmful, as this data can distort the true picture of the market. Several respondents pointed out that the requirement to report intragroup transactions may also reduce the use of delegation of reporting by corporates,

⁸⁸ Although the sources of the vast majority of data on intragroup trades received by the European Commission are confidential, several anonymised examples were provided.

as these trades do not involve an external counterparty to which reporting could be delegated. For the same reason, it requires NFCs which are part of a group to establish relationships with trade repositories, in many cases just for a few intragroup trades.

3.2.2.3. Reporting of exchange-traded derivatives ('ETDs')

According to Article 9(1) of EMIR, counterparties are required to report the details of all of their derivative contracts to trade repositories, irrespective of whether these are OTC or ETD contracts. As far as the reporting obligation is concerned, EMIR does not make any distinction between these two types of derivative contracts.

Many respondents felt that the obligation to report ETDs is superfluous since the exchanges should normally possess a good portion (if not all) of the relevant data on the trade, as a result of the set-up of the reporting obligation in Article 26 of Regulation (EU) No 600/2016 of the European Parliament and the Council (Markets in Financial Instruments Regulation - MiFIR) and Regulatory Technical Standard 22 to MiFIR⁸⁹. The respondents (primarily companies and industry associations, but also public authorities and trade unions) claimed that this requirement therefore increases burdens without adding any value. They also pointed out that the G20 never called for the reporting of ETDs, and many other jurisdictions do not require the reporting of ETDs. The majority of respondents called for the exemption of ETDs from EMIR reporting requirements.

ESMA acknowledges that the requirement to report ETDs on a trade-by-trade basis poses a rather significant burden in terms of costs of reporting and data storage capacity⁹⁰ of counterparties and trade repositories. These costs are due to the substantial number of ETDs trades being transacted on a daily basis and the significant number of positions that are opened and closed intraday.⁹¹

Given the significant number of derivative transactions concluded on exchanges and the fact that the exchanges already possess many of the details of such transactions, the claim that the requirement to report ETDs is burdensome and even to some extent redundant appears to have some merit. More broadly, ESMA shares the respondents' view concerning significant costs and burdens of ETD reporting. Nevertheless, as it is also pointed out by ESMA, the reporting of ETDs under EMIR serves a variety of purposes for several EU authorities and there are direct linkages with other pieces of legislation (e.g. MiFIR exemptions provided transactions are reported under EMIR). Furthermore, the data received by trading venues is not the same as that required to be reported under EMIR⁹². In light of the above, at this stage ESMA does not recommend an exemption for ETDs from the reporting obligation. However, they suggest that, by modifying certain aspects of the requirement, it seems possible reduce the burden of reporting ETDs while ensuring that the necessary data is reported to TRs.

⁸⁹ Commission Delegated Regulation C(2016) 4733 final of 28 July 2016

⁹⁰ EMIR imposes record keeping requirements on both counterparties and TRs. Article 9 obliges counterparties to maintain record of the information reported for at least five years from the termination of the contract. In addition, Article 80(3) requires Trade Repositories to maintain record of the information received for at least ten years following the termination of the relevant contracts.

⁹¹ Based on the contribution by ESMA.

⁹² For example, data reported under MiFIR includes very specific information on the timing of the execution, the identity of the investment firm responsible to executing the transaction, or the underlying index. None of these are relevant for EMIR, which however requires information on margins and collateralisations, as well as a much greater level of detail on the types of derivatives being transacted.

3.2.2.4. Double sided reporting

Article 9(1) of EMIR requires all counterparties and CCPs to ensure that the details of any derivative contract that they have concluded, as well as any modification or termination of such a contract, are reported to trade repositories. While a counterparty or a CCP may delegate the reporting to another actor, this does not exonerate it from the obligation to report the transaction. In other words, both sides to the transaction have the obligation to report the contract in a system known as 'double-sided reporting' (as opposed to 'single-sided reporting', where only one party to the transaction reports).

Respondents (primarily companies and industry associations, but also including public authorities, trade associations, non-governmental organisations and others) to the public consultation considered that the requirement for double-sided reporting causes significant costs and burdens, leads to a high-level of mismatched trades, and produces a risk of double-counting contracts. This in turn supposedly puts into question the data held in TRs and its usefulness for assessing systemic risk. Some respondents went so far as to say that double-sided reporting actually increases risk. Many claimed that the lack of standardised data fields and insufficient guidance further accentuate the problem. The vast majority of industry respondents suggested a move to single-sided reporting, though there were a number of variants (e.g. for all trades/counterparties, only for NFCs/NFC-s, for all smaller counterparties, only for exchange-traded derivatives, only CCPs to report, etc.). It should also be mentioned that a small number of respondents (including at least one company and one industry association) opposed the idea of moving to single-sided reporting for all transactions, either because they felt that double-sided reporting ensures better quality of data by facilitating trade reconciliation or because they did not wish to see the investments made to put into place the necessary reporting system go to waste.

While there is no question that double-sided reporting does entail a greater burden in terms of reporting when looking at it from the point of view of both counterparties to a transaction, the main reason for using this approach in EMIR is to help ensure a high level of data quality. Good data quality is indispensable for supervisory authorities to be able to carry out their obligations in terms of monitoring systemic risk and market abuse. Without high quality data, regulators and supervisors cannot fully optimise the data at their disposal. National competent authorities frequently complain about the poor quality of data at present, which restricts their ability to effectively monitor the market and identify risks. Nevertheless, even despite the poor quality of data, the reported data is already starting to be used for assessing market liquidity, market concentration, for checking whether various thresholds have been met, etc., as was evidenced by anecdotal confidential information from several regulators/supervisors as part of the EMIR public consultation. Several other jurisdictions globally also apply a double-sided reporting system to ensure data quality.⁹³

Specifically, when both counterparties to a trade are required to report data on their transaction, all elements of the reported data should match. Where the data do not match, this is a clear indication that there is a problem either with the reporting or, in the worst case scenario, with the underlying transaction. The trade repository can then request the two sides to verify their data with a view to reconciling the trade. In a single-sided reporting system, this automatic check does not exist, and the trade repository has to trust that the reporting counterparty has submitted correct data. As such, contrary to what was

⁹³ E.g. Australia, Brazil, Hong Kong, Japan and Mexico.

claimed by some respondents to the public consultation, double-sided reporting generally results in higher rather than lower quality of data in trade repositories, which in turn means that the data is more useful to market supervisors when carrying out their obligations.

In fact, it has been found that most of the data quality issues are due to insufficiently defined and harmonised reporting standards, an issue which has to a large degree been addressed by way of amendments to the relevant technical standards adopted recently by the Commission.⁹⁴ ESMA is currently also working on more detailed guidelines for trade repositories on the method for aggregating trades, which should help to minimise the double-counting of trades.

ESMA generally shares the view that double-sided reporting ensures better data quality and recommends in its contribution that this reporting system be maintained, although it suggests that the approach taken in the Securities Financing Transactions Regulation ('SFTR')⁹⁵, to exempt from reporting small and medium-sized non-financial counterparties, could be considered.⁹⁶ Also, double-sided reporting simplifies the enforcement of the reporting obligation. With this system, there is no doubt that both counterparties to the trade need to report the transaction, and there is no excuse for not doing so. In a single-sided reporting system, sometimes quite complex rules are necessary for defining which counterparty is responsible for reporting the trade. There are known instances where trades have gone unreported as both sides to the trade claimed that they believed the obligation to report was on the other counterparty.⁹⁷ With double-sided reporting, such situations will not occur by definition. It should be noted that, recently, some jurisdictions which currently use the single-sided reporting approach are recognising that significant data quality issues may in part stem from the use of this system.

3.3. Insufficient transparency of OTC derivatives positions and exposures

A number of different issues adversely affect transparency of OTC derivatives positions and exposures, thus hampering supervision and oversight of the derivatives market.

3.3.1. Trade repositories – insufficient quality of data and difficulties of data use

In the EMIR public consultation, numerous respondents (in particular companies and industry associations) indicated that the data produced by trade repositories is of low quality and not sufficiently transparent, and therefore difficult to use. This is despite the

⁹⁴ Commission Delegated Regulation (EU) of 19.10.2016 with regard to regulatory technical standards on the minimum details of the data to be reported to trade repositories, C(2016) 6624 final, and Commission Implementing Regulation (EU) of 26.10.2016 amending Implementing Regulation (EU) No 1247/2012 laying down implementing technical standards with regard to the format and frequency of trade reports to trade repositories, C(2016) 6801 final.

⁹⁵ Regulation (EU) 2015/2365 of the European Parliament and of the Council of 25 November 2015 on transparency of securities financing transactions and of reuse and amending Regulation (EU) No 648/2012.

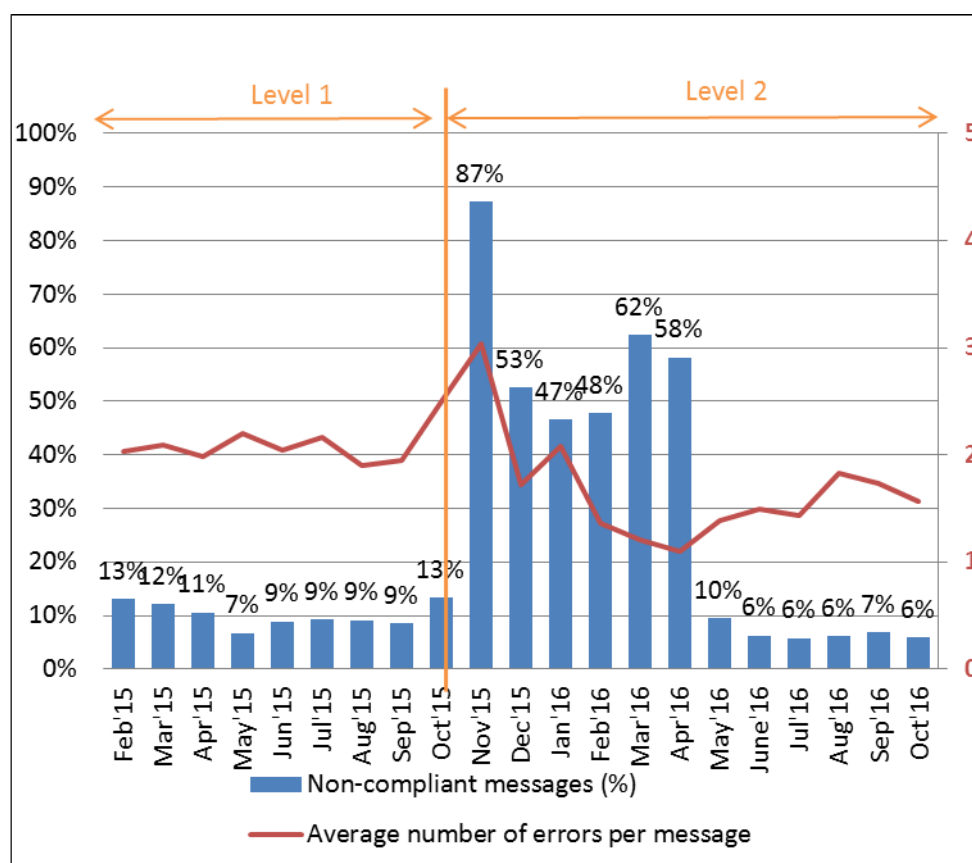
⁹⁶ https://www.esma.europa.eu/sites/default/files/library/2015/11/esma-2015-1254_-_emir_review_report_no.4_on_other_issues.pdf

⁹⁷ Information presented in the framework of an OTC Derivatives Regulators' Forum meeting. Source confidential.

large volumes of data being made available; in fact, the sheer volume of data may even further complicate the matter.

In the public consultation three main reasons for the poor quality of data were identified: (i) the excessive complexity and insufficient standardisation of reporting requirements; (ii) the lack of validations of the reported data by the trade repositories and reconciliations between them; and (iii) the lack of a common methodology or clear rules for the subsequent production of the data. By way of example, prior to the introduction of ESMA's validation requirement (verification of the correctness of the data) through technical standards at the end of October 2015, the level of non-compliant reporting messages was, on average, above 10%. After the introduction of this requirement, and after an initial spike or the level of erroneous messages (which suggests that the error levels in the previous period may have been underestimated), the level of incompliant messages dropped to 6%.

Figure 9 - Level of non-compliant reporting messages



Source: European Securities and Markets Authority

Underlying these problems is the absence of adequate binding guidance in this respect.

In order to remedy the problem of low data quality, the respondents (in particular companies and industry associations) suggested that the standards, format, and content of reported data should be further harmonised and, where possible, simplified; that trade repositories should be obliged to validate (i.e. verify) incoming data for completeness and correctness and reconcile data between them; that end users (counterparties) should be granted access to data reported by them or on their behalf in order to be able to ensure its correctness; and that trade repositories should be required to make available anonymised consolidated/aggregated data to facilitate its use and promote greater transparency of the OTC derivative markets while ensuring data privacy. Finally, it was suggested that ESMA should provide adequate guidance in these areas, for example by setting out harmonised validation rules and a common aggregation methodology to be implemented by all trade repositories.

Easily accessible, high quality derivatives data is crucial for regulators and relevant authorities to be able to fulfil their respective mandates correctly. Unfortunately, it is now acknowledged that the data produced by trade repositories is not only of insufficient quality, but that the way in which it is produced and made available to the relevant authorities makes it very difficult to use for the intended purpose of monitoring the derivatives market. This is not only inefficient (high reporting costs with limited benefits) but it could potentially prevent regulators and supervisors from identifying financial stability risks in a timely manner.

The problem is due in part to the fact that EMIR was not precise enough in some of its elements relating to trade reporting and data availability. In line with its mandate, ESMA developed draft regulatory technical standards, which were adopted by the Commission, specifying that an application for registration of a trade repository should include a description of the procedures and arrangements to ensure the compliance of the reporting entity with the reporting requirements and the correctness of the data reported. However, there was no requirement for such procedures and arrangements to be harmonised, resulting in trade repositories not verifying the compliance of the reports with EMIR requirements in a consistent manner. As a result, the quality of the data held in trade repositories varies. In an attempt to remedy this situation, ESMA has developed guidance (in the form of Q&As) on the data validations to be commonly applied by trade repositories.⁹⁸ It must be noted, however, that these Q&As are not legally binding. A similar situation exists with regard to the EMIR requirement for trade repositories to publish aggregate data and make data available to the relevant entities. Technical standards were adopted, but these too were very general due to the strict mandate for the development of the technical standards, thus giving insufficient guidance on what was expected in practice.

Some efforts to address these issues are already ongoing. Recently adopted technical standards⁹⁹ introduce much more detailed requirements and standards to the data which is to be reported, and another set of technical standards currently under preparation by ESMA will tackle the consolidation, aggregation, and publication of data. Nevertheless, remaining flexibility in terms of the form of the reports, the data standards which can be used, and the methods and arrangements for reporting, as well as the lack of a legal basis for the definition of the procedures to be used for the validation and reconciliation by TRs of reported data continue to pose challenges. Finally, there are currently no requirements for TRs to make data reported on their behalf available to counterparties.

Action in this area would help to improve the quality and transparency of the reported data, enabling authorities to use it more efficiently and effectively to monitor and identify financial stability risks. Given that the Regulation on Securities Financing Transactions¹⁰⁰ (SFTR) already gives ESMA a broader mandate to develop draft technical standards in this respect, it would also have the benefit of aligning the two Regulations in order to ensure a common quality framework for trade repositories.

3.3.2. *Trade repositories – insufficient fines*

Article 65 of EMIR empowers ESMA to impose fines on trade repositories in case they intentionally or negligently commit any of the infringements listed in the Annex I to EMIR. The same fines apply to trade repositories for securities financing transactions under the Regulation on Securities Financing Transactions (SFTR) by way of a cross-reference to EMIR.

⁹⁸ https://www.esma.europa.eu/sites/default/files/library/2016-1176_ga_xix_emir.pdf

⁹⁹ Commission Delegated Regulation (EU) of 19.10.2016, C(2016) 6624 final, and Commission Implementing Regulation (EU) of 26.10.2016, C(2016) 6801 final.

¹⁰⁰ Regulation (EU) 2015/2365 of the European Parliament and of the Council of 25 November 2015 on transparency of securities financing transactions and of reuse and amending Regulation (EU) No 648/2012.

The basic amounts of fines depend on the infringement and vary between EUR 5 000 and 10 000 or EUR 10 000 and 20 000. When deciding on the basic amount of the fines, ESMA needs to have regard to the annual turnover of the preceding business year of the trade repository concerned. The basic amounts can be adjusted by taking into account aggravating or mitigating factors that are listed in Annex II to EMIR. The amount of a fine cannot exceed 20% of the annual turnover of the trade repository concerned in the preceding business year, unless the trade repository has directly or indirectly benefited financially from the infringement, in which case the amount of the fine should be at least equal to that benefit.

In its input to the Commission's consultation on the EMIR Review¹⁰¹, ESMA first states that the amounts are not adequate and therefore not sufficiently dissuasive in view of the current turnover of the trade repositories (between EUR 1 and EUR 10 million). Accordingly, ESMA suggests that the basic amounts should be raised to EUR 50 000, 100 000 and 200 000 respectively, and that a provision should be added that the amount of the fine is at least 2% of the trade repository's turnover. As to the aggravating and mitigating factors, ESMA considers that the current list should be reviewed to be more appropriate with the trade reporting industry and the type of infringements at stake. In particular, ESMA points out that the factors which relate to the duration of the infringement should be reviewed. The significance of a confidentiality breach is, for example, not linked to its duration, which can be very short. Therefore, too many infringements could benefit from the mitigating factor that the infringement has been committed for less than 10 days. On the contrary, the aggravating factor that the infringement has been committed for more than six months would be applicable in only very few cases. Second, ESMA draws attention to an oversight whereby no basic amounts have been specified for infringements relating to obstacles to the supervisory activities (Section IV of Annex I of EMIR).

The amount of fines imposed by ESMA on the largest EU registered trade repository for negligently failing to put in place systems capable of providing regulators with direct and immediate access to derivatives trading data was low. The amount of fines for the breach that lasted for nine months with three applicable aggravating factors was EUR 64 000¹⁰². In comparison, for Credit Rating Agencies (CRAs), ESMA can impose fines between EUR 10 000 and 150 000 for infringements related to obstacles to supervisory activities, and between EUR 90 000 and 750 000 for infringements related to conflict of interest, organisational or operational requirements.

As such, the level of fines that ESMA may impose potentially limits the effectiveness of ESMA's supervisory powers under EMIR vis-à-vis trade repositories. Furthermore, the inability to impose adequate fines may limit the compliance with trade repositories with EMIR requirements, in particular on transparency, and thus indirectly financial stability.

3.4. Insufficient access to clearing

Article 4 of EMIR requires a wide range of counterparties to clear through CCPs the OTC derivatives pertaining to a class that has been declared subject to the clearing

¹⁰¹ ESMA, *EMIR Review Report no.4*, ESMA input as part of the Commission consultation on the EMIR Review, https://www.esma.europa.eu/sites/default/files/library/2015/11/esma-2015-1254_-_emir_review_report_no.4_on_other_issues.pdf.

¹⁰² <https://www.esma.europa.eu/press-news/esma-news/esma-fines-dtcc-derivatives-repository-limited-%E2%82%AC64000-data-access-failures>.

obligation. Only a limited number of these counterparties have direct access to CCPs and have become clearing members.¹⁰³

Figure 2 in section 2 helps illustrate this degree of intermediation, through the visualisation of the outstanding bilateral IRS positions. Presented by the ESRB in a September 2016 paper, the chart shows that several layers of intermediation exist between core and non-core market participants. While CCPs, G16 dealers, and banks, which appear in the core of the chart, are connected to a large number of counterparties, with many connections between them, peripheral counterparties, including NFCs and other financials, tend to access CCPs only indirectly, via only one intermediary.

Although CCPs lowered their membership requirements to enable more counterparties to become clearing members,¹⁰⁴ a clearing membership still requires sufficient financial and knowledge resources, efforts that are only economically reasonable to make if they can be spread over a high business volume most of these counterparties do not have. As described in section 3.2., for OTC derivatives asset classes already with a clearing obligation, in the OTC interest rate asset class 6 000 European financial counterparties were active, whereas in the OTC credit asset class the number of active European financial counterparties oscillated between around 2 000 and 2 800. These numbers do not include non-financial counterparties that typically¹⁰⁵ do not fulfil the regulatory requirements for a direct access to clearing. In contrast, CCPs in the EU have between 3 (ICE Clear Netherlands) and 186 (Eurex Clearing) clearing members.¹⁰⁶

The second subparagraph of Article 4(3) of EMIR requires counterparties that are not themselves clearing members to become a client of a clearing member or to establish indirect clearing arrangements with a clearing member in order to fulfil their clearing obligation for certain OTC derivatives once such an obligation enters into force for these counterparties. Some of these counterparties need to become the client of a clearing member or establish indirect clearing arrangements with a clearing member (i.e. becoming the client of a client) because they have to fulfil certain requirements for client status or want to pool clearing related activities within groups. The ability of most counterparties to fulfil their clearing obligations is therefore subject to the availability of clearing services provided by clearing members or their clients in the case of indirect clearing.

It seems that very few clearing members are currently offering client clearing services and indirect clearing services to financial counterparties and NFC+¹⁰⁷, or at least not to the smallest ones: the offer is not sufficient and/or is concentrated on very few clearing members in the market.¹⁰⁸

¹⁰³ Timothy Lane, Jean-Philippe Dion and Joshua Slive, Access to central counterparties: why it matters and how it is changing, in: Banque de France, Financial Stability Review, No. 17, April 2013, p. 169 – 179, see p. 173.

¹⁰⁴ Timothy Lane, Jean-Philippe Dion and Joshua Slive, Access to central counterparties: why it matters and how it is changing, in: Banque de France, Financial Stability Review, No. 17, April 2013, p. 169 – 179, see p. 172 and 176.

¹⁰⁵ Nevertheless, clearing memberships of non-financial counterparties do exist especially in the field of commodity clearing.

¹⁰⁶ See Annex 2B: Overview of the clearing activities in Europe.

¹⁰⁷ Non-Financial Counterparties exceeding the clearing threshold.

¹⁰⁸ See ESMA, *Consultation Paper on the clearing obligation for financial counterparties with a limited volume of activity*, 13 July 2016, ESMA/2016/1125,

The reason for this seems to be that if customers like (very) small financial counterparties or small NFC+ trade only rarely, the fixed costs per trade make the clearing economically not feasible both for the counterparty that seeks access to clearing and the counterparty that provides that access. The ratio of fixed and variable costs differ from CCP to CCP, clearing member to clearing member and depends on the product cleared. In general, a counterparty will only become a clearing member and a clearing member/client will only on-board another counterparty as its client if this generates immediate shareholder value (net profit after cost) or for which providing the clearing service at a loss is a way to keep or attract other types of business ("cross selling"). Clearing members face significant fixed costs as they need to fulfil the membership requirements of the respective CCP. The membership requirements vary from CCP to CCP. Clients of clearing members do not face these costs as they access the CCP indirectly via a clearing member. They thereby only need to satisfy any requirements imposed by the clearing member. These requirements are typically in line with those of the CCP. Who is responsible for what is, in such cases, typically governed by an agreement between the CCP, the clearing member and the client. In cases of indirect clearing even more counterparties are involved.

Examples for requirements to be met are: regulatory requirements (e.g. the need to be a regulated financial counterparty or certain capital requirements); IT requirements (e.g. certain interfaces, automated back office systems); HR requirements (e.g. the need to employ certified clearing specialists that fulfil the knowledge requirements of the CCP and are, therefore, permitted to operate clearing systems); availability requirements (e.g. the need to be available for intraday margin calls during a certain period of time at each clearing day); collateral requirements; documentation, reporting and compliance requirements.

Different fees are charged including admission fees, license fees, fees per cleared trade and/or volume and maturity, booking fees, maintenance fees, fees for different collateral services, etc.. The Financial Times reports that ISDA estimates that many clearing members are setting minimum revenues or clearing fees that range from USD 100 000 to USD 280 000 per year, amounting according to current exchange rates to EUR 95 000 to EUR 265 000.¹⁰⁹ This corresponds with the estimation of a CCP supervisor and clearing specialist who assumes costs of one trading screen to be about EUR 100 000 per year. Minimum fees in this price range essentially exclude clients from clearing services which execute only very few trades per year. Assuming a minimum fee of USD 100 000, the clearing of 10 trades per year would cost USD 10 000 per trade. These costs undermine the economic feasibility of centralised clearing for small counterparties with infrequent trading patterns. In effect, they are prevented from taking advantage of the benefits of the clearing market such as increased liquidity.

Even if a clearing member or client does not apply such a minimum fee, on-boarding a (very) small client as an (indirect) client is not economically feasible for a clearing member or client. Notwithstanding the number of trades or their volume the clearing

https://www.esma.europa.eu/sites/default/files/library/2016-1125_cp_on_clearing_obligation_for_financial_counterparties.pdf; ESMA, *Final Report on the clearing obligation for financial counterparties with a limited volume of activity*, 10 November 2016, ESMA/2016/1565, https://www.esma.europa.eu/sites/default/files/library/2016-1565_final_report_on_clearing_obligation.pdf.

¹⁰⁹ Philip Stafford, OTC markets, Derivatives 'Big Bang' catches market off guard, Financial Times, 02.02.2017, <https://www.ft.com/content/086ec02a-e6fc-11e6-967b-c88452263daf>

member or client would have to assess if that client fulfils all requirements to accept it as a client, set up an account for assets and positions of that (very) small client, monitor its positions and fulfil all obligations towards any up-stream intermediary counterparty including earmarking assets for potential default management procedures which tend to become more complicated and costly when counterparties' assets and positions are consolidated in one omnibus segregated account.¹¹⁰ These costs are not compensated by any rebate the clearing member or client might earn from the (very) few additional trades to clear.¹¹¹ Therefore, even if minimum fees are not applied and fixed cost are low because a standardised clearing platform which minimises (IT) implementation costs is used, the variable costs of each trade must be significantly higher for (very) small than for bigger clients to be economically feasible for a clearing member or client. Counterparties with a very limited volume of activities in centrally cleared markets for which an access to clearing through standard clearing platforms that are typically designed to handle bigger amounts of trades will have to negotiate – in case of a very small number of trades even on a case-by-case basis – tailor-made solutions. The costs of those solutions must be significantly higher because documentation, reporting, etc. cannot be automated in these cases, so that much more manpower per trade is needed. The costs of such individual solutions are hard to quantify.

Data from the Financial Stability Board shows that, taking into account the current clearing offering in the EU, the estimated percentage in the EU of transactions that have been centrally cleared out of all the new transactions that can be centrally cleared stands at 60-80%, while other G20 jurisdictions such as the US reaches estimates of 80-100%. In other words, market participants in the EU tend to enter into an uncleared OTC derivative on a clearable instrument more than market participants in other G20 jurisdictions. This suggests that there is scope for further uptake of central clearing and that there may be obstacles limiting access to central clearing offerings.

¹¹⁰ Individual segregated accounts are even more costly so that they are typically out of question for (very) small counterparties from an economic point of view.

¹¹¹ Examples for CCP price lists for OTC clearing of IRS and ZCIS derivatives can be found here: http://www.eurexclearing.com/blob/866458/cf5ce0a38a901e65ddd89df233f15a6a/data/eurexotc_clear_fees.pdf; <http://www.lch.com/asset-classes/otc-interest-rate-derivatives/fees>. Please note that this is only an example and prices can differ significantly from CCP to CCP and from product to product. Furthermore, tailor-made pricing is a common practice.

Figure 10 – Estimated existing scope for central clearing of OTC interest rate derivatives, March 2016

	Of all new transactions, estimated percent that can be centrally cleared (given current clearing offerings in jurisdiction)					Of all new transactions that can be centrally cleared (given current clearing offerings in jurisdiction), estimated percent that has been centrally cleared				
	0-20	20-40	40-60	60-80	80-100	0-20	20-40	40-60	60-80	80-100
AR										
AU	-	-	-	•	-	-	-	-	-	•
BR	-	-	-	-	•	•	-	-	-	-
CA	-	-	-	•	-	-	-	-	-	•
CN	-	-	-	-	•	-	-	-	-	•
EU	-	-	-	•	-	-	-	-	•	-
HK	-	-	•	-	-	-	-	•	-	-
IN	-	-	•	-	-	•	-	-	-	-
ID										
JP	-	-	-	•	-	-	-	•	-	-
KR	•	-	-	-	-	-	•	-	-	-
MX	-	•	-	-	-	•	-	-	-	-
RU	-	-	-	-	•	•	-	-	-	-
SA										
SG	-	-	•	-	-	-	•	-	-	-
ZA										
CH										
TR										
US	-	-	-	-	•	-	-	-	-	•
	0-20	20-40	40-60	60-80	80-100	0-20	20-40	40-60	60-80	80-100

(a) Estimates provided by FSB member jurisdictions, using information available as at March 2016.

no CCPs authorised to operate in jurisdiction to clear OTC derivatives transactions in this asset class.

CCPs operating, but data not able to be provided (typically because trade reporting requirements are not yet in force in this asset class, or due to data aggregation challenges).

For jurisdiction codes see Table A on page 3.

Source: FSB member jurisdictions.

S

Source: FSB OTC Derivatives Market Reforms - 11th progress report, August 2016

Several issues have been identified under the EMIR public consultation as inhibiting the provision of clearing services. In their responses, a large number of stakeholders have mentioned the leverage ratio framework under Basel III and CRR as the main reason why banks are not incentivised to provide client clearing services.¹¹² This hurdle to the access to clearing is already dealt with in the Commission's legislative proposal to amend Regulation (EU) No 575/2013 as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements and amending Regulation (EU) No 648/2012¹¹³. In that proposal, the Commission aims to exclude from the leverage

¹¹² ESMA, *Final Report on the clearing obligation for financial counterparties with a limited volume of activity*, 10 November 2016, ESMA/2016/1565, https://www.esma.europa.eu/sites/default/files/library/2016-1565_final_report_on_clearing_obligation.pdf.

¹¹³ Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 575/2013 as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements and amending Regulation (EU) No 648/2012, 23 November 2016, COM(2016) 850 final, para. 8, http://ec.europa.eu/finance/bank/docs/regcapital/crr-crd-review/161123-proposal-amending-regulation_en.pdf.

ratio the initial margins on centrally cleared derivative transactions received by institutions in cash from their clients and that they pass on to CCPs.¹¹⁴ It will, once adopted, therefore, ease access to clearing as the capital requirements to offer client or indirect clearing services will diminish.

There are other hurdles on access to clearing. First, although Article 4 of EMIR Delegated Regulation 149/2013 already requires clearing members that facilitate indirect clearing services to do so on reasonable commercial terms, this requirement does not seem to be efficient enough to encourage a sufficient offer of client and indirect client services. Stakeholders cite many different reasons why they are experiencing difficulties in establishing clearing relationships with clearing members. They claim fixed costs of clearing to be disproportionately high for counterparties with low volume of activity. They find them not transparent because of frequent pricing adjustments. In addition, they report frequent changes in legal documentation models as well as complicated onboarding processes. In general, counterparties with a limited volume of activity explain that they generally face a lack of commitment from clearing members.¹¹⁵

Second, some CCPs suggest that, among other things, the required default management procedures are an impediment to the development of clearing services from a legal and operational perspective.¹¹⁶ Although it is a requirement under international principles¹¹⁷ for CCPs to have portability arrangements in place, several issues have been identified. In particular, there are concerns that EMIR does not explicitly provide for potential conflicts with Member States' national insolvency regimes with respect to requirements for CCPs to transfer client positions in the case that a clearing member defaults ('portability') or to pay directly to clients the proceeds of a liquidation ('leapfrog payment'). The second sentence of Article 39(7) of EMIR only requires CCPs and clearing members to publicly disclose details of the different levels of segregation and to describe the main legal implications of the respective levels of segregation offered including information on the insolvency law applicable in the relevant jurisdictions. Recital 64 of EMIR seems to suggest, however, that the portability and leapfrog payment requirements may conflict with Member States' insolvency laws since it states that *'the requirements laid down in this Regulation on the segregation and portability of clients' positions and assets should therefore prevail over any conflicting laws, regulations and administrative provisions of the Member States that prevent the parties from fulfilling them'*. This creates legal uncertainty for clients and indirect clients about the risks they

¹¹⁴ See Recital 11 and Article 429c para. 4 of that Proposal.

¹¹⁵ ESMA, *Final Report on the clearing obligation for financial counterparties with a limited volume of activity*, 10 November 2016, ESMA/2016/1565, https://www.esma.europa.eu/sites/default/files/library/2016-1565_final_report_on_clearing_obligation.pdf.

¹¹⁶ ESMA, *EMIR Review report n°3 - Review on the segregation and portability requirements*, ESMA/2015/1253, 13 August 2015, https://www.esma.europa.eu/sites/default/files/library/2015/11/esma-2015-1253_-_emir_review_report_no.3_on_segregation_and_portability.pdf. ESMA reports in paragraph 32 of that report, that some CCPs found discrepancies between some Member States insolvency laws and EMIR because of which the EMIR default management tools are not enforceable under the current legal framework.

¹¹⁷ CPMI-IOSCO, *Principles for Financial Market Infrastructures* (PFMIs), Principle 14.

would face in a default situation, and potentially prevents the default management elements from operating as intended.¹¹⁸

Such issues cause inefficient (i.e. lack of access) and potential ineffective (i.e. lack of clarity in the event of default or insolvency) clearing procedures, which could ultimately indirectly impact on financial stability.

3.5. Potential risks from inaction

Not dealing with the problems described above would imply that the EMIR objectives to increase the transparency of the OTC derivatives market, to reduce counterparty credit risk associated with OTC derivatives, and to reduce the operational risk associated with OTC derivatives¹¹⁹ cannot be met in the most effective and most efficient way since, without any EU action, the current EMIR requirements would stay in place. EMIR harmonises the regulatory framework in those areas so actions by the Member States to remedy problems of effectiveness and efficiency or to alleviate disproportionate financial and administrative burden on counterparties are not possible. Furthermore, several of the inefficiencies identified could negatively impact financial stability in a variety of ways described above. The specific consequences are discussed in more detail in section 5 for the respective policy areas where actions are considered. In short, they concern the following areas.

In the absence of any policy action **Pension Scheme Arrangements** would be required to centrally clear, once the temporary exemption has expired (in August 2018). If no technical clearing solution for PSAs has emerged by this date, the resulting significant additional costs would negatively impact the retirement income of pensioners.

Some **non-financial counterparties** that present very limited systemic risk to the financial system would be subject to the clearing obligation even in asset classes where due to their small volume of activity the resulting burden is disproportionate.

Despite the persisting hurdles to have access to central clearing, some (very) **small financial counterparties** would – after the full phase-in – be captured by the clearing obligation pursuant to EMIR, even where it is not economically feasible for them to clear, effectively subjecting them to an obligation that they cannot meet.

With regard to **reporting**, disproportionate costs and burdens that are not justified by financial stability considerations will continue to be in place. There will also continue to be instances of redundant reporting, as with the ETDs.

Concerning the **transparency of OTC derivatives and positions**, the ability of authorities to monitor systemic risk in OTC derivative markets would continue to face hurdles, as the level of data quality and data transparency would continue to be suboptimal. This is due to imprecise rules and procedures, the lack of sufficient guidance

¹¹⁸ See para. 5.2 of ESMA, *EMIR Review report n°3 - Review on the segregation and portability requirements*, ESMA/2015/1253, 13 August 2015, https://www.esma.europa.eu/sites/default/files/library/2015/11/esma-2015-1253_-_emir_review_report_no.3_on_segregation_and_portability.pdf

¹¹⁹ Reaching these specific objectives was considered necessary to achieve the general objective of reducing systemic risk by increasing the safety and efficiency of the OTC derivatives market.

in the absence of a sound legal basis for issuing such guidance, and the lack of clarity as to the allocation of responsibility for verifying, correcting, and reconciling reported data.

The amount of **fin**es that ESMA can impose to trade repositories would remain low and limit the effectiveness of ESMA's supervisory powers vis-à-vis the trade repositories, as the fines would not have the dissuasive effect considered necessary by regulators.

The difficulties of **access to clearing** in general and especially the legal uncertainty with regard to the interaction between the EMIR default management tools and the national insolvency laws would remain unchanged, conflicting with the counterparties' need for such access in the light of the clearing obligation for certain OTC derivatives classes. The resulting inability to hedge their positions could lead to an increase of risk in the financial system.

The transmission mechanism is shown in the problem tree below. Besides the main drivers, problems, and consequences that are assessed in detail in the current text, the problem tree also shows a number of other issues related to the existing framework that are outside of the assessment scope, namely:

- the requirement to clear contracts before the clearing obligation takes effect (frontloading),
- the lack of a mechanism to suspend the clearing obligation, and
- the lack of transparency in CCPs' and counterparties' risk controls and methodologies.

A detailed description of these issues and an analysis of whether or not they should be addressed in the context of the EMIR Review is contained in Annex 6. These issues have not been included in the main body of the impact assessment as the corresponding amendments of EMIR are of a minor nature or merely codify existing international requirements in EU law. In the case of the 'frontloading requirement', there are no real policy options to be assessed, it can either be kept or deleted and the requirement is of a temporary nature without impact on financial stability. Concerning the mechanism to suspend the clearing obligation, the withdrawal or amendment of an existing clearing obligation is already possible under the current framework, but in a lengthy procedure that may not be appropriate in certain scenarios; the issue at stake is thus merely whether an expedited procedure for a temporary suspension is warranted to allow for a quicker regulatory response to market developments. The issues of the approval of the internal margin models and the transparency of risk controls are related to the implementation of international standards developed by CPMI-IOSCO and the FSB.

Problem tree

Drivers

Mandatory clearing and bilateral margin requirements do not sufficiently take into account the features of certain participants

Reporting requirements applying to certain transactions are excessively burdensome (e.g. backloading, intragroup transactions, ETD, and double-sided reporting)

The reported data is of low quality and difficult to use

Fines for infringements of EMIR provisions by TRs are insufficient

Legal uncertainty related to default management procedures and cumbersome segregation requirements make many clearing members consider client clearing economically unviable

Problems

Compliance costs that in a number of cases outweigh prudential benefits

Insufficient transparency of OTC derivatives positions and exposures

Insufficient access to clearing

Consequences

EMIR objective to reduce systemic risk in the OTC derivatives market not met in most effective and efficient way
Disproportionate regulatory and compliance burdens

Other changes to existing framework (out of assessment scope)

The requirement to clear contracts concluded before the clearing obligation takes effect (frontloading) causes inconsistencies

There is no mechanism for temporary suspension of the clearing obligation

CCPs' and counterparties' risk controls and methodologies lack transparency

4. OBJECTIVES

4.1. Subsidiarity

EMIR is a regulation and as such binding in its entirety and directly applicable in all Member States. The legal basis for EMIR is Article 114 of the Treaty on Functioning of the European Union ('TFEU') and any changes to it would have the same legal basis. The objectives of EMIR to mitigate the risks and improve the transparency and standardisation of OTC derivative contracts by laying down uniform requirements for such contracts and for the performance of activities of CCPs and trade repositories cannot be sufficiently achieved by the Member States and can therefore, by reason of the scale of actions, be better achieved at Union level in accordance with the principle of subsidiarity as set out in Article 5 of the TFEU.

4.2. Objectives

The broad **general objectives** behind the initiative are to ensure that the **EMIR objectives are met in a more effective and efficient way** and thus to **reduce the risk of disproportionate regulatory and compliance burdens** emanating from the application of EMIR, without putting financial stability at risk.

These can be broken down in the following **specific objectives**:

- Reduce administrative burden and compliance costs without putting financial stability at risk (S-1);
- Increase the transparency of OTC derivatives positions and exposures (S-2);
- Reduce impediments to access to clearing (S-3).

Problems	Problem drivers	Specific objectives
Compliance costs that in a number of cases outweigh prudential benefits	Mandatory clearing and bilateral margin requirements do not sufficiently take into account the features of certain participants.	<i>Reduce administrative burden and compliance costs, where this is possible without putting financial stability at risk</i>
	Reporting requirements applying to certain transactions are excessively burdensome.	

Problems	Problem drivers	Specific objectives
Insufficient transparency of OTC derivatives positions and exposures (data not clear, incomplete)	Fines for infringements of EMIR provisions by TRs are insufficient	<i>Increase the transparency of OTC derivatives positions and exposures</i>
	The reported data is of low quality and difficult to use	

Problems	Problem drivers	Specific objectives
Insufficient access to clearing	Legal uncertainty with regard to default management procedures in client clearing.	<i>Reduce impediments to access to clearing</i>

4.3. Consistency of the objectives with other EU policies

While EMIR pursues the general objective to reduce the systemic risk by increasing the safety and efficiency of the OTC derivatives market, the present initiative aims to render the application of EMIR more effective and efficient and, by fine-tuning certain requirements, to reduce the regulatory and compliance burden for market participants where compliance costs outweigh prudential benefits, but without endangering financial stability. The initiative thus contributes to the Commission's Better Regulation Agenda and the Regulatory Fitness and Performance (REFIT) programme, which emphasise, inter alia, the review of existing EU laws, so that EU policies achieve their objectives in the most effective and efficient way and aims, in particular, at reducing regulatory and administrative burden.

The present initiative is also in line with the objectives of the ongoing initiative to establish Capital Markets Union ('CMU'). Efficient and resilient post-trading systems and collateral markets are essential elements for the well-functioning of CMU. Effective and efficient EMIR rules contribute to achieving the objectives of CMU and to the Jobs and Growth agenda in line with the political priorities of the Commission.

4.4. Consistency of the objectives with fundamental rights

The EU is committed to high standards of protection of fundamental rights and is signatory to a broad set of conventions on human rights. In this context, the proposed objectives as discussed above are not likely to have a direct impact on these rights, as listed in the main UN conventions on human rights, the Charter of Fundamental Rights of the European Union which is an integral part of the EU Treaties, and the European Convention on Human Rights ('ECHR').

5. POLICY OPTIONS AND ANALYSIS OF IMPACT

5.1. Methodology

This section summarises the policy options and their impacts on stakeholders. The analysis of policy options and the comparison thereof is grouped by how these options relate to the problem drivers and respond to the problems identified in section 3. This is in line with the overall approach pursued, as set out in section 1, which consists in examining targeted amendments to EMIR that address specific issues that have given rise to concern, keeping in mind that the framework as such has not been put into question by any of the stakeholders and that the limited experience with its application (certain requirements are only being phased in now) is not a sufficient basis to consider a more far reaching overhaul. EMIR sets out requirements for clearing, risk mitigation and reporting and regulates the activities of CCPs and of TRs. The problem drivers that have been identified are (separately) related to different requirements imposed by EMIR, concern different types of entities and can therefore be addressed independently from each other.

Particular attention in the selection of policy options to be examined in this impact assessment was given to the input provided by public and private stakeholders in the context of the public consultation on the EMIR Review and the Call for Evidence as well as the reports received pursuant to Article 85(1) of EMIR from ESMA, ESRB and ESCB. The ideas put forward were screened in order to establish whether it could in principle be

reasoned that they addressed the problems identified and were in line with the approach of proposing targeted amendments to EMIR in areas where the need for such amendments had been demonstrated in a sufficiently robust way, keeping in mind that a more general overhaul of EMIR could only be considered at a later stage when more experience with the application of all requirements would be available. Certain ideas advanced by stakeholders were not included as policy options to be examined in the present impact assessment as they were not sufficiently operational or went beyond the scope of the initiative (e.g. the proposals to modify the third country regime and of reconsidering institutional aspects relating to CCP colleges), or were opposed by public authorities and regulators pointing out the resulting risks attached to the proposal (e.g. facilitating the access of CCPs to central bank liquidity facilities). Other suggestions raised by stakeholders and authorities, relating for instance to the clarification of the application of the hedging/non-hedging distinction, require to be further examined by European authorities at horizontal level as the overall EU financial services supervisory infrastructure is based on an horizontal Union approach. Initiatives across the European Supervisory Authorities, and in particular within ESMA, to improve supervisory convergence should help in that respect.

Priority was also given to options which could help either pre-empt significant burdens or risks for financial stability or alleviate existing burdens without compromising EMIR's objective to increase financial stability. For instance, the clearing obligation for PSAs will apply in August 2018, meaning that, should this not be the favoured option, alternatives should be in place by then. Likewise, the clearing obligation for small financials will soon start applying to NFCs and small financials. It should also be noted that, according to the recently adopted revised ITS on trade reporting, the deadline for backloading historic trades expires in February 2019.

The policy options developed consist of one or of several combined measures. The assessment weighs the additional costs or the cost reductions related to specific options and the effect they have on balance on reaching the EMIR objectives, thus contributing to financial stability. To the extent possible, administrative and compliance costs are quantified. In addition, and in particular where available data sources and other limitations do not allow to quantify costs, impacts are assessed on the basis of qualitative criteria.

When comparing the options, the tables illustrate how each of the policy options contributes to meeting the objectives in terms of effectiveness and their efficiency (cost-effectiveness) in doing so when compared to the 'Do nothing' option. The following schema is used: 0 (baseline scenario, no policy change), ++ (strongly positive contribution), + (positive contribution), -- (strongly negative contribution), - (negative contribution), ≈ (marginal/neutral contribution), ? (uncertain contribution), n.a. (not applicable) and 0 (neutral contribution).

5.2. Baseline scenario

Maintaining the status quo would mean retaining the scenario described in the problem definition above and further elaborated as option 1 ("No policy action") for each area in which policy actions are considered.

This would mean the following:

- removing **PSAs** from the scope of the clearing obligation, given that PSAs have not been subject to the clearing obligation, as the Commission has extended twice the transitional exemption;
- subjecting after full phase-in **some non-financial counterparties (NFC+)**, even though they present limited systemic risk to the financial system, to all of the requirements of the EMIR clearing obligation;
- subjecting after full phase-in **some (very) small financial counterparties**, even though they present limited systemic risk to the financial system, to all of the requirements of the EMIR clearing obligation;
- maintaining **the current requirements of the EMIR reporting obligation**, including in relation **the quality of the data** that TRs need to provide;
- maintaining **the current level of fines that ESMA** can impose on TRs; and
- **leaving current obstacles to access central clearing untouched and** maintaining uncertainty **limiting the ability of counterparties to hedge their positions.**

5.3. On compliance costs that in a number of cases outweigh prudential benefits

5.3.1. On mandatory clearing and bilateral margin requirements that do not sufficiently take into account the features of certain participants

5.3.1.1. Pension scheme arrangements (PSAs)

The objective is to reduce unnecessary administrative burden and compliance costs without putting financial stability at risk. To this end, the clearing obligation should be applied to PSAs in a more proportionate way.

Policy option	Description
1. No policy action	Remove PSAs from the scope of the clearing obligation.
2. Submit PSAs to the clearing obligation and oblige CCPs to accept non-cash collateral	Let the current transitional exemption lapse and amend EMIR to require CCPs to accept eligible non-cash collateral for certain market participants.
3. Provide for a new transitional exemption	Amend EMIR to extend the transitional exemption beyond August 2018, with regular reviews assessing progress in developing clearing solutions for PSAs.

Option 1 - Remove PSAs from the scope of the clearing obligation

The baseline scenario consists of removing PSAs from the scope of the clearing obligation, given that PSAs have not been subject to the clearing obligation, as the Commission has extended twice the transitional exemption.

A minority of PSAs have called for a permanent exemption from the clearing obligation, on the ground that (i) such an exemption would avoid disproportionate costs, and that (ii) PSAs would continue to be subject to risk-mitigation obligations applying to uncleared derivatives. Regarding (i), removing PSAs from the scope of the clearing obligation would avoid that PSAs shift a part of their assets into cash in order to meet the CCP variation call margins. This would therefore prevent an adverse impact on the retirement

income of their pensioners. Regarding (ii), from a prudential perspective, the participation of PSAs in the OTC derivatives market would remain subject to the risk-mitigation and margins requirements for OTC transactions that are not centrally cleared. Option 1 would also not prevent PSAs from centrally clearing on a voluntary basis, should clearing solutions emerge.

However, option 1 raises several concerns, both in terms of consistency with EMIR's objective to encourage central clearing and in terms of financial stability. First, a permanent exemption would remove regulatory incentives for CCPs to explore viable clearing solutions for PSAs. As such, option 1 would be inconsistent with EMIR's objective that '*the ultimate aim [for PSAs], however, is central clearing as soon as this is tenable*'. Second, while PSAs enjoy a specific risk profile subject to strict investment policies, they are however active participants in the OTC derivatives market. Excluding them from the scope of central clearing could have implications in terms of financial stability, as their OTC activities, which may include clearable instruments, would remain outside of central clearing. A number of Member States expressed concerns that a permanent exemption could contribute to creating a two-tier market for liquid and standard OTC derivatives, with large volume of such derivatives remaining outside of CCPs. Representatives of large PSAs also highlighted that a permanent exemption should be the option of last resort, as this would deprive PSAs from the benefits of the clearing market.

Finally, taking into account the broader scope of the clearing obligation, such an exemption could also contribute to an uneven level playing field between other financial counterparties, such as insurers, that may also have difficulties in meeting the clearing obligation, but remain subject to the clearing obligation.

Option 2 – Submit PSAs to the clearing obligation and oblige CCPs to accept non-cash collateral

Submitting PSAs to the clearing obligation would not require any change to EMIR. The Commission adopted on 20 December 2016 a delegated act extending the current transitional exemption until August 2018¹²⁰. Beyond this date, the temporary exemption will automatically expire, and the clearing requirement will apply to PSAs, regardless of whether a technical clearing solution for PSAs has emerged.

Requiring PSAs to centrally clear would reduce the systemic risk related to their activities in the OTC derivatives market, in line with EMIR's objective to increase the stability of that market. However, there is a genuine risk that there will be no viable technical solution for PSAs to post non-cash collateral in August 2018, raising concerns both in terms of cost-effectiveness and broader financial stability issues. When the temporary clearing exemption expires, PSAs will have either to (i) increase their cash holdings instead of higher yielding assets that they commonly hold, such as government bonds, with a negative impact on the retirement incomes of pensioners or (ii) rely on bilateral repo markets for collateral transformation, potentially creating new liquidity issues for PSAs in market stressed scenarios. Both scenarios imply significant costs that may outweigh the benefits of central clearing.

¹²⁰ Commission Delegated Regulation C(2016)8542 of 20 December 2016.

Indeed, several PSAs representatives have stressed the negative impact of requiring PSAs to clear without a viable solution. A number of Member States, as well as the European Parliament¹²¹, have also expressed concerns about requiring PSAs to clear centrally before a viable solution is in place.

As far as clearing solutions are concerned, a number of PSAs have suggested that CCPs could accept non-cash collateral for variation margin, such as high-quality government bonds, in order to allow them to participate in central clearing. EMIR already enables CCPs to accept highly-liquid non-cash collateral. Article 46 of EMIR contains requirements on what type of collateral can be considered highly liquid, including non-cash collateral, such as government and high-quality corporate bonds and covered bonds. The EU adopted in December 2012 a Delegated Regulation spelling out these provisions.¹²² However, as CCPs generally only accept cash as variation margin, it may be necessary to go a step further and amend EMIR to require CCPs to accept eligible non-cash collateral for PSAs meeting certain conditions.

On the one hand, this requirement would help meet the initial objective of EMIR's transitional clearing exemption, by providing a solution ensuring a relatively smooth shift of PSAs to central clearing.

On the other hand, requiring CCPs to accept non-cash collateral could have broader consequences that could negatively impact financial stability. In particular, the ESRB and ESMA have cautioned against measures that could weaken the financial soundness and robustness of CCPs in case the non-cash collateral would prove insufficiently liquid. This approach also raises procyclicality concerns.¹²³ In addition, tailoring collateral requirements to the specificity of PSAs could weaken the level-playing field vis-à-vis other market participants who may also face challenges in clearing centrally.

Option 3 - Providing for a new transitional exemption

Option 3 would provide a new transitional clearing exemption for PSAs, on the ground that no viable technical clearing solution has emerged to date. It would give more time to develop technical solutions and measures to facilitate them and be consistent with EMIR's objective that the ultimate aim for PSAs is central clearing as soon as this is feasible (Recital 26).

On the one hand, option 3 would acknowledge that the 7-year clearing exemption for PSAs has not been as effective as intended, as the clearing obligation has only started to apply as of June 2016. It would also avoid an adverse impact on the retirement income of pensioners and on market liquidity. In addition, this option would satisfy the call by several representatives of PSAs to extend the clearing exemption until a viable solution is found. This option would also accommodate concerns by the European Parliament and by several Member States that a new transitional exemption may be needed to find a clearing solution for PSAs to avoid an adverse impact on the retirement income of pensioners and on market liquidity.

¹²¹ European Parliament [Resolution 2015/2106 \(INI\)](#) of 19 January 2016, paragraph (19).

¹²² Commission Delegated Regulation (EU) No 153/2013 of 19 December 2012, Official Journal of the European Union, L 52, 23 February 2013

¹²³ ESRB, *Report on the efficiency of margining requirements to limit pro-cyclicality and the need to define additional intervention capacity in this area*; ESMA, *EMIR Review Report no.2 - Review on the efficiency of margining requirements to limit procyclicality*.

On the other hand, the experience of the last five years indicates that the prospect of mandatory clearing has not created a sufficient incentive for CCPs to develop viable technical solutions. In order to avoid that option 3 only postpones the issue further, it could be necessary to consider incentives for CCPs, clearing members and PSAs to explore viable clearing solutions, and to regularly review progress towards that goal. For instance, the Commission's recent proposal to amend the Capital Requirement Regulation¹²⁴ might help in the development of solutions for central clearing. It proposes not to include under the leverage ratio the provision of clearing services, which should alleviate the costs of offering those services. Representatives both from PSAs and from a number of Member States consider that this may provide an incentive to develop clearing solutions for PSAs. In addition, another incentive towards central clearing solutions could stem from the application of the margin requirements for bilateral clearing, which the Commission adopted in October 2016. Those will cover PSAs as of March 2017. Although variation margins will also need to be posted when clearing on a bilateral level, PSAs will be able to post non-cash collateral, meaning that no opportunity costs arise. However, the margin requirements are expected to increase the price of bilateral clearing and hence narrow the cost differential between cleared and non-cleared derivative contracts in the future. Taking into account the upcoming changes to the regulatory landscape, the Commission could also consider bringing PSAs and CCPs together to develop a coordinated viable solution, accommodating the various constraints at play.

To properly measure the impact of these incentives on the development of clearing solutions for PSAs, and assess whether further policy measures are needed, a mechanism to extend the new temporary exemption could be introduced, subject to a review based on input from the ESAs and the ESRB, providing greater flexibility in case more time is needed to develop PSAs clearing solutions, while ensuring that central clearing remains the ultimate objective for PSAs.

Table 2. Comparison of policy options against effectiveness and efficiency criteria

Objectives Policy option	EFFECTIVENESS			EFFICIENCY (cost-effectiveness)
	Objective 1 <i>Increase proportionality of rules without putting financial stability at risk</i>	Objective 2 <i>Increase transparency of OTC derivatives positions and exposures</i>	Objective 3 <i>Reduce impediments to access to clearing</i>	
Option 1 <i>No policy change PSAs not subject to the clearing obligation</i>	0	0	0	0
Option 2 <i>PSAs subject to the clearing obligation and CCPs required to accept non-cash</i>	--	+	+	--

¹²⁴ Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 575/2013 as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements and amending Regulation (EU) No 648/2012.

<i>collateral</i>		
Option 3 <i>New transitional exemption</i>	++ ≈ +	++

Magnitude of impact as compared with the baseline scenario (the baseline is indicated as 0): ++ strongly positive; + positive; -- strongly negative; - negative; ≈ marginal/neutral; ? uncertain; n.a. not applicable

The preferred option is option 3. This is the option that is the least likely to put financial stability at risk, as it maintains the ultimate objective for PSAs to participate in central clearing, without creating new risks relating to market liquidity or procyclicality (option 2). This option is also more proportionate than option 2 as it takes into account the specific risk profile of PSAs, which are subject to strict mandates governing their investment management, while not ruling out their participation in central clearing (option 1). Option 3 also helps avoid adverse costs for policy holders and provide scope for a cost-effective clearing solution in the medium-term.

The operational objective corresponding to the preferred option is the development of solutions to facilitate the participation of PSAs in central clearing.

5.3.1.2. Non-Financial Counterparties

Policy option	Description
1. No policy action	The baseline scenario applies.
2. Reduce the scope of the clearing obligation for NFCs	Introducing a higher clearing threshold that would only place the largest NFCs in scope of clearing requirements.
3. Exempt NFCs from clearing and bilateral margin requirements	Removal of the threshold and the concept of 'NFC+' and removal of the requirement for NFCs to exchange collateral.

Option 1 - No policy action

In the absence of any policy action, the baseline scenario applies. NFCs would continue to be subject to all the requirements set out in EMIR. The advantage of this option is that it is currently understood by market participants. It ensures that only non-hedging contracts that create risk count towards the determination of whether an NFC is systemically important. This excludes NFCs that genuinely only carry out hedging activity, which is prudent as these firms do not cause systemic risk. However, NFCs which exceed a certain volume of activity in non-hedging derivatives transactions are considered as presenting the same systemic risk profile as financial counterparties and are therefore subject to the same requirements as financial counterparties.

Option 2 – Reduce the scope of the clearing obligation for NFCs

This option involves introducing a higher threshold that would only place the largest NFCs in scope of clearing requirements. One way of doing this is by applying the same clearing threshold as in the baseline scenario, but only requiring that those asset classes for which the thresholds have been exceeded and for which there is a clearing obligation should be subject to the clearing obligation. It recognises that in general NFCs are significantly active in only a few asset classes, very often only one. This option introduces more proportionality and reduces the number of NFCs subject to the clearing obligation. This is particularly the case today as NFCs are mostly active in Commodity

derivatives, an asset class for which there is so far no clearing obligation. NFCs exceeding a certain volume of activity in non-hedging derivatives would still be considered as having the same profile as financial counterparties and would therefore be subject to the same requirements as financial counterparties, in particular the margin requirements.

The advantage of this option is that it would recognise the ability for NFCs to distinguish between hedging and non-hedging activities and simplify their clearing requirement. By imposing the clearing obligation only in the asset class or classes for which the clearing threshold has been breached and for which a clearing obligation exists, NFCs would only have to negotiate clearing arrangements for that particular asset class or classes, reducing the legal and operational burden. However, as the bilateral margin requirement would still apply, there would be an appropriate degree of systemic risk mitigation.

This option was supported by a number of stakeholders in the public consultation, in particular European associations¹²⁵ representing corporates.

Option 3 - Exempt NFCs from clearing and bilateral margin requirements

This option would imply that only reporting requirements would apply to NFCs. The advantage is that it would lower the burden on all NFCs, meaning that costs associated with determining whether an NFC is above or below the threshold would cease and the costs of providing collateral would also be removed. This option is therefore the one that most closely meets the objective of reducing burdens on corporates. As the ESMA report identified that contracts with all NFCs only represent a small proportion of the overall number of contracts, the impact on systemic risk may be limited. However, this would be a deregulatory measure that is not justified by market developments since EMIR has been introduced, as there has been no evidence subsequently that suggests that these contracts are sufficiently safe that they can be subject to neither clearing nor margin requirements. This option is supported by non-financial counterparties (in particular firms dealing with commodities) mainly based on the argument that NFCs only act on the OTC derivatives market for hedging purposes and do not add systemic risk. However, this option is not supported by financial regulators, given the fact that corporates deal with huge volumes of derivatives and not applying any risk-mitigation technique could entail important financial risks to their counterparties and would also reduce the level of liquidity in the relevant derivatives markets.

Table 3. Comparison of policy options against effectiveness and efficiency criteria

<i>Objectives</i> <i>Policy option</i>	<i>EFFECTIVENESS</i>			<i>EFFICIENCY</i> <i>(cost-effectiveness)</i>
	<i>Objective 1</i> <i>Increase proportionality of rules without putting financial stability at risk</i>	<i>Objective 2</i> <i>Increase transparency of OTC derivatives positions and exposures</i>	<i>Objective 3</i> <i>Reduce impediments to access to clearing</i>	
<i>Option 1</i> <i>No policy change</i>	<i>0</i>	<i>0</i>	<i>0</i>	<i>0</i>

¹²⁵ Including the European Association of Corporate Treasurers and the Joint Energy Associations Group.

Option 2 <i>Reduce the scope of the clearing requirements</i>	++	≈	+	+
Option 3 <i>Exempt NFCs from clearing and margin requirements</i>	-	≈	-	-

Magnitude of impact as compared with the baseline scenario (the baseline is indicated as 0): ++ strongly positive; + positive; -- strongly negative; - negative; ≈ marginal/neutral; ? uncertain; n.a. not applicable

The preferred option is option 2. This option is least likely to put financial stability at risk as it does not remove the obligation to exchange variation margin for NFC+s and initial margin for those NFC+s that are above the threshold of €8bn introduced in the margins rules. Most Member States consider that it is necessary to monitor the appropriateness of the current thresholds, whereas option 3 would cause lots of contracts to be subject to neither clearing nor margin obligations. Option 2 is preferable to option 1, despite the fact that a few Member States would support it, as it introduces more proportionality in how rules are applied to NFCs. A lot of NFCs would be able to exchange margin bilaterally in lieu of having to centrally clear their contracts. This would reduce compliance costs where those firms have difficulty in accessing clearing.

The preferred option corresponds to the operational objective of better adjusting the clearing requirements with a view to reducing unnecessary compliance costs that are not justified by financial stability requirements.

5.3.1.3. Small Financial Counterparties

Policy option	Description
1. No policy action	The baseline scenario applies.
2. Narrower definition of small financial counterparties than currently defined as Category 3	Those very small financial counterparties for which central clearing is not economically feasible are exempted from the clearing obligation that stays in place for the other small financials.
3. Exempt all Category 3 financial counterparties from mandatory clearing	All small financials as currently defined as Category 3 are exempted from mandatory clearing.

Option 1 - No policy action

In the absence of any policy action, the baseline scenario applies. The advantage of this option is that it is currently understood to market participants. It ensures that all financial counterparties irrespective of their volume of activity are subject to the clearing obligation. This ensures the widest possible scope of application of the clearing obligation as far as financial counterparties are concerned. Thus, each transaction of a financial counterparty and, therefore, each related risk of a financial counterparty is captured by the clearing obligation. Furthermore, keeping the clearing obligation in place for all financial counterparties while providing for different compliance periods for counterparties with a phased-in implementation schedule with regard to the volume of their activities keeps CCPs, clearing members and their clients incentivised to develop solutions to on-board small financial counterparties in due time.

However, ESMA's assessment of the access of small financial counterparties to central clearing shows that at least for the smaller of the small financial counterparties the use of central clearing is not only a disproportionate burden, but impossible for them in 2017. Where the reason for this impossibility is that central clearing is not economically feasible because of a (very) small volume of activity, this hurdle will stay in place even

after the longer phase-in period proposed by ESMA ends. To impose a clearing obligation on such (very) small financial counterparties would then mean to require something that is not doable for the addressees of that obligation.

Option 2 – Provide a narrower definition of the category of small financial counterparties

A narrower definition of what constitutes a small financial counterparty that would be subject to the clearing obligation could be set to capture only those firms with a certain volume of activity smaller than the current threshold of EUR 8bn as defined in the three Commission Delegated Regulations on the clearing obligation for Category 3 counterparties. The new threshold should be calibrated based on clear criteria set out in the legislation to determine the volume of activity above which the mandatory clearing applies, taking into consideration the type of financial institution and the type and volume of derivative trading with the objective of not damaging financial stability. All financial counterparties would stay subject to the margin requirements (covering both the exchange of variation margin and, where above the EUR 8 billion threshold set up in the margin rules, the exchange of initial margin); therefore no additional financial stability risk would be created for the financial system.

The advantage of this option is that it allows lightening the burden of those (very) small financial counterparties for which central clearing is not economically feasible because of their small volume of activity, while keeping the largest of the small financial counterparties obliged to clear once the phase-in period set in the regulatory technical standards ends. Such an option would remove the difficulties to find access to clearing for those counterparties that are not able to clear because their OTC derivatives portfolio is too small, but keep most of those counterparties bound by the clearing obligation that fall in Category 3¹²⁶ of the existing Commission Delegated Regulations on the clearing obligation which are still big enough to fulfil the clearing obligation. This keeps CCPs, clearing members and their clients incentivised to develop solutions to on-board small financial counterparties which remain obliged to centrally clear in due time. When developed, these solutions may attract even those financial counterparties that are not anymore obliged to centrally clear but find it more attractive to use central clearing voluntarily as they remain subject to bilateral margin and reporting requirements which can become even more costly than central clearing depending on the trading volume of the counterparty.

Most EU regulators have called for the need to introduce further proportionality in the application of the rules, in particular taking into consideration the difficulties to have access to clearing and the fact that in other jurisdictions the very small financial counterparties are exempted from clearing.

Option 3 - Exempt all Category 3 financial counterparties from mandatory clearing

¹²⁶ These are financial counterparties (and certain funds which are classified as non-financial counterparties) belonging to a group whose aggregate positions in OTC derivatives are EUR 8bn or below according to Commission Delegated Regulation (EU) 2015/2205 of 6 August 2015 supplementing Regulation (EU) No 648/2012, OJ L 314, 1.12.2015, p. 13; Commission Delegated Regulation (EU) 2016/592 of 1 March 2016 supplementing Regulation (EU) No 648/2012, OJ L 103, 19.4.2016, p. 5, and Commission Delegated Regulation (EU) 2016/1178 supplementing Regulation (EU) No. 648/2012, OJ L 195, 20.7.2016, p. 3.

An exemption from mandatory clearing would imply that only bilateral margins and reporting requirements would apply to Category 3 firms. The advantage of this option is that it uses the existing definition of small financials that is currently understood to market participants. However, as option 3 excludes all small financials from the clearing obligation in comparison with option 2, it would dis-incentivise the development of solutions to foster the access to central clearing for small financials. As according to ESMA's assessment, access to central clearing is impossible only for some, but not for all, small financials because of their limited volume of activity, option 3 would exempt more small financials from the clearing obligation than is necessary to achieve a better calibration of the rules and could thus hinder financial stability. Furthermore Option 3 would create an un-level playing field in the case where, one way or another, non-financial counterparties stay subject to the clearing obligation.

Table 4. Comparison of policy options against effectiveness and efficiency criteria

Objectives Policy option	EFFECTIVENESS			EFFICIENCY (cost-effectiveness)
	Objective 1 <i>Increase proportionality of rules without putting financial stability at risk</i>	Objective 2 <i>Increase transparency of OTC derivatives positions and exposures</i>	Objective 3 <i>Reduce impediments to access to clearing</i>	
Option 1 <i>No policy change</i>	0	0	0	0
Option 2 <i>Narrower definition of small financial counterparties</i>	++	≈	+	+
Option 3 <i>Exemption of all small financials as currently defined as Category 3</i>	--	-	≈	-

Magnitude of impact as compared with the baseline scenario (the baseline is indicated as 0): ++ strongly positive; + positive; -- strongly negative; - negative; ≈ marginal/neutral; ? uncertain; n.a. not applicable

The preferred option is option 2. This option keeps a bigger part of the financial counterparties that are currently defined as small obliged to clear than option 3, while taking into consideration the persisting hurdles to central clearing for (very) small counterparties. Therefore, option 2 is the most balanced option. It keeps as many counterparties and as much risk as possible subject to the clearing obligation, but increases proportionality by lightening the burden for those financial counterparties that have no access to central clearing because it is not economically feasible for them to clear. No increase in financial stability risk would be introduced into the financial system because the rules on margins would still apply to the small financial counterparties. In addition, most Member States consider that there is a need to redefine the small financials category.

The preferred option corresponds to the operational objective of better adjusting the clearing requirements with a view to reducing unnecessary compliance costs that are not justified by financial stability requirements.

5.3.2. *On excessively burdensome reporting requirements applying to certain transactions*

Policy option	Description
1. No policy action	The baseline scenario applies.
2. Fine-tuning the rules in the identified problem areas	Better calibrate some of the requirements: elimination of the requirement to report historic trades; to exempt intragroup transactions in which one of the counterparties is an NFC from the reporting obligation; to remove from the counterparties the obligation to report ETD transactions and give it to the CCPs; to alleviate the burden of EMIR reporting for small NFC.
3. Significantly restructuring or removing certain reporting requirements	The requirements to report historic trades and intragroup transactions are eliminated, the reporting requirement for ETDs is eliminated by using the data reported under MiFID II/MiFIR, double-sided reporting is replaced with single-sided reporting according to appropriate reporting hierarchies.

Option 1 - No policy action

In the absence of any policy action, the baseline scenario applies. The advantage of this option is that it provides legal certainty to market participants, as the reporting rules remain unchanged. To a certain extent, some of the respondents' concerns (concerning insufficiently clear and harmonised reporting rules) will be addressed by recent and upcoming changes to technical standards. Moreover, the investments already undertaken by counterparties to implement double-sided reporting will be effectively utilised. However, the drawback of remaining with the current rules is that all of the other excessive costs and burdens will continue to be in place, and that the quality of data will remain suboptimal. EMIR reporting rules will continue to exist in parallel – but will not be aligned – with SFTR rules. There will also continue to be instances of redundant reporting, as with the ETDs.

Option 2 – Fine-tuning the rules in the identified problem areas

In light of the work already underway in ESMA to clarify and harmonise the reporting rules and requirements, and with a view to limiting the modifications to the reporting rules to areas most urgently requiring action while ensuring that data necessary for the monitoring of the market by authorities continues to be reported with the minimum amount of disruption, Option 2 focuses on four distinct areas: (i) the obligation to 'backload' historic trades; (ii) intragroup transactions; (iii) exchange-traded derivatives; and (iv) reporting by smaller NFCs.

With regards to the 'backloading' requirement, under this option, the obligation to report historic trades would be eliminated. The advantage of removing this obligation would significantly reduce costs and burdens on counterparties and eliminate the potentially insurmountable obstacle of having to report data which may simply not be available. It is important to note that SFTR does not contain a 'backloading' requirement for securities financing transactions, so this option would have the additional benefit of aligning the two pieces of legislation. The drawback is that the removal of the obligation to 'backload' trades would imply some loss of data for the supervisory authorities, but given that virtually no such data has yet been reported and in light of the claims that it would not be useful in any case, the negative impact of such a decision would likely be limited. The

vast majority of contributors¹²⁷ to the EMIR public consultation suggested a removal of this obligation. This suggestion also found broad consensus among the Member States.

Concerning the requirement to report intragroup transactions, this option envisages that any intragroup transactions in which one of the counterparties was an NFC would be exempted from the reporting obligation. Given the nature of such trades, such an approach would have the advantage of significantly reducing the costs and burdens of reporting for those counterparties which are the most disproportionately affected by the requirement. In terms of disadvantages, there would be a very limited loss of data, but given that intragroup trades with NFCs by their very nature have a limited impact on systemic risk and that the vast majority of intragroup trades would still be reported, the impact on the ability to monitor systemic risk in the OTC derivative markets would be minimal. The vast majority of respondents¹²⁸ to the EMIR public consultation called for completely removing the obligation to report intragroup transactions, with a small number suggesting limiting the exemption to NFCs or even NFCs-. Some financial regulators called for the exemption of NFCs. The ECB and ESMA called for a cautious approach so as not to lose too much data.

Concerning the EMIR requirement to report ETDs, this option would remove the obligation to report ETD transactions from the counterparties and place it on the CCP instead. Since a CCP is involved in every ETD transaction, CCPs by definition have in their possession a significant amount of data pertaining to these transactions. The principal advantage of this approach is that, overall, the reporting of ETDs will be greatly simplified without a negative impact on the transparency of the derivatives market. Although the CCPs will face a slightly higher reporting burden, given that they are already required to report all centrally-cleared derivative transactions under EMIR, the additional burden will be minimal. At the same time, as far as ETDs are concerned, it will be eliminated for all other counterparties. While for the moment, CCPs may not possess all data on ETD transactions required as part of the EMIR reporting framework, this should change as of January 2018, when a requirement will come into force for all exchange-trade derivatives to be cleared by CCPs. As such, there is no risk of a loss of data. Several industry associations¹²⁹ and financial regulators identified the reporting of ETDs as an issue. Some respondents suggested completely exempting ETDs from the reporting obligation and others suggested moving to single-sided reporting for these types of transactions. Several financial regulators have also suggested single-sided reporting for ETDs. The ECB and ESMA called for maintaining the reporting obligation for ETDs on account of the need for the data to correctly monitor the market.

¹²⁷ Including a large number of associations such as the European Fund and Asset Management Association (EFAMA), PensionsEurope, the European Association of Public Banks (EAPB), the European Association of Co-operative Banks (EACB), the Managed Funds Association, FIA Europe, the International Swaps and Derivatives Association (ISDA), the Commodity Markets Council – Europe (CMCE), etc.

¹²⁸ Including several associations such as the European Banking Federation (EBF), the Managed Funds Association, FIA Europe, the International Swaps and Derivatives Association (ISDA), the Coalition for Derivative End-Users, the Commodity Markets Council – Europe (CMCE), EURELECTRIC, etc.

¹²⁹ For example the European Association of Co-operative Banks (EACB), the European Banking Federation (EBF), the International Swaps and Derivatives Association (ISDA), the European Association of CCP Clearing Houses (EACH), FIA Europe, etc.

Finally, this option would modify the reporting rules so that in cases of transactions between a financial counterparty and a smaller NFC, the financial counterparty would be required to report the transaction on behalf of both counterparties. This approach would have the advantage of significantly reducing the burdens of reporting for those counterparties for which it is most significant, without leading to any loss of data. While the automatic data quality check would disappear for these transactions, only a limited proportion of trades would be affected. In addition, this approach would have the benefit of aligning at a certain extent the reporting rules in EMIR and SFTR. Most respondents to the public consultation (including almost 40 industry associations) raised the issue of the excessive burden of a double-sided reporting system, in particular for non-financials. Several financial regulators also considered that it would be appropriate to reduce the burden of reporting for small NFCs, taking inspiration from the SFTR approach.

Taken together, the modifications considered under Option 2 would on balance reduce the costs and burdens of reporting for all entities – significantly so for those, like smaller NFCs, for which that burden is greatest – while reducing the loss of data to a minimum.

Option 3 – Significantly restructuring or removing certain reporting requirements

This option implies a more radical approach to reforming trade reporting rules, in that some of the current requirements would be significantly amended and others removed entirely.

With respect to the 'backloading' obligation, it would still be removed as in Option 2, with the same positive and negative effects as identified above.

Concerning ETD transactions, this option proposes to eliminate the reporting requirement for ETDs under EMIR and use the data provided under the MiFID II/MiFIR rules for reporting ETDs instead. This approach would be neutral in terms of reducing reporting overall burdens, as MiFID II/MiFIR currently exempts ETDs which have already been reported to a trade repository under EMIR from having to be reported again under MiFID II/MiFIR. As such, the approach would simply move the obligation from one framework to another. On the other hand, there would be several important disadvantages. Firstly, the type of data collected under the two regimes is very different – while EMIR focuses on the details of the financial contract required for the monitoring of systemic risk, the focus of MiFID II/MiFIR reporting is much more on data required for the detection of market abuse. Secondly, MiFID II/MiFIR does not require data to be reported to a Trade Repository but rather directly to the national competent authorities. As such, this option implies either a significant loss of data which would negatively impact the ability to monitor systemic risk in derivative markets, or otherwise the need to introduce significant amendments to MiFID II/MiFIR and various corresponding technical standards. This solution would therefore necessitate changes which would be quite burdensome for many market actors without ensuring that an equivalent data quality could be maintained.

Option 3 would also exempt all intragroup transactions from having to be reported under EMIR. Such a modification would have the advantage of significantly reducing the costs and burdens of reporting for those counterparties which engage in intragroup derivatives transactions. However, since the number and volume of intragroup transactions carried out by financial entities is understood to be quite high, exempting intragroup transactions carried out by financials counterparties – even smaller ones – would result in a very

significant loss of data, and would therefore have important negative consequences for authorities' ability to monitor risks in the OTC derivative market.

Finally, this option would replace the current double-sided reporting system with single-sided reporting for all types of transactions, while at the same time specifying or setting out rules to define which counterparty would have the obligation to report the transaction. The main advantage of a move to general single-sided reporting under EMIR is that it would reduce costs and burdens for those counterparties which would no longer have to report the transaction. However, this advantage would be fully neutralised by several negative side-effects. The move to single-sided reporting would remove the automatic data quality check effect of reporting by both sides to a transaction, risking a significant deterioration of data quality and thereby putting into question its usefulness to supervisors. This in turn implies a reduced ability of these authorities to monitor systemic risks in derivative markets. New means of verifying the correctness of data might need to be devised, presenting the potential risk of increasing costs and burdens for the reporting counterparty, for supervisors, and for ESMA. Furthermore, if the rules for determining which counterparty should report the transaction are not sufficiently well defined or unclear, some of the transactions may go unreported, as both counterparties will be of the opinion that the other one should report the trade. This would have a very detrimental effect on the transparency of OTC derivatives markets. Finally, the investments undertaken to build up reporting systems by those counterparties which would no longer be required to report would effectively have been wasted. Concerning the outcome of the public consultation, several stakeholders called for the move towards single-sided reporting, but financial regulators considered that all the necessary data to fulfil their tasks to monitor market risk would not be available if such a change was introduced.

Overall, the package of changes considered as part of Option 3 would significantly reduce the costs and burdens of the requirement to report OTC derivative transactions, but the level of loss of data in which they would result would be very significant, putting into question the representativeness – and therefore the usefulness for the purposes of the monitoring of market risk – of the residual data which would continue to be reported. In addition, there would be much less certainty as to the quality and completeness of the data which were still being reported, as the automatic check function of double-sided reporting would disappear.

Table 5. Comparison of policy options against effectiveness and efficiency criteria

Objectives Policy option	EFFECTIVENESS			EFFICIENCY (cost-effectiveness)
	Objective 1 <i>Increase proportionality of rules without putting financial stability at risk</i>	Objective 2 <i>Increase transparency of OTC derivatives positions and exposures</i>	Objective 3 <i>Reduce impediments to access to clearing</i>	
Option 1 <i>No policy change</i>	0	0	0	0
Option 2 <i>Fine-tuning the rules in the identified problem areas</i>	++	-	n.a.	++
Option 3 <i>Significantly restructuring or</i>	≈	--	n.a.	-

removing certain reporting requirements		
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Magnitude of impact as compared with the baseline scenario (the baseline is indicated as 0): ++ strongly positive; + positive; -- strongly negative; - negative; ≈ marginal/neutral; ? uncertain; n.a. not applicable

The preferred option is option 2. This option will significantly increase the proportionality of the reporting obligations with respect to the baseline scenario, while its impact on the transparency of OTC derivatives positions will be only marginally negative. As such, Option 2 does not in any way put financial stability at risk. Option 3, on the other hand, is neutral at best in terms of its impact on the proportionality of rules, as the ability of relevant authorities to adequately monitor risk in OTC derivative markets would be diminished due to the significant loss of data (i.e. a strongly negative impact on transparency) and the likely drop in the quality of data which this option would imply. Finally, Option 3 would be less cost-efficient due to the additional procedures which would need to be put in place to verify the correctness of data further to a move to single-sided reporting. For these reasons, while Option 2 would be an improvement on the baseline scenario, Option 3, on the contrary, would result in a worse situation than at present.

In terms of the operational objective to be pursued, the preferred option aims at better adjusting the reporting requirements with a view to reducing unnecessary compliance costs and administrative burden that are not justified by financial stability requirements.

5.3.3. Overview of preferred options relating to compliance costs

Table 6 below summarises the preferred options relating to compliance costs and shows how they relate to each other.

	FC	SFC	PSAs	NFC+	NFCs-
Clearing obligation	Yes	No	Transitional exemption	Only in relevant asset class	No
Operational risk-mitigation techniques for uncleared OTC derivatives	Yes	Yes	Yes	Yes	Yes (except daily valuation)
Variation Margin requirements	Yes	Yes	Yes	Yes	No
Initial Margin requirements (when OTC derivatives uncleared activities are above EUR 8 bn in gross notional outstanding amounts)	Yes	Yes	Yes	Yes	No
Reporting of all derivative	Yes (IGTs and double-sided)	Yes (IGTs and double-sided)	Yes (IGTs and double-sided)	Yes (double-sided)	Yes (reporting by FCs when

contracts	reporting)	reporting)	reporting)	reporting)	transacting with NFCs)
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5.4. On insufficient transparency of OTC derivatives positions and exposures

5.4.1. Trade repositories – insufficient quality of data and difficulties of data use

Policy option	Description
1. No policy action	The baseline scenario applies.
2. Introduce new TR requirements and expand the scope of technical standards to further harmonise the reporting rules and procedures and ensure the transparency and quality of data	The scope of technical standards is expanded to allow for the harmonisation of the form of the reports, the standards to be used, and the methods and arrangements for reporting, as well as for the harmonisation of TR procedures for the validation and reconciliation of data. TRs are required to grant counterparties access to data reported on their behalf.
3. Expand ESMA's mandate to regulate the TRs	In addition to all elements of Option 2, ESMA is granted additional powers to regulate TRs (e.g. requirement for TRs to submit periodic information, simplifying procedures for on-site inspections, expanding enforcement powers).

Option 1 - No policy action

In the absence of any policy action, the baseline scenario applies. The advantage of this scenario is that it provides a certain amount of legal certainty to stakeholders, in that the outlines of ESMA's mandate for developing technical standards remains unchanged and no new burdens are placed on any of the stakeholders. The disadvantages include a continuing suboptimal level of data quality and data transparency, principally due to imprecise rules and procedures, a lack of sufficient guidance in the absence of a sound legal basis for issuing it, and lack of clarity as to the allocation of responsibility for verifying, correcting, and reconciling reported data. The ability of authorities to monitor systemic risk in OTC derivative markets would continue to face hurdles.

Option 2 – Introduce new TR requirements and expand the scope of technical standards to further harmonise the reporting rules and procedures and ensure the transparency and quality of data

This option would involve two related sets of amendments. Firstly, the scope of the technical standards to be developed by ESMA would be expanded to allow for the further harmonisation of the reporting rules and requirements (including the form of the reports, the standards to be used, and the methods and arrangements for reporting, as well as the harmonisation of the procedures to be applied by trade repositories to validate the reported data as to its completeness and correctness and the procedures for the reconciliation of data between them. Secondly, trade repositories would be required to grant counterparties – upon specific request only, without the need to do so automatically and on a recurrent basis – access to all data reported on their behalf, once again in order to allow for a verification of its correctness. The advantage of this option is that the quality of data reported to beneficiaries and subsequently made available to authorities would increase, which will make the derivatives market more transparent and facilitate the monitoring of systemic risk therein. Moreover, after the initial transition phase to the new rules, reporting of transaction data by counterparties and the processing of the reported data (due to greater standardisation and better quality thereof) would become more straightforward, reducing the costs and burdens resulting from the reporting

obligation. Finally, it is important to note that Article 26 of MiFIR already gives ESMA the mandate to specify the “*data standards and formats for the information to be reported (...), including the methods and arrangements for reporting financial transactions and the form and content of such reports*”, and that Article 5(2) of SFTR already requires a trade repository to “*apply procedures to verify the completeness and correctness of the details reported to it*”. As such, this option has the added advantage of aligning the rules in these three pieces of legislation. The disadvantages of this option are the possibility that reporting counterparties will incur some additional costs and efforts in the initial stages of implementation, and the additional burden placed on trade repositories to ensure the quality and transparency of the data. However, given the SFTR requirement mentioned above, trade repositories will need to implement such procedures for securities financing transactions in any case, the impact on them of this option would in effect be neutral. In the public consultation, most of the respondents¹³⁰ suggested that improvements in transparency are needed. A wide variety of suggestions were made, ranging from insufficient standardisation of reporting, to a need for access by a broader range of authorities, to problems with aggregation by TRs. There was consensus among financial regulators on the need to put in place additional rules to ensure the quality and transparency of data.

Option 3 – Expand ESMA's mandate to regulate the TRs

This option would include all of the elements of Option 2 aimed at extending the scope of technical standards to be adopted by ESMA for the harmonisation of the reporting requirements and ensuring the transparency and quality of data, but would also go beyond that by granting ESMA a number of new powers in its role as a regulator of trade repositories. These would include: (i) requiring TRs to submit periodic information (e.g. financial accounts or audit, risk, and compliance reports) to ESMA; (ii) allowing ESMA to regulate the documents which TRs can require authorities to sign before accessing data; (iii) expanding the list of the enforcement decisions that ESMA can adopt for breaches by TRs and introducing an accelerated adoption procedure; and (iv) removing the need for a judicial authorisation for non-coercive on-site inspections. The main advantages of this option are that it would increase the transparency of TR activities and any potential risks to TRs' business activity, would give ESMA greater flexibility in responding to any breaches, and might facilitate authorities' access to TR data. The principal disadvantage is that it would place significant additional burdens on TRs and introduce new costs and uncertainties into their operations, creating a risk that some TRs may decide that this activity is no longer viable and choose to exit the market. Furthermore, these additional powers would have a very limited direct impact on data quality and transparency and some of them would be very difficult to implement taking into consideration national judiciary systems. Some financial regulators were not in favour of empowering ESMA with additional powers.

Table 7. Comparison of policy options against effectiveness and efficiency criteria

	<i>EFFECTIVENESS</i>	<i>EFFICIENCY</i>

¹³⁰ Including several European and national associations such as the European Association for Investors in Non-Listed Real Estate Vehicles (INREV), the Commercial Real Estate Finance Council Europe, (CREFC), etc.

Objectives Policy option	Objective 1 <i>Increase proportionality of rules without putting financial stability at risk</i>	Objective 2 <i>Increase transparency of OTC derivatives positions and exposures</i>	Objective 3 <i>Reduce impediments to access to clearing</i>	(cost-effectiveness)
Option 1 <i>No policy change</i>	0	0	0	0
Option 2 <i>Introduce new TR requirements and expand the scope of technical standards</i>	+	++	n.a.	+
Option 3 <i>Expand ESMA's mandate to regulate TRs</i>	-	+	n.a.	-

Magnitude of impact as compared with the baseline scenario (the baseline is indicated as 0): ++ strongly positive; + positive; -- strongly negative; - negative; ≈ marginal/neutral; ? uncertain; n.a. not applicable

The preferred option is option 2. This option will significantly increase the transparency of OTC derivative markets and the quality of reported data, facilitating the task of the relevant authorities of monitoring systemic risk. Additionally, in the medium and long term it will increase the proportionality of the reporting rules and reduce costs and burdens while maintaining to the greatest extent possible alignment with international standards in this field. As such, this option is generally supported by the Member States. While option 3 might have a similar effect on the transparency and quality of data, due to the additional burdens placed on TRs, it could disincentivise TRs from offering these services and would be much more neutral in terms of the proportionality of the rules and, due to the additional costs which will be generated and may be passed by TRs onto counterparties, will be significantly less efficient.

The preferred option corresponds to the operational objective of improving the quality of transaction data reported to TRs and of the processed data provided by TRs.

5.4.2. Trade repositories – insufficient fines

Policy option	Description
1. No policy action	The baseline scenario applies.
2. Increase the upper limit of the basic amount of fines	The upper limit of the basic amounts of fines would be significantly increased.
3. Introduce a minimum fine calculated as a percentage of the TR's turnover	The minimum amount of the fine would be a percentage of the TR's turnover and increase the lower amount of fines.

Option 1 - No policy action

In the absence of any policy action, the amount of fines that ESMA can impose would remain low and limit the effectiveness of ESMA's supervisory powers vis-à-vis the trade repositories.

Option 2 - Increase the upper limit of the basic amounts of fines

Increasing significantly the upper limits of the basic amounts of fines to take into account the current turnover of trade repositories would make the fines more efficient and

dissuasive, make ESMA's supervisory powers more effective and incentivise the trade repositories' compliance with EMIR requirements and indirectly increase financial stability. To increase the upper limits basic amounts as proposed by ESMA - by multiplying the current upper limits by ten - would in relative terms bring the amounts close to the fines that ESMA can impose on credit rating agencies which ESMA also directly supervises while still keeping the fines proportionate for smaller trade repositories. Member States generally favour ensuring that the fines are dissuasive to which this option corresponds.

Option 3 – Increase the lower limit of the basic amounts of the fines and introduce a minimum fine calculated as a percentage of the trade repository's turnover

Introducing a minimum fine calculated as a percentage of the trade repository's turnover could better take into account the turnover of big trade repositories, if the final fine imposed would be the higher one between the fine calculated on the basis of the basic amounts and taking into account the aggravating and mitigating factors and the minimum amount calculated as a percentage. On the other hand, it could result in disproportionate fines for big trade repositories committing less important infringements and generally for smaller trade repositories. This option would also deviate from the framework for credit rating agencies that does not recognise a percentage based minimum amount for fines. Similarly, increasing the lower limit of the basic amounts could lead to disproportionate fines for smaller trade repositories.

Table 8. Comparison of policy options against effectiveness and efficiency criteria

Objectives Policy option	EFFECTIVENESS			EFFICIENCY (cost-effectiveness)
	Objective 1 Increase proportionality of rules without putting financial stability at risk	Objective 2 Increase transparency of OTC derivatives positions and exposures	Objective 3 Reduce impediments to access to clearing	
Option 1 <i>No policy change</i>	0	0	0	0
Option 2 <i>Increase the upper limit of the basic amount of fines.</i>	n.a	++	n.a	++
Option 3 <i>Introduce a minimum fine and increase the lower limit of the basic amount of fines</i>	n.a	+	n.a	-

Magnitude of impact as compared with the baseline scenario (the baseline is indicated as 0): ++ strongly positive; + positive; -- strongly negative; - negative; ≈ marginal/neutral; ? uncertain; n.a. not applicable

The preferred option is option 2. It would increase the efficiency and dissuasive effect of the fines which is considered to be necessary by regulators to incentivise the good quality of the data for the purpose of monitoring financial stability risks. It is more proportionate than combination 3 as well as more consistent with the other regime under which ESMA can impose fines on entities it directly supervises.

Translated into an operational objective, the preferred option aims at adjusting fines for infringements of EMIR provisions by TRs to a level that corresponds to the needs of effective supervision, thus contributing to ensuring the quality of TR data.

5.5. On insufficient access to clearing

Policy option	Description
1. No policy action	The baseline scenario applies.
2. Clarify the interaction between EMIR default management tools and national insolvency laws and introduce a FRAND principle provision	Providing for the insolvency remoteness of EMIR default management tools. A specific FRAND principles provision would apply to clearing members and clients that offer client and indirect client clearing.
3. Oblige clearing members and their clients to offer clearing services to all counterparties required to centrally clear	Providing for provisions that oblige clearing members and their clients to offer clearing services to all counterparties required to centrally clear and, thus, constituting clearing members and their clients as new types of financial market infrastructures offering clearing services in the public interest.

Option 1 - No policy action

In the absence of any policy action, the baseline scenario applies. The difficulties of access to clearing in general and especially the legal uncertainty with regard to the interaction between the EMIR default management tools and the national insolvency laws would remain if no policy actions were taken. This contradicts the counterparties' need to access CCPs for clearing purposes, so that they are able to conclude OTC derivatives which are subject to mandatory clearing. In the absence of access, counterparties may be unable to hedge their positions which could lead to increasing risk.

Option 2 - Provide for the insolvency remoteness of EMIR default management tools within EMIR and introduce a more specific FRAND principles provision for clearing members and clients that offer client and indirect client clearing

Option 2 is to make the EMIR default management tools insolvency remote by providing for a clear provision that EMIR overrides the national insolvency law in respect to EMIR default management tools. This would give legal certainty to CCPs, clearing members and clients and fulfil their objective of giving an appropriate level of protection to clients. This option is the one supported by ESMA in paragraph 5.2 of its EMIR Review report n°3 - Review on the segregation and portability requirements.¹³¹ This option does not relate to any of the elements included in the Commission legislative proposal on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures¹³².

This option would increase the clients' level of protection and limit their exposure to the default of a clearing member or, in the case of indirect clearing, a clearing member's client acting on their behalf. EMIR seeks to ensure the protection of clients of clearing members through specific records of positions and assets given as collateral, as well as

¹³¹ ESMA, *EMIR Review report n°3 - Review on the segregation and portability requirements*, ESMA/2015/1253, 13 August 2015, https://www.esma.europa.eu/sites/default/files/library/2015/11/esma-2015-1253_-_emir_review_report_no.3_on_segregation_and_portability.pdf

¹³² COM(2016) 723 final of 22.11.2016

specific procedures in case of a clearing member's default. The most protective scheme allows clients to be immune to their clearing member's default as much as possible, through transfer of positions and assets of a defaulting clearing member's clients to a solvent clearing member ('portability') or, as the case may be, the orderly liquidation of the clients' positions and the return of excess collateral directly to the clients ('leapfrog payment'), see Articles 39 and 48(5) to (7) of EMIR, but does not provide for the insolvency remoteness of these EMIR default management tools. Adding a provision providing for their insolvency remoteness would further foster the effectiveness and predictability of the EMIR default management tools such as portability and leapfrog payments. It removes a legal hurdle CCPs and clearing members experience in practice when assessing the enforceability of the EMIR default management tools.

On the other hand, introducing this additional insolvency remoteness provision might modify in some Member States their current national insolvency law and thus modify the ranking order set out by their national insolvency law by giving further preference to some insolvency creditors – i.e. the clients of the insolvent institution may it be a clearing member or a client of a clearing member who provides indirect clearing services. Some Member States have already introduced these changes in their national systems (e.g. UK and France) and others have started the necessary legislative procedures to do so (e.g. Italy).

The value of making EMIR default management tools insolvency and default remote can be at least theoretically quantified as the insurance premium of an insolvency contingency insurance of the affected assets.

In addition, the lack of efficiency of the requirement for clearing members to facilitate indirect clearing services on reasonable commercial terms could be mitigated by introducing a FRAND principles provision into EMIR. A more developed requirement for clearing members and their clients which choose to offer clearing services to other counterparties to do so under fair, reasonable and non-discriminatory (FRAND) commercial terms would foster the access to clearing for those counterparties that currently face problems to get access to clearing.

The current market allows clearing members or clients offering indirect clearing services to explicitly price discriminate between downstream customers. While there is generally no situation of market dominance or monopoly of a single provider, the characteristics of the market, in particular the lack of price transparency prevents efficient forms competition. It also implies significant search costs for downstream customers, who, given the clearing obligation, require access to the clearing market or face problems to hedge risks. Subjecting providers of clearing services to minimum transparency and non-discriminatory access requirements will mitigate these issues. It may, however, not be sufficient to lower costs for the smallest of clients to the extent necessary to make clearing services economically feasible for them.

These very small clients will profit from the lifting of the clearing obligation for (very) small financials and the alleviation of the clearing obligation for NFCs as described in section 5.3.

The FRAND requirements could include in addition to the existing requirement for clearing members to facilitate indirect clearing services on reasonable commercial terms:

- detailed requirement on what constitutes reasonable commercial terms;

- the requirement to facilitate indirect clearing services on the basis of costs and risks;
- the requirement to facilitate indirect clearing services on a non-discriminatory basis so that any differences in prices charged are proportionate to costs, risks and benefits connected to the clearing services offered; and
- a transparency obligation with respect to fees, prices, discount policies and other contractual terms and conditions regarding the price list.

Introducing more detailed FRAND requirements responds to the observation of many stakeholders that clearing members and especially their clients have no interest in offering indirect clearing services to counterparties whose clearing portfolio they consider to be too small.¹³³ These FRAND requirements will foster transparency with regard to the costs and other requirements of clearing services and, therefore, will facilitate the access to clearing.

Option 3 – Oblige clearing members and their clients to offer (indirect) clearing services to all counterparties obliged to centrally clear

Option 3 is to oblige clearing members and their clients to offer clearing services to all counterparties obliged to centrally clear.¹³⁴ This would change the role of clearing members and their clients from for-profit financial institutions that offer the access to clearing among other services on a contractual basis, to that of service providers in the interest of the public. Consequently, this change would make them a new type of financial market infrastructure requiring additional regulation. While EMIR currently relies on contractual commitments by CCPs, clearing members, clients and indirect clients, the rights and obligations of clearing members and clients in their capacity of newly created financial market infrastructures and clients and indirect clients as their customers would have to be spelled out in EMIR or new level 2 measures.¹³⁵ In addition, price regulation provisions may well be necessary to facilitate the mandatory offering of clearing services that are not economically feasible. This option would entitle each counterparty to access clearing regardless if economically feasible or desired by the clearing member or client and, therefore, remove any possible hurdle preventing it. But it would fundamentally change the nature of (indirect) client clearing which would be governed mainly by mandatory law instead of contractual commitments of market participants. Option 3 would further require a legal definition of those services that would fall under the offering obligation and distinguish them from (additional) services within (indirect) client clearing that clearing members and their clients would not be legally obliged to offer. This distinction would be not easy to make because (indirect) client clearing is still developing.

Table 7. Comparison of policy options against effectiveness and efficiency criteria

¹³³ Exempting (very) small financial counterparties and more non-financial counterparties from the clearing obligation will further reduce the insufficiency of the access to clearing as it removes the necessity for counterparties that are too small for central clearing their portfolio to be economically reasonable will no longer be obliged to seek that access.

¹³⁴ This option was suggested in confidence by a regulator in case the introduction of new FRAND requirements (see option 2) would not be sufficient to create an adequate access to clearing.

¹³⁵ Examples for potential further legal requirements that could be introduced in Articles 39 and 48 of EMIR can be found in ESMA, *EMIR Review report n°3 - Review on the segregation and portability requirements*, page 10 to 11, ESMA/2015/1253, 13 August 2015, https://www.esma.europa.eu/sites/default/files/library/2015/11/esma-2015-1253_-_emir_review_report_no.3_on_segregation_and_portability.pdf

Objectives Policy option	EFFECTIVENESS			EFFICIENCY (cost-effectiveness)
	Objective 1 <i>Increase proportionality of rules without putting financial stability at risk</i>	Objective 2 <i>Increase transparency of OTC derivatives positions and exposures</i>	Objective 3 <i>Reduce impediments to access to clearing</i>	
Option 1 <i>No policy change</i>	0	0	0	0
Option 2 <i>Insolvency remoteness of the EMIR default management tools and new FRAND requirements for clearing members and clients that offer client and indirect client clearing</i>	++	++	+	++
Option 3 <i>Oblige clearing members and their to offer clearing services to all counterparties obliged to centrally clear</i>	--	++	++	--

Magnitude of impact as compared with the baseline scenario (the baseline is indicated as 0): ++ strongly positive; + positive; -- strongly negative; - negative; ≈ marginal/neutral; ? uncertain; n.a. not applicable

The preferred option is option 2. It tackles the two main hurdles to access to clearing not already dealt with in the Commission's legislative proposal to amend the Capital Requirements Regulation as regards the leverage ratio calculation¹³⁶. This option responds to practical problems reported by several stakeholders.¹³⁷ Option 2 may require changes in the national insolvency laws, but given the public interest in making central clearing work and the clearing obligation been obeyed and having evidence about the fact that some Member States have already introduced these rules into their systems, this is justified. In addition to this preferred option, counterparties with (very) limited activities (in certain classes of derivatives) profit from the lifting of the clearing obligation for (very) small financials and the restriction of the clearing obligation for NFC+ to those classes of OTC derivatives for which the clearing threshold has been reached. These changes would prevent situations in which (very) small counterparties had to pay prohibitive prices of – in extreme cases – USD 10 000 per trade.

¹³⁶ Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 575/2013 as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements and amending Regulation (EU) No 648/2012, 23 November 2016, COM(2016) 850 final. http://ec.europa.eu/finance/bank/docs/regcapital/crr-crd-review/161123-proposal-amending-regulation_en.pdf.

¹³⁷ See ESMA, EMIR Review report n°3 - Review on the segregation and portability requirements, ESMA/2015/1253, 13 August 2015, https://www.esma.europa.eu/sites/default/files/library/2015/11/esma-2015-1253_-_emir_review_report_no.3_on_segregation_and_portability.pdf

Introducing new FRAND requirements may lead to new requirements clearing members and their clients have to comply with, but the limited additional regulatory burden is justified by the public interest in making central clearing work and the clearing obligation being obeyed.

Option 2 is preferable to option 1 which would mean to let the existing hurdles to the access to clearing remain untouched. It is as well preferable to option 3 that would fundamentally change the nature of (indirect) client clearing. Prior to such an extreme legislative measure, market participants should be enabled to invent solutions through contractual arrangements. This is even more true as the main hurdle to access to clearing cited by a large number of stakeholders is the leverage ratio framework under Basel III and CRR, a problem that will be solved by Commission's legislative proposal to amend the CRR. Furthermore, the exemption of the smallest financial and non-financial counterparties from the clearing obligation will benefit the counterparties with the smallest market power that would first and foremost need to rely on an obligation of clearing members and their clients to offer (indirect) clearing services. Thus, it is necessary to await the outcome of the proposed measures before obliging clearing members and their clients to offer (indirect) clearing services to all counterparties obliged to centrally clear.

In terms of operational objectives, the preferred option aims at reducing obstacles to the provision of clearing services, with a view to achieving a significant increase in the accessibility of clearing by providing for legal clarity with regard to default management procedures in client clearing and the implementation of the FRAND principles.

6. OVERALL IMPACT OF THE PACKAGE

6.1. Global estimates of cost reductions and impact on financial stability

To the extent possible, taking into account the limitation in having access to the necessary data for the assessment, this section estimates the cost and burden reductions associated with the preferred options.

6.1.1. Avoiding liquidity costs for PSAs

Given the continued absence of viable non-cash central clearing solutions, a new transitional clearing exemption for PSAs would avoid the liquidity costs associated with central clearing, which would ultimately be passed on to pensioners.

Such costs would depend on the level of additional costs associated with the cash buffers that PSAs would have to set up for the purpose of meeting potential variation margin calls. Providing accurate estimates on the level of such cash buffers is extremely difficult and would depend on the respective PSA concerned. Based, however, on the estimate of one major pension fund¹³⁸ central clearing would require holding an additional 0.5%-1% of assets in cash. Assuming that these figures are representative of the whole PSA industry and based on total assets under management of the industry of EUR 5.2

¹³⁸ PensionsEurope's contribution to the Call for Evidence.

trillion¹³⁹, this implies cash buffers in the range of EUR 26 - 52 billion. Given an average long-term risk free rate of approximately 1.5% and average long-term returns on assets of PSA of 5% this would imply **additional costs of between EUR 780 million and 1.56 billion**.

6.1.2. *Reducing compliance costs for NFCs*

The exemption from the reporting obligation of intragroup transactions in which one of the counterparties is an NFC and the exemption of the obligation of small NFCs also to report transactions between themselves and financial counterparties would reduce EMIR-related compliance costs for NFCs.

While it is not possible to estimate the exact level of compliance cost reductions associated specifically with the two above-mentioned exemptions, **such reductions would represent an important part of the current total compliance costs for NFCs associated with the EMIR reporting requirements**. The level of current total compliance costs arising from the reporting requirements under EMIR can be estimated based on compliance cost data triggered by similar regulatory reporting requirements, including those contained in CRR/CRD.¹⁴⁰ Based on these figures it is possible to calculate the approximate costs that NFCs face by taking into account the reporting population, the share of NFCs in the various derivatives market segments¹⁴¹ (CDS, interest rates, currency (FX), equity and commodity-based derivatives), and the relative weight of these market segments¹⁴². Given that the share of NFCs in the various segments of the derivatives market cannot be measured very accurately and will furthermore vary over time and for each specific market, the calculations are based on percentage share ranges rather than concrete figures. These ranges are then extrapolated to EU-wide figures using national accounts data. This results in high and low-end cost figures and leads to the following ballpark estimate of total EMIR-related compliance costs for NFCs in the EU:

- **annual compliance costs of between EUR 350 million and EUR 1.1 billion**, although such costs may, however, fall over time as reporting systems become more automated; and

- **one-off (fixed) costs of between EUR 1.8 billion and EUR 5.3 billion**, e.g. for setting up IT reporting systems. Such costs may, however, have already been incurred to a large extent because the reporting requirement became applicable in February 2014.

Concerning the reduction of EMIR-related compliance costs for the clearing obligation, according to the sources described in section 3.4, **a minimum fee of EUR 95 000** would

¹³⁹ Figure for 2012; Europe Economics and Bourse Consult, *Baseline report on solutions for the posting of non-cash collateral to central counterparties by pension scheme arrangements*

¹⁴⁰ Europe Economics 2009, Study on the Cost of Compliance with Selected FSAP Measures on compliance costs, http://ec.europa.eu/internal_market/finances/docs/actionplan/index/090707_cost_of_compliance_en.pdf

¹⁴¹ NFCs are present in less than 1% of CDS derivatives transactions; their share in the other market segments is assumed to be as follows for the calculation of the cost estimate ranges: FX: 5-10% of trades, IRS: 3-10%, equity and commodity derivatives: 5-15%, based on BIS, Statistical release, OTC derivatives statistics at end-June 2016, November 2016 http://www.bis.org/publ/otc_hy1611.pdf

¹⁴² http://www.bis.org/publ/otc_hy1611.pdf

be applied, thus for NFCs that have a reduced portfolio and that will not fall under the clearing obligation in accordance to the favoured option described in Section 5.3, there would be an important reduction of costs. Annex 8 provides further details on the calculation of the estimated cost reductions for NFCs.

6.1.3. Reducing compliance costs for small financials

For small financials, there will be an alleviation of compliance costs related to the clearing obligation. Given the fact that, according to the sources described in section 3.4, **a minimum fee of EUR 95 000** would apply to small financials that have a reduced portfolio and that will not fall under the clearing obligation in accordance to the favoured option described in Section 5.3, there would be an important reduction of costs. Annex 8 provides further details on the calculation of the estimated cost reductions for SFCs.

6.1.4. Financial stability

The overall impact of the package of preferred options on financial stability is neutral or positive. On the one hand, there is a natural trade-off: the adjusted clearing and reporting requirements translate into cost reductions for market participants, but at the same time mean that a limited number of OTC derivatives transactions do not benefit from the safety provided by central clearing and that some data is not reported to TRs.

However, the preferred options concern very targeted adjustments. The overall volume of transactions involving NFCs and SFCs that will be removed from the clearing obligation constitutes a very small fraction of the market. The clearing exemption for PSAs is of a temporary nature and the ultimate objective of PSAs' participating in central clearing is maintained. Any potential risks emanating from bilateral transactions during this transitional period will be mitigated by applicable risk-mitigation rules including bilateral margins requirements put in place as of March 2017. The fine-tuning of reporting rules does not lead to a significant loss of data for authorities, as the transactions concerned represent minimal systemic risk. At the same time, the reduction of financial burdens from the envisaged options contribute to the resilience of the market participants concerned, thus fostering financial stability and benefitting society.

Other options strengthen financial stability. New TR requirements and the expansion of the scope of technical standards to harmonise reporting rules and procedures will lead to an increase of the quality of data available to authorities. The increase of the upper limits of the basic amounts of fines will incentivise trade repositories' compliance with EMIR requirements and also help enhance the quality of TR data. These options will make the OTC derivatives market more transparent and facilitate the monitoring of systemic risk.

Improved access to clearing resulting from the clarification of interactions between EMIR and national insolvency rules and the introduction of FRAND principles will improve access to clearing and more transactions will be centrally cleared.

6.1.5. Global estimates of total cost reductions

Table 9 below provides an overview of global estimates of cost reductions that the preferred options would bring about, on the basis of calculations presented earlier in this section and of a methodology further detailed in Annex 8. The cost reductions have been estimated solely for the purpose of this impact assessment, under the REFIT framework.

On the basis of the table below, the range of total cost reductions is:

- Total operational cost reductions: EUR 1.1bn – 2.66bn
- Total fixed (one-off) cost reductions: EUR 2.3bn – 6.9bn

It is necessary to stress a number of limitations that have a bearing on the reliability of the estimated cost reductions. First, the estimated cost reductions are valid only at the current point in time. Requirements that will apply at a later stage, such as the phased-in application of margin requirements, have not been taken into account in the calculations. The estimates do not distinguish between cost reductions that are expected to (i) be delivered both immediately and in the mid-term, and (ii) be effectively reduced or avoided, depending on the preferred option considered. Second, calculations rely on a number of underlying assumptions that were necessary to quantify the magnitude of the estimated cost reductions. These are based on the limited amount of data that is publicly available and on anecdotal market intelligence, which may not accurately capture the diversity and the specificity of the counterparties at play. In addition, calculations are based on the assumption that the cost reductions generated by the preferred options will be entirely passed on to end-users, namely the NFCs and the SFCs. Annex 8 sets out in greater detail under which assumptions the cost reductions apply. Third, the estimates focus on the quantification of cost reductions. Minimal adjustment costs resulting, for instance, from introducing FRAND terms (expected impact on clearing members) and from measures to increase the quality of data (expected impact on TRs) have not been included in this calculation. It is expected that after an initial transition phase the resulting administrative burden from FRAND requirements will be limited and that some administrative costs should even decrease in the mid-term to long-term as a result of a more straightforward reporting approach. More details on changes in the administrative burden are provided in section 6.3. Annex 7 also provides a detailed qualitative description of who is affected by the preferred options and how.

Table 9 - Estimates of total cost reductions (in EUR)

Entities Pref. Options	PSAs	NFCs		FCs (including SFCs)	CCPs	TRs	Impact on financial stability	Society
Scope of clearing requirement [Since the clearing obligation does not apply yet to the entities considered, the figures provided below represent a range estimate of the costs that will be immediately avoided.]								
1. Provide transitional exemption for PSAs (option 3)	Operational costs avoided 780mn – 1.56bn	Non-applicable (n.a.)		No cost reduction. Some costs for clearing members of developing a solution for PSAs.	No cost reduction. Some costs of developing a solution for PSAs.	n.a.	Limited - PSAs remain subject to risk-mitigation rules applying to uncleared derivative contracts.	Adverse impact on revenue income of PSAs policy holders is avoided.
2. Limit clearing obligation to asset class(es) where NFCs+ exceed threshold (opt. 2)	n.a.	Fixed costs avoided 9.6mn - 26.7mn		n.a.	n.a.	n.a	Limited - exempted transactions amount to 0.001% of total notional amount for NFCs and FCs.	Cost reduction for corporates, which can instead invest savings into growth and jobs.
3. Remove SFCs from the scope of the clearing obligation (option 2)	Small PSAs may also be SFCs. See other column.	n.a.		Fixed costs avoided 509.7mn – 1.4bn	n.a.	n.a.	Limited - estimates in considered IRS class reach 0.32% of total notional amount for NFCs and FCs.	SFCs, e.g. co-operative saving or mortgage banks, can further finance real economy.
Scope of reporting requirements [Since the reporting obligation already applies, and costs have been and are incurred, the figures below represent a range estimate of the costs that will be immediately reduced.]								
4. Fine-tune reporting rules (different depending on counterparty) (option 2)	Cost reduction related to removal of ETDs & backloading.	Cost reduction		Cost reduction related to removal of ETDs & backloading.	No cost reduction. Limited costs as need to introduce ETD reporting.	n.a.	Neutral – no significant data loss for supervisors.	Cost reduction for corporates, which can instead invest savings into growth and jobs.
		Operational 350mn - 1.1bn	Fixed 1.8bn - 5.3bn					
Transparency of OTC derivatives market [For details on the nature and magnitude of administrative costs, please see related part in section 6.3 of the impact assessment.]								
5. Improve quality of data (option 2)	n.a.	No cost reduction. Minimal adjustment cost		No cost reduction. Minimal adjustment cost	n.a.	No cost reduction. Adjustment costs.	Positive - as will help better identify risks.	Reduced risks of financial crisis.
6. Increase level of fines (option 2)	n.a.	n.a.		n.a.	n.a.	Fines only if TRs breach law.	Positive - as will help ensure enforcement.	Reduced risks of financial crisis.
Access to clearing [As the clearing obligation applies to clearing members and Cat. 2 counterparties, but not yet to Cat. 3 counterparties, the figures below provide a range estimate of costs that will be both avoided and reduced in the mid-term.]								
7. Clarify interaction with national insolvency rules and introduce FRAND terms. (option 2)	n.a.	For NFCs+, fixed cost reduction of 24.8mn-69.5mn		For FCs that use indirect or client clearing, fixed cost reduction of 32.6mn-91.3mn FRAND-adjusting costs for clearing members.	n.a.	n.a.	Positive – as will strengthen incentives to centrally clear and reduce systemic risk.	Cost reduction will free up further investment opportunities, benefiting growth.
Grand total	Operational 780mn – 1.56bn	Operational: 350mn - 1.1bn	Fixed: 1.8bn - 5.4bn	Fixed: 542.3mn-1.5bn	Minimum adjustment cost.	Minimum adjustment cost.	Neutral to positive.	Positive as cost reduction will benefit investment and growth, without putting financial stability at risk.

6.2. Small and medium-sized enterprises

SMEs will, in particular, benefit from the options aimed at (i) reducing regulatory requirements in cases where disproportionate compliance costs appear to outweigh prudential benefits and (ii) improving access to clearing. Notably, some, especially the very small financial counterparties or those non-financial counterparties with only a limited volume of activity, will be exempted from the clearing obligation. The simplification of reporting requirements will benefit all counterparties, including SMEs. In addition, SMEs that qualify as 'medium-sized undertakings' in the meaning of Directive 2013/34/EU will benefit from the obligatory delegation of reporting requirements to the financial counterparty of the trade. Finally, introducing new FRAND principles will make it easier to find access to clearing for many counterparties.

Other proposed options in the Impact Assessment are not expected to have any material impact on SMEs.

6.3. Administrative burden

Administrative burden is related to legal obligations to provide information to public authorities or to private parties. The envisaged simplification and increased proportionality of rules on reporting will therefore considerably reduce the overall administrative burden borne by firms that are subject to reporting requirements under EMIR.

The removal of the backloading obligation will benefit all counterparties that would otherwise have to backload historic trade data and reduce their administrative burden.

The exemption of intragroup transactions involving NFCs from the reporting obligation will benefit such NFCs.

Transferring the obligation to report ETD transactions from counterparties to CCPs will reduce administrative costs borne by counterparties. At the same time, such a transfer could be seen as shifting the onus to CCPs; however, CCPs already have a significant amount of data concerning these transactions in their possession and are already required to report all centrally-cleared derivative transactions under EMIR. Therefore, the additional burden placed on CCPs will be limited. Moreover, due to the economies of scale involved the overall administrative costs should be considerably lower if CCPs report the data of all transactions concerned centrally instead of many counterparties reporting a small number of transactions each.

The reporting of the trade by the financial counterparty of the transactions with small NFCs reduces the administrative burden for the smaller and smallest market participants; these firms may only carry out a very limited number of transactions per year and are therefore likely to bear, in relative terms, the highest burden linked to reporting obligations considering that the (partially fixed) costs to establish and maintain an adequate reporting infrastructure (e.g. employing and training of qualified staff, necessary informatics systems etc.) have to be apportioned to a small number of transactions. While the reporting fulfilled by the financial counterparties involved will mean a certain additional administrative burden for those counterparties, the resulting increase of costs should only be incremental considering their much higher volume of transactions.

The further harmonisation of reporting rules and procedures could involve limited additional administrative costs in the initial stages of implementation in order to meet requirements pursuant to new technical standards to be developed by ESMA, including the reporting standards to be used, and the methods and arrangements for reporting. After an initial transition phase to the new rules, reporting would become more straightforward and hence less burdensome for the reporting counterparties. In the mid-term and long-term a decrease of administrative costs imposed on reporting counterparties can therefore be expected.

Additional administrative costs could result from a new EMIR requirement for clearing members and their clients who choose to offer clearing services to other counterparties to do so under fair, reasonable and non-discriminatory (FRAND) commercial terms, linked, for instance to a possible need to provide additional information to authorities in order to comply with a transparency obligation with respect to fees, prices, discount policies and other contractual terms and conditions. However, the additional administrative burden would be limited.

6.4. EU budget

The above policy options do not have any implications for the budget of the European Union. Possible additional tasks arising for ESMA, such as the development of additional technical standards, should be manageable with ESMA's currently planned resources.

6.5. Social impacts

The preferred options are expected to have a positive social impact, consisting of the following aspects (see in Annex 7):

- *reduced compliance costs and burden imposed on certain market participants, such as PSAs, SFCs and NFCs* – in the case of PSAs reduced costs increase the retirement income of (future) pensioners; with regard to SFCs and NFCs the reduction of compliance costs strengthens the competitiveness and potential for growth of these companies and benefits the job security of their employees;
- *greater transparency of OTC derivatives positions and exposures* – this will enable authorities to identify any potential problems at an earlier stage and to take timely action addressing any risks, thus benefitting the resilience of financial markets; given the pivotal role of financial markets for the functioning of modern economies, this will ultimately benefit the real economy and support the jobs and growth agenda of the European Commission;
- *improved access to clearing* – this will allow additional market participants, in particular from the "real economy" to manage and hedge their risks and by reducing the likelihood of sudden shocks and business disruptions occurring contribute to a less volatile business development and job security of their employees.

6.6. Impact on third countries

The proposal concerns a limited number of targeted adjustments to the existing EMIR Regulation. It does not create any new obligations concerning the relations with third countries. Consequently, no significant impact on third countries is expected.

6.7. Environmental impacts

No significant environmental impact is expected.

7. MONITORING AND EVALUATION

The envisaged options aim at rendering the application of EMIR more effective and efficient. To this end, a number of targeted adjustments to EMIR are considered.

The proposed legislative amendment to EMIR should include a provision stating that an evaluation of EMIR in its entirety should be carried out, with a particular focus on its effectiveness and efficiency in meeting EMIR's original objectives (i.e. increase the transparency of the OTC derivatives market, reduce counterparty credit risk associated with OTC derivatives, and reduce the operational risk associated with OTC derivatives). The evaluation should thus consider all aspects of EMIR, but in particular the following elements:

Indicator	Target	Data for monitoring provided by:
Development of solutions to facilitate the participation of PSAs in central clearing. Level of central clearing by PSAs.	Confirmation that practicable solutions are available from a significant number of PSAs directly or from industry associations representing a significant number of PSAs. Level of central clearing of OTC derivatives transactions by PSAs: 90%.	ESMA
Level of central clearing by NFC+. Distribution of clearing within the class of NFCs (number of counterparties per asset class, volume and share of outstanding notional amount of OTC derivatives), especially with regard to the appropriateness of the clearing thresholds	Level of central clearing of OTC derivatives transactions by NFC+: 70%. Systemic risk represented by the OTC derivative transactions of NFCs is adequately captured by the clearing obligation.	ESMA
Level of central clearing by SFCs. Distribution of clearing within the class of SFCs (number of counterparties per asset class, volume and share of	Level of central clearing of OTC derivatives transactions by current 'Category 3' counterparties ¹⁴³ : 80%.	ESMA

¹⁴³ Financial counterparty as defined in Category 3 of the existing Commission Delegated Regulations on the clearing obligation: Commission Delegated Regulation (EU) 2015/2205 of 6 August 2015 supplementing Regulation (EU) No 648/2012, OJ L 314, 1.12.2015, p. 13; Commission Delegated Regulation (EU) 2016/592 of 1 March 2016 supplementing Regulation (EU) No 648/2012, OJ L 103,

outstanding notional amount of OTC derivatives captured and not captured by a clearing obligation), especially with regard to the appropriateness of the clearing thresholds	Systemic risk represented by the OTC derivative transactions of SFCs is adequately captured by the clearing obligation	
Quality of transaction data reported to TRs	Level of non-compliant reporting messages is below 3%	ESMA
Ease of access to data held by TRs and quality of data provided by TRs	Absence of complaints received by relevant stakeholders, i.e. close to 0%	ESMA
Accessibility of clearing to all counterparties especially via indirect and client clearing	Increase participation in central clearing especially via indirect and client clearing by 20%.	ESMA

In principle, this evaluation should take place at least 3 years after the application of these amendments. In certain cases, notably for pension scheme arrangements, it is important to monitor progress in the availability of solutions for PSA clearing on an ongoing basis.

The evaluation should seek to collect input from all relevant stakeholders, but in particular CCPs, clearing members, PSAs, NFCs and small financials. Input would also be required from ESMA as well as national authorities and central banks. Statistical data for the analysis should be sought from ESMA.

19.4.2016, p. 5, and Commission Delegated Regulation (EU) 2016/1178 supplementing Regulation (EU) No. 648/2012, OJ L 195, 20.7.2016, p. 3.

ANNEX 1: OVERVIEW OF CHANGES ADDRESSING THE RECOMMENDATIONS OF REGULATORY SCRUTINY BOARD (RSB)

The main modifications introduced after the meeting with the Regulatory Scrutiny Board relate to the following issues:

1. Problem definition. Introduction of a better description of the overall Union legal framework applying to derivatives markets and the implementation by other jurisdictions of the G20 OTC derivatives reforms. Inclusion of the main elements of the evaluation annex in the main body of the impact assessment. Reference to additional qualitative and quantitative evidence in the description of the problems in order to illustrate their magnitude, especially for small market players. Explanation about why not all issues raised by stakeholders have been assessed.

2. Political trade-offs. Explicit reference to financial stability in the policy options for the assessment of the trade-off between the potential burden reductions for market players and the potential risks associated to financial stability.

3. Calculating burden reduction. Inclusion of some quantitative data for the calculation of the burden reductions for different market players, taking into consideration the existing limitations to quantify the overall burden reduction. Insertion of the main underlying assumptions behind cost estimates in the body of the report, together with additional caveats on the reliability of the estimates. Description of the costs which are not quantified.

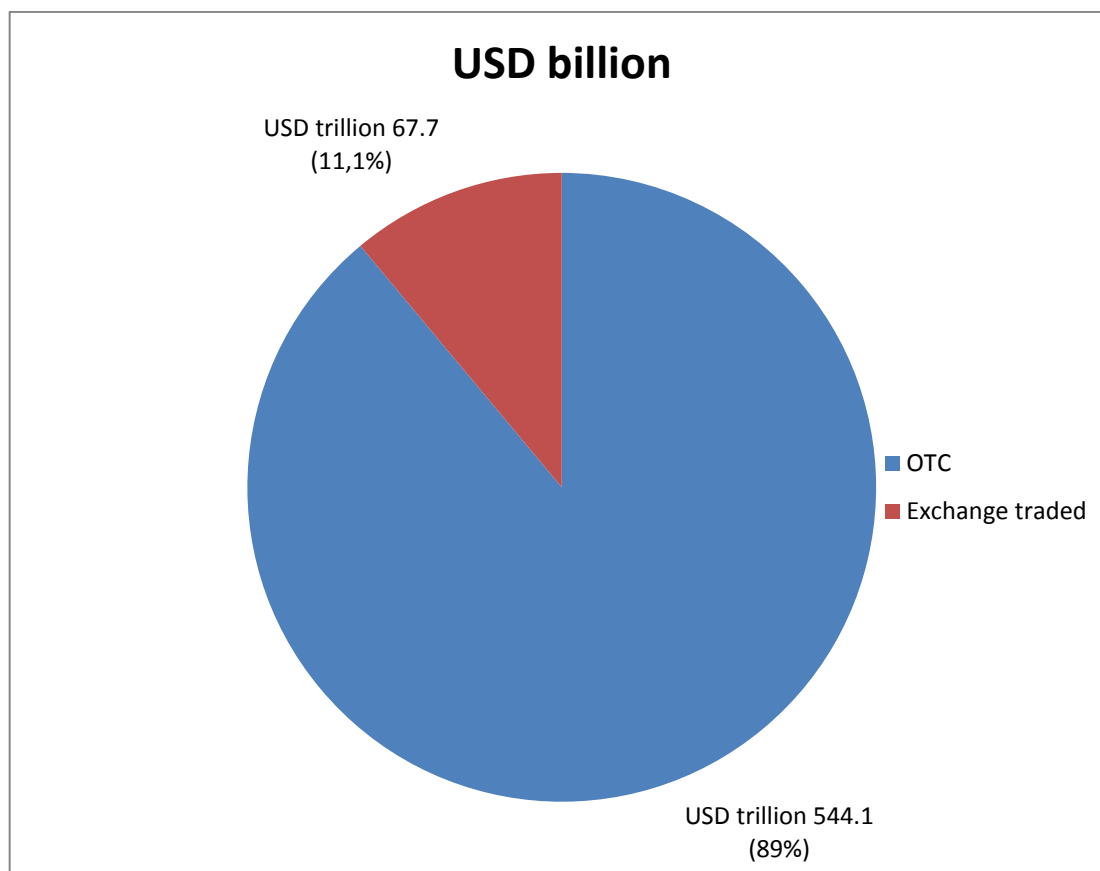
4. Options. The options have been streamlined to present alternative packages of measures.

ANNEX 2A: OVERVIEW OF DERIVATIVES MARKETS

A derivative is a financial contract linked to the future value or status of the underlying to which it refers, e.g. the development of interest rates or of a currency value, or the possible bankruptcy of a debtor. Derivatives redistribute risk and can be used for hedging as well as for speculative purposes. The degree to which derivatives are standardised differs, ranging from full standardisation of parameters, such as notional value or maturity, to bespoke contracts that are fully tailored to the specific needs of a particular user. Fully standardised derivatives can be traded on organised trading venues, such as exchanges, whereas bespoke derivatives are traded bilaterally off-exchange, commonly referred to as over-the-counter ('OTC'). The definition of OTC derivatives in EMIR refers to all derivatives contracts which are not "executed on a regulated market". As a result all derivative contracts executed on a venue of execution which is not a regulated market (e.g. a Multilateral trading facility) are considered as OTC derivative contracts under EMIR.

As shown in Chart A-2/1 below, the outstanding notional of over the counter (OTC) derivatives amounted to USD 544.1 trillion, corresponding to 89% of the overall derivatives market, as of end-June 2016.

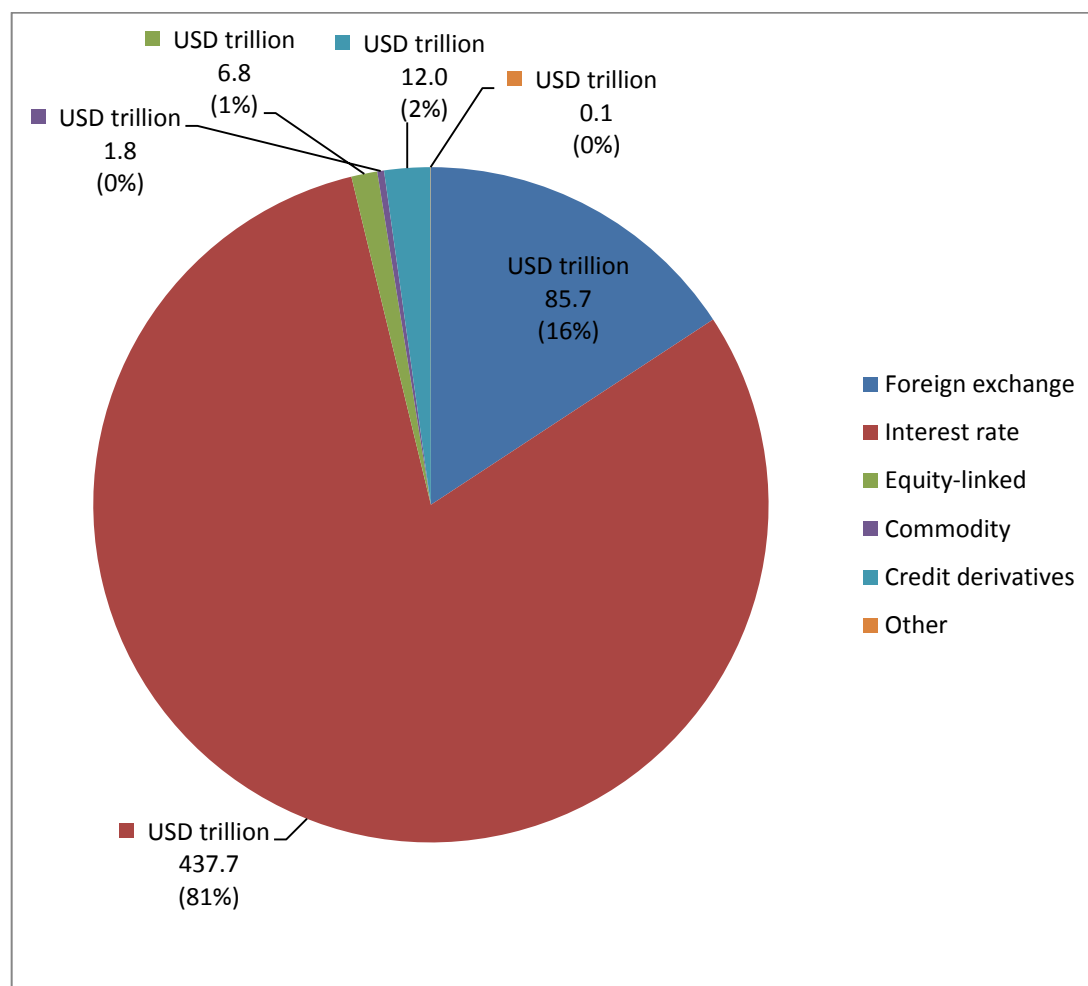
Chart A-2A/1: Exchange-traded and OTC derivatives as of end-June 2016



Source: Bank for international settlements¹⁴⁴

Chart A-2/2 below illustrates the different types of contracts in the OTC derivatives market. It shows that interest rate derivatives are the dominant type of contracts, representing about 80.5% of the total market as of end-June 2016, followed by foreign exchange (FX) derivatives (15.8%).

Chart A-2A/2: Constituents of the OTC derivatives market as of end-June 2016



Source: Bank for international settlements¹⁴⁵

Trading statistics are based on the location of the primary intermediaries that have registered the derivatives contracts with their counterparties and do not necessarily coincide with the clearing location. As far as trading is concerned, according to the 2016 triennial BIS derivatives survey, the US market is the most important OTC interest rate derivatives market with a daily average turnover of around USD 1.24 trillion (41%). The UK comes second with USD 1.18 trillion (39%). Other leading European markets are

¹⁴⁴ See Bank for International Settlements, Triennial Central Bank Survey - OTC derivatives positions at end-June 2016, Table 1, Monetary and Economic Department, 11 December 2016, http://www.bis.org/publ/otc_hy1612/triensurvstatannex.pdf

¹⁴⁵ See Bank for International Settlements, Triennial Central Bank Survey - OTC derivatives positions at end-June 2016, Table 1, Monetary and Economic Department, 11 December 2016, http://www.bis.org/publ/otc_hy1612/triensurvstatannex.pdf

France (USD 141 billion or 5%) and Germany (USD 31 billion or 1%)¹⁴⁶. As regards the OTC FX derivatives market, the UK market is the world's largest market with a daily average turnover of around USD 2.4 trillion (37%), followed by the US with USD 1.3 trillion (19%). Other leading EU markets are France (USD 181 billion or 3%) and Germany (USD 116 billion or 2%)¹⁴⁷. The UK is a clear global market leader in trading of euro-denominated interest rate derivatives with a daily turnover of USD 574 billion¹⁴⁸, before France, Netherlands, Germany, Belgium, Italy and the US respectively¹⁴⁹.

Overview of the clearing activities in Europe

Following the commitment of G20 leaders in September 2009 that all standardised OTC derivatives should be cleared through central counterparties, the percentage of centrally cleared transactions has increased significantly. While end of 2009 about 36% of interest rate OTC derivatives had been centrally cleared, at the end of 2015 this percentage had gone up to 60%. For credit OTC derivatives the percentage of centrally cleared transactions went up from about 12% to 45% in the same period.

Table A-2A/3 offers an overview of the 17 CCPs that are currently active in Europe¹⁵⁰ and are authorised under EMIR, with the respective number of clearing participants (major banks) for each of them at the end of 2015. They are located across 12 Member States¹⁵¹. One more CCP not yet authorised under EMIR is active in Croatia.

These CCPs vary in size, instruments admitted to clearing and geographical importance in terms of clearing members (i.e. national versus foreign) and markets served.

Table A-2A/3: CCPs active in Europe and number of participants as of December 2016

Source: ECB, ESMA, CCPs' websites

Denomination	Country	Number of participants	EMIR authorisation ¹⁵²
Eurex Clearing AG	DE	186	YES
European Commodity Clearing	DE	23	YES
Hellenic Exchanges SA (Athexclear)	EL	25	YES
BME Clearing	ES	60	YES
OMIClear	PT	32	YES
LCH Clearnet SA	FR	110	YES
CC&G	IT	82	YES
European Central Counterparty	NL	45	YES

¹⁴⁶ See Bank for International Settlements, Triennial Central Bank Survey of foreign exchange and OTC derivatives markets in 2016, table D.12.2, http://www.bis.org/statistics/d12_2.pdf

¹⁴⁷ See Bank for International Settlements, *Triennial OTC derivatives statistics 2016*, table D.11.2, <http://www.bis.org/statistics/derstats3y.htm>

¹⁴⁸ Forward rate agreements, swaps, options and other products. Adjusted for local inter-dealer double-counting (i.e. "net-gross" basis).

¹⁴⁹ See: Bank for International Settlements, *Triennial Central Bank Survey, Interest rate derivatives market turnover in 2016*, Table 3.2, Monetary and Economic Department, September 2016

¹⁵⁰ As per the register provided by ESMA in relation to Article 13 (2) of the MiFID implementing Regulation (No 1287/2006 of 10 August 2016).

¹⁵¹ As per the list maintained by ESMA for the purposes of Articles 88(1)(c) and (e) of Regulation (EU) No 648/2012 (EMIR).

¹⁵² Insofar the clearing activities of the related CCP concern a product for which a clearing obligation is applicable.

NV			
ICE Clear Netherlands	NL	3	YES
CCP	AT	70	YES
Keler Zrt.	HU	25	YES
KDPW CCP SA	PL	43	YES
Nasdaq OMX DM	SE	92	YES
LCH Clearnet Ltd	UK	154	YES
ICE Clear Europe	UK	79	YES
CME CE	UK	19	YES
LME Clear Ltd	UK	42	YES
SKDD CCP Smart Clear d.d.	HR		NO

As can be seen, Germany, France and the UK are the home countries of major CCPs in Europe as well as internationally. The UK is home to LCH Clearnet Ltd, ICE Clear, CME and LME. Germany's largest CCP is Eurex, while France is home to LCH Clearnet SA.

The EU has adopted three central clearing determinations, on the basis of draft regulatory technical standards drafted by ESMA, following analysis carried out according to criteria set out in EMIR. The determinations cover two different asset classes: OTC interest rate derivatives and OTC credit derivatives.

The central clearing determination covering OTC interest rate swaps (IRS) related to the Euro, the USD, the Yen, and the British Pound has started to apply to clearing members (as of 21 June 2016) and financial counterparties above the EUR 8 billion threshold (as of 21 December 2016). For other IRS in European currencies (Norwegian Krone, Polish Zloty, and Swedish Krona) and Credit Default Swaps (CDS), the application has started phasing-in as of February 2017 for clearing members. The compliance deadlines for the central clearing determination applying to various asset classes and to different types of counterparties are summarised in the tables below.

Table A-2A/4 - First Commission Delegated Regulation covering interest rate derivatives in the G4 currencies

Category of counterparty	Short description of the category	Date of taking effect for new contracts	Minimum remaining maturity		
Category 1	Clearing Members in the classes subject to the clearing obligation		21 June 2016	6 months (as of 21 June 2016) for contracts entered into or novated on or after 21 February 2016	
	The CCPs listed below have published the lists of their clearing members in Category 1 ⁸ :				
	BME	Spain			Clearing Members in Category 1 - BME Clearing
	CME CE	UK			Clearing Members in Category 1 - CME Clearing Europe
	Eurex	Germany			Clearing Member in Category 1 - Eurex Clearing AG
	LCH Ltd	UK			Clearing Members in Category 1 - LCH Ltd
	Nasdaq	Sweden			Clearing Members in Category 1 - Nasdaq OMX Clearing
	JSCC	Japan			Clearing Members in Category 1 - JSCC
OTC HK	Hon-Kong	Clearing Members in Category 1 - OTC Clearing HK			
Category 2	<ul style="list-style-type: none">— Financial counterparties above the EUR 8bn threshold— Alternative investment funds that are non-financial counterparties and above the EUR 8bn threshold	21 December 2016	6 months (as of 21 December 2016) for contracts entered into or novated on or after 21 May 2016		
Category 3	<ul style="list-style-type: none">— Financial counterparties below the 8bn threshold— Alternative investment funds that are non-financial counterparties and below the 8bn threshold	21 June 2017	Not applicable		
Category 4	Non-financial counterparties not included in Categories 1, 2 or 3	21 December 2018	Not applicable		

Source: European Securities and Markets Authority

Table A-2A/5– Second Commission Delegated Regulation covering European index CDS

Category of counterparty	Short description of the category	Date of taking effect for new contracts	Minimum remaining maturity
Category 1	Clearing Members in the classes subject to the clearing obligation The CCP listed below has published the list of its clearing members in Category 1 ⁹ : LCH SA France Clearing Members in Cat 1 - LCH SA	9 February 2017	6 months (as of 9 February 2017) for contracts entered into or novated on or after 9 October 2016
Category 2	— Financial counterparties above the EUR 8bn threshold — Alternative investment funds that are non-financial counterparties and above the EUR 8bn threshold	9 August 2017	6 months (as of 9 August 2017) for contracts entered into or novated on or after 9 October 2016
Category 3	— Financial counterparties below the 8bn threshold — Alternative investment funds that are non-financial counterparties and below the 8bn threshold	9 February 2018	Not applicable
Category 4	Non-financial counterparties not included in Categories 1, 2 or 3	9 May 2019	Not applicable

Source: European Securities and Markets Authority

Table A-2A/6 - Third Commission Delegated Regulation covering interest rate derivatives in NOK, PLN and SEK

Category of counterparty	Short description of the category	Date of taking effect for new contracts	Minimum remaining maturity
Category 1	Clearing Members in the classes subject to the clearing obligation The CCPs listed below have published the list of their clearing members in Category 1 ¹⁰ : CME Clearing Europe UK Clearing Members in Cat 1 – CME CE KDPW_CCP Poland Clearing Members in Cat 1 - KDPW_CCP LCH Ltd UK Clearing Members in Cat 1 – LCH Ltd Nasdaq OMX Sweden Chicago Mercantile Exchange Inc US	9 February 2017	6 months (as of 9 February 2017) for contracts entered into or novated on or after 9 October 2016
Category 2	— Financial counterparties above the EUR 8bn threshold — Alternative investment funds that are non-financial counterparties and above the EUR 8bn threshold	9 August 2017	6 months (as of 9 August 2017) for contracts entered into or novated on or after 9 October 2016
Category 3	— Financial counterparties below the 8bn threshold — Alternative investment funds that are non-financial counterparties and below the 8bn threshold	9 February 2018	Not applicable
Category 4	Non-financial counterparties not included in Categories 1, 2 or 3	9 August 2019	Not applicable

Source: European Securities and Markets Authority

Finally, table A-2A/7 below offers an overview of the 6 TRs that are currently active in Europe and are authorised under EMIR.

Table A-5/2 – List of trade repositories registered by ESMA, as of May 2015

Trade Repository	Derivative asset class	Effective date
DTCC Derivatives Repository Ltd. (DDRL)	All asset classes	14 November 2013
Krajowy Depozyt Papierów Wartościowych S.A. (KDPW)	All asset classes	14 November 2013
Regis-TR S.A.	All asset classes	14 November 2013
UnaVista Limited	All asset classes	14 November 2013
CME Trade Repository Ltd. (CME TR)	All asset classes	5 December 2013
ICE Trade Vault Europe Ltd. (ICE TVEL)	Commodities, credit, equities, interest rates	5 December 2013
	Foreign exchange	4 June 2015

Source: European Securities and Markets Authorities

ANNEX 2B: ADDITIONAL TABLES AND FIGURES REFERRED TO IN THE TEXT

The following tables and figures provide additional details with respect to the discussion of mandatory clearing requirements for Non-Financial Counterparties in section 3.2.1.2.

Table A-2B/1: Financial and Non-Financial Counterparties¹⁵³

	A	B	C	D	E	F	G	H
Counterparty zone / status	Number of counterparties	Number of counterparties (%)	Number of trades	Number of trades (%)	Notional Amount (EUR mn)	Notional Amount (%)	Average number of trades per counterparty	Average notional per counterparty (EUR mn)
1 Financial	23,613	27%	24,301,464	93%	598,562,507	98%	1,029.2	25,349
2 Europe	22,540	25%	23,648,593	90%	592,645,910	97%	1,049.2	26,293
3 Third country	1,073	1%	652,871	2%	5,916,598	1%	608.5	5,514
4 Non Financial	65,325	73%	1,924,052	7%	9,649,908	2%	29.5	148
5 Europe	64,295	72%	1,870,319	7%	9,497,337	2%	29.1	148
6 Third country	1,030	1%	53,733	0%	152,570	0%	52.2	148
7 Grand Total	88,938	100%	26,225,516	100%	608,212,415	100%	294.9	6,839

Source: TR data, ESMA calculations. Counterparties reporting without LEI are excluded. Counterparties with unknown status (FC or NFC) are excluded.

Source: European Securities and Markets Authority

Table A-2B/2: Overview of Financial Counterparties, NFC+ and NFC+¹⁵⁴

	A	B	C	D	E	F	G	H
Counterparty status	Number of counterparties	Number of counterparties (%)	Number of trades	Number of trades (%)	Notional Amount (EUR mn)	Notional Amount (%)	Average number of trades per counterparty	Average notional per counterparty (EUR mn)
1 Non Financial Above (NFC+)	424	0.6%	221,005	11%	1,568,375	16%	521	3,699
2 Not notified + exceeds CT	206	0.3%	112,430	6%	913,906	9%	546	4,436
3 Notified + does not exceed CT*	138	0.2%	39,643	2%	362,830	4%	287	2,629
4 Notified + exceeds CT*	80	0.1%	68,932	4%	291,639	3%	862	3,645
5 Non Financial Below (NFC-)	64,901	99.4%	1,703,047	89%	8,081,533	84%	26	125
6 Large NFC-	615	0.9%	380,513	20%	3,395,397	35%	619	5,521
7 Small NFC-	64,286	98.4%	1,322,534	69%	4,686,136	49%	21	73
8 Grand Total	65,325	100.0%	1,924,052	100%	9,649,908	100%	29	148

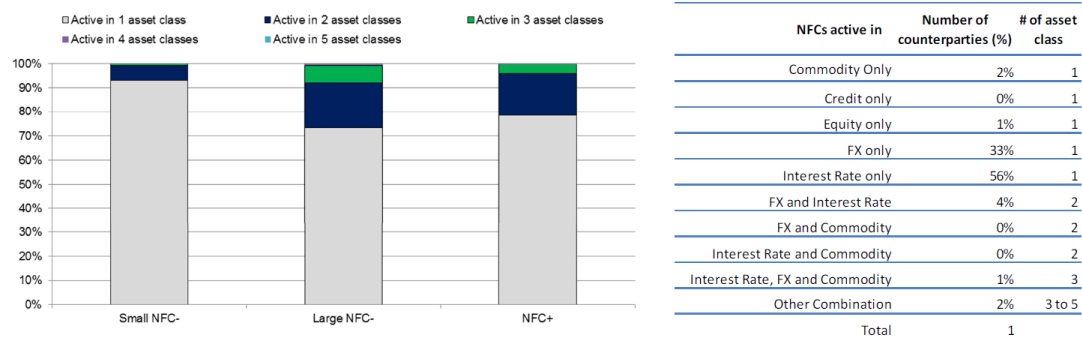
Source: TR data, ESMA calculation.

Source: European Securities and Markets Authority

¹⁵³ ESMA, EMIR Review report n°1 – Review of the use of OTC derivatives by non-financial counterparties, Figure 2, p. 16. <https://www.esma.europa.eu/sites/default/files/library/2015/11/esma-2015-1251-emir-review-report-no.1-on-non-financial-firms.pdf>

¹⁵⁴ *Ibid*, Table 4, p. 13.

Table A-2B/3: Presence of NFCs across asset classes (based on number of counterparties)+¹⁵⁵



Source: TR data, ESMA calculations. Counterparties reporting without an LEI not included. Counterparties which could not be classified as NFC+ or NFC- not included.

A counterparty is deemed "active" in an asset class when it reported at least one trade in this asset class.

Source: European Securities and Markets Authority

The next tables and figures provide additional details with respect to the discussion of mandatory clearing requirements for small financials in section 3.2.1.3.

Table A-2B/4: Interest rate derivative asset class, as of 29 February 2016

	Cumulated number of counterparties	Cumulated % of counterparties	Cumulated Notional Amount (EUR Bn)	Cumulated Notional Amounts (%)
0. Above 1,000bn	33	0.6%	310,921	92.26%
1. Above 500bn	41	0.7%	316,912	94.04%
2. Above 100bn	88	1.5%	326,149	96.78%
3. Above 50bn	130	2.2%	329,162	97.67%
4. Above 5bn	490	8.4%	335,009	99.41%
5. Above 500mn	1,453	24.8%	336,652	99.90%
6. Above 100mn	2,551	43.6%	336,924	99.98%
7. Above 30mn	3,545	60.5%	336,984	99.99%
8. Above 5mn	4,839	82.6%	337,003	100.00%
9. Below 5mn	5,855	100.0%	337,005	100.00%
Grand Total	5,855	100.0%		100.0%

Source: European Securities and Markets Authority¹⁵⁶

¹⁵⁵ Ibid, Figure 2, p. 16.

¹⁵⁶ https://www.esma.europa.eu/sites/default/files/library/2016-1125_cp_on_clearing_obligation_for_financial_counterparties.pdf

TableA-2B/5: Credit derivative asset class, as of 29 February 2016

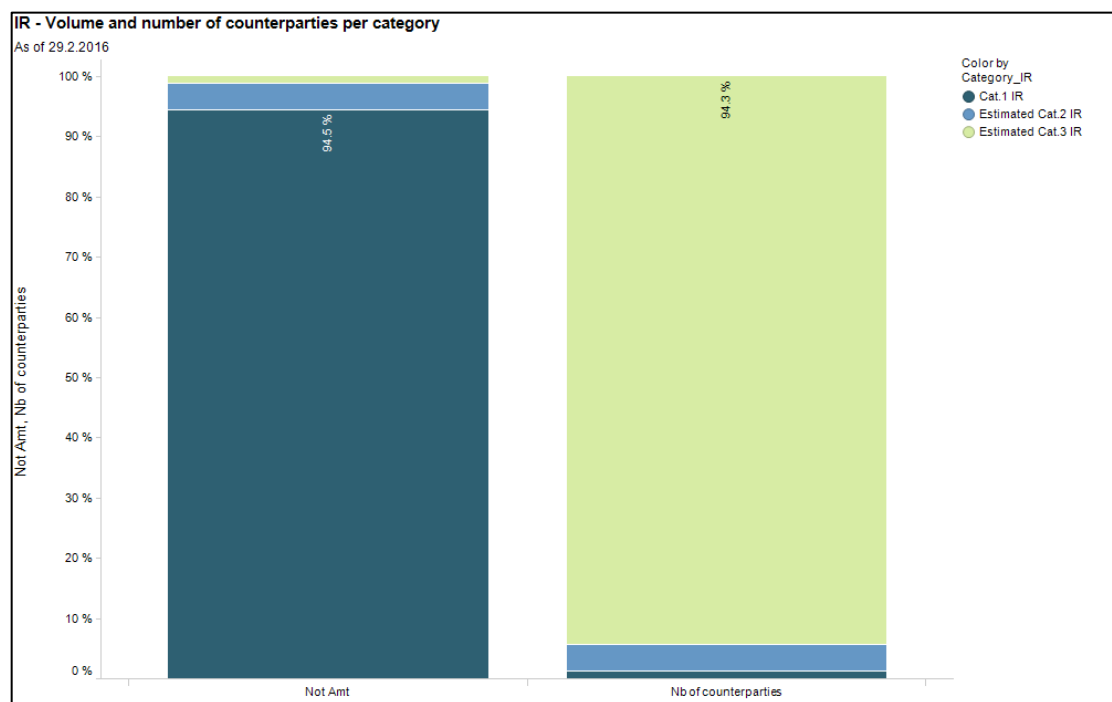
	Cumulated number of counterparties	Cumulated % of counterparties	Cumulated Notional Amount (EUR Bn)	Cumulated Notional Amounts (%)
0. Above 1,000bn	3	0.1%	5,180	42.85%
1. Above 500bn	8	0.3%	9,055	74.91%
2. Above 100bn	13	0.5%	10,412	86.14%
3. Above 50bn	20	0.8%	10,919	90.33%
4. Above 5bn	58	2.2%	11,479	94.97%
5. Above 500mn	379	14.5%	11,917	98.59%
6. Above 100mn	915	35.0%	12,046	99.66%
7. Above 30mn	1,431	54.7%	12,076	99.91%
8. Above 5mn	2,113	80.8%	12,086	99.99%
9. Below 5mn	2,614	100.0%	12,087	100.00%
Grand Total	2,614	100.0%		100.0%

Source: European Securities and Markets Authority¹⁵⁷

Figure A-2B/4 (for Interest rate derivatives) and Figure A-2B/5 (for Credit derivatives) provide an overview at EU level of the share of each of the 3 existing categories of counterparties, in terms of volume and number of counterparties.

¹⁵⁷ https://www.esma.europa.eu/sites/default/files/library/2016-1125_cp_on_clearing_obligation_for_financial_counterparties.pdf

Figure A-2B/6: IR – Volume and number of counterparties per category¹⁵⁸

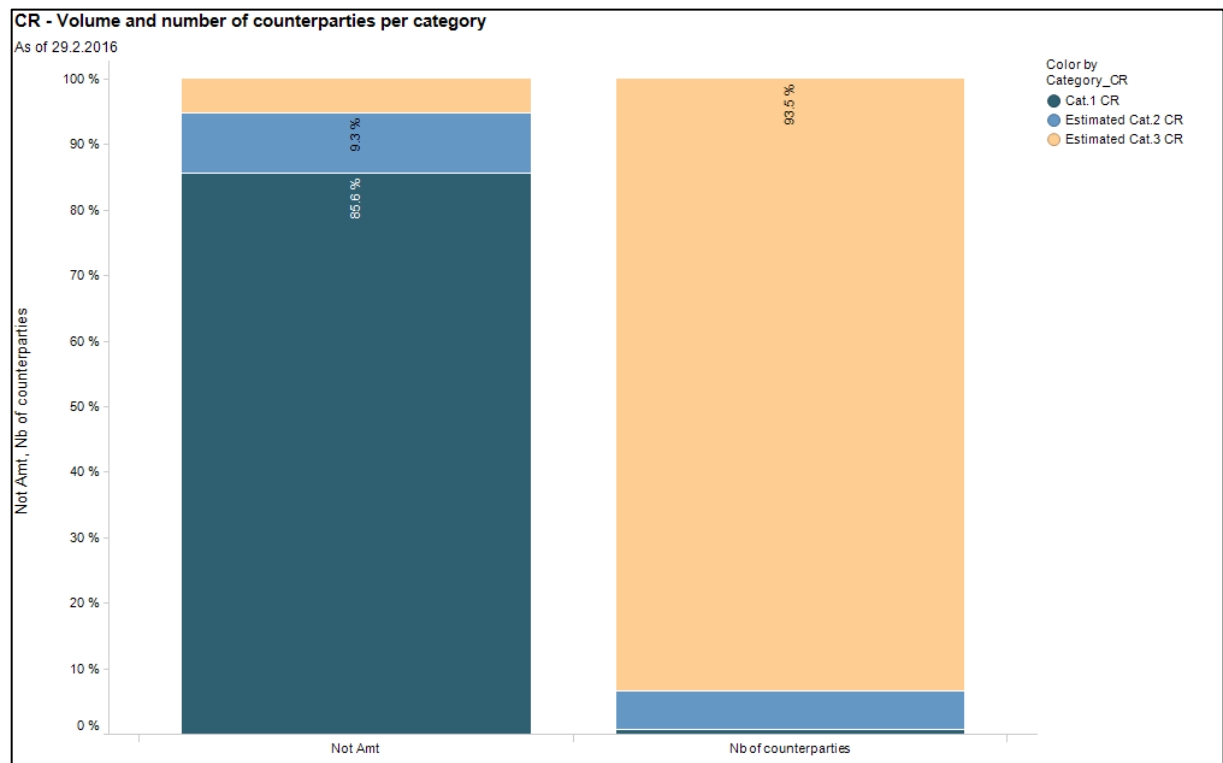


Source: European Securities and Markets Authority¹⁵⁹

¹⁵⁸ For the purpose of applying the clearing obligation for different classes of OTC derivatives, counterparties have been divided in four categories that are defined in regulatory technical standards. See, for instance, Article 2 of Commission Delegated Regulation (EU) 2016/592 of 1 March 2016 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on the clearing obligation.

¹⁵⁹ https://www.esma.europa.eu/sites/default/files/library/2016-1125_cp_on_clearing_obligation_for_financial_counterparties.pdf

Figure A-2B/7: CR – Volume and number of counterparties per category



Source: European Securities and Markets Authority¹⁶⁰

¹⁶⁰ https://www.esma.europa.eu/sites/default/files/library/2016-1125_cp_on_clearing_obligation_for_financial_counterparties.pdf

ANNEX 3: PROCEDURAL INFORMATION CONCERNING THE PROCESS TO PREPARE THE IMPACT ASSESSMENT REPORT AND THE RELATED INITIATIVE

- Lead Directorate-General: Directorate-General for Financial Stability, Financial Services and Capital Markets Union.
- The initiative is included in the Commission Work Programme 2017 as a REFIT item.¹⁶¹
- Organisation and timing of Inter Service Steering Group's meetings: four meetings on 17 November, 2 December, 21 December 2016, and 8 February 2017. The Inter Service Steering Group included representatives of the Directorates General Agriculture and Rural Development (AGRI), Climate Action (CLIMA), Competition (COMP), Economic and Financial Affairs (ECFIN), Energy (ENER), Internal Market, Industry, Entrepreneurship and SMEs (GROW), Justice and Consumers (JUST), Taxation and Customs Union (TAXUD), Trade (TRADE), the Legal Service (LS) and the Secretariat General (SG).
- Evidence used in the impact assessment:
 - Replies by stakeholders to the following public consultations:
 - From 21 May 2015 to 13 August 2015: a public consultation in the framework of the EMIR Review to obtain feedback from stakeholders on their experiences in the implementation of EMIR, http://ec.europa.eu/finance/consultations/2015/emir-revision/index_en.htm
 - From 30 September 2015 to 31 January 2016: a public consultation in the framework of the Call for Evidence on the EU regulatory framework for financial services inviting feedback and empirical evidence on the benefits, unintended effects, consistency and coherence of the financial legislation, http://ec.europa.eu/finance/consultations/2015/financial-regulatory-framework-review/index_en.htm
 - A public hearing on the review of the EMIR Regulation, held on 29 May 2015: http://ec.europa.eu/finance/events/2015/0529-emir-revision/index_en.htm
 - A public hearing on the Call for evidence, held on 17 May 2016: http://ec.europa.eu/finance/events/2016/0517-call-for-evidence/index_en.htm
 - Reports from European Securities and Markets Authority (ESMA): <https://www.esma.europa.eu>, European Systemic Risk Board (ESRB): <https://www.esrb.europa.eu/home/html/index.en.html>, European System of Central Banks (ESCB): <https://www.ecb.europa.eu/ecb/orga/escb/html/index.en.html>

¹⁶¹ REFIT is the Commission's Regulatory Fitness and Performance programme. See: http://ec.europa.eu/atwork/pdf/201621025_refit_scoreboard_2016_en.pdf, p. 201.

- The EMIR review report: http://ec.europa.eu/finance/financial-markets/docs/derivatives/161123-report_en.pdf
- Discussions with experts from Member States' authorities
- Report assessing the progress and effort made by CCPs in developing technical solutions for the transfer by pension scheme arrangements (PSAs) of non-cash collateral as variation margin, as well as the need for any measures to facilitate such solution, adopted on 3 February 2015: <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52015DC0039>
- Statistics and reports published by the Financial Stability Board (FSB) and the Bank of International Settlements (BIS).

ANNEX 4: PROCEDURAL ISSUES AND CONSULTATION OF INTERESTED PARTIES

This annex outlines the feedback received from stakeholders via the public consultation on the EMIR review (section 1), and the Call for Evidence on the EU regulatory framework on financial services (section 2). It also provides an overview of an exchange of views on the EMIR review with representatives of Member States, of European Union bodies and authorities, and of the European Free Trade Association (EFTA) during a meeting of the Derivatives and Market Infrastructures Member States Working Group, which took place in Brussels on 7 December 2016 (section 3).

1. Stakeholder consultation in the framework of the EMIR Review

1.1. Overview

The consultation¹⁶² generated 172 contributions from a broad range of stakeholders.¹⁶³ The majority came from companies (79) and industry associations (64). In addition, 15 public authorities responded as well as 3 private individuals. Responses came from various sectors and some respondents indicated more than one area of activity. The majority of respondents which indicated only one area of activity were non-financial/corporate enterprises (46) and industry associations (28). There were also replies from governmental organisations/regulators (8), market infrastructure operators (17), banks (16), and investment managers (13). The vast majority of respondents were based in the EU and the European Economic Area, with only 6 coming from the rest of the world (2 were from the USA, 1 from Japan, 1 from Thailand, and 2 others declared themselves as covering multiple jurisdictions). A large number of respondents were based in either the UK or Belgium reflecting the importance of the financial centre of the City of London and Belgium as the home of many industry associations. A significant number of responses also came from Germany, Sweden, Finland, and France.

Of the 15 pre-defined topics for consultation, most replies related to trade reporting (117), clearing obligations (85), non-financials (77), risk mitigation techniques (76), exchange of collateral (64), definition and scope (63), and CCP margins and collateral (63).

1.2. Summary of responses to the consultation

1.2.1. Questions on elements of EMIR to be reviewed

Feedback was sought on a number of specific elements of EMIR individually. The following sections present a summary of the contributions received in response to each particular question.

1.2.1.1. CCP liquidity

¹⁶² The consultation can be found at: http://ec.europa.eu/finance/consultations/2015/emir-revision/index_en.htm. Responses were published at: <https://ec.europa.eu/eusurvey/publication/emir-revision-2015>.

¹⁶³ Moreover, reports of a more technical nature that are formally required by Article 85(1) of EMIR, were received from ESMA, the ESCB, and the ESRB. In addition, a public hearing was held in Brussels on 29 May 2015, which gathered around 200 stakeholders. Information on the public hearing can be found at http://ec.europa.eu/finance/events/2015/0529-emir-revision/index_en.htm, the summary report is available at: http://ec.europa.eu/finance/events/2015/0529-emir-revision/docs/20150529-emir-hearing-summary-report_en.pdf.

Most industry respondents supported the need for measures to facilitate the access of CCPs to central bank liquidity facilities in order to mitigate CCPs' exposure to commercial bank risk, to decrease their liquidity risk, to strengthen CCP resilience, and to safeguard the level playing field for CCPs. Most public authorities and regulators, however, opposed any such measure as they claimed it would undermine central bank independence and discretion, and stated that mandatory provision of central bank liquidity could create moral hazard.

1.2.1.2. Non-financial firms

a) Clearing thresholds for non-hedging transactions and the corresponding definition of 'hedging'

The majority of respondents considered that the clearing thresholds for non-hedging transactions and the corresponding definition of contracts objectively measurable as reducing risks directly relating the commercial activity or treasury financing activity adequately captures those non-financial counterparties that should be deemed as systemically important.

Some respondents, however, mainly from the industry but also including public authorities considered that some elements should be improved. In particular, they suggested excluding intragroup transactions from the calculation of the clearing threshold and treating each asset class separately in order to avoid that a breach of a clearing threshold in one asset class should trigger obligations for clearing in all other asset classes. Some industry participants suggested increasing the clearing thresholds. In contrast, two public authorities considered the current approach too broad and stated that it did not capture all systemically important non-financials.

Some respondents, mainly from the industry, raised issues about the implementation of these thresholds suggesting that there was too much room for interpretation of the hedging definition resulting in supervisors taking inconsistent approaches. They further argued that it was difficult for counterparties of non-financial counterparties to ascertain whether they were above the clearing threshold, with a number of respondents from the industry and public authorities suggesting the establishment of a central register.

Finally, some industry participants and public authorities stated that ESMA's current interpretation of portfolio, macro or proxy hedging is problematic and that the treatment of these types of transactions should be clarified in a legally binding manner.

b) Elements of EMIR that created unintended consequences for non-financial counterparties.

Some industry participants pointed out disproportionate costs for non-financial counterparties, with some recommending excluding non-financial counterparties below the clearing threshold from the obligations of EMIR entirely in order to mitigate unintended consequences. Other respondents suggested an exemption from reporting for non-financial counterparties below the clearing threshold.

Finally, several respondents – almost all from the Nordic region – criticised the fact that EMIR does not allow the option of posting non-collateralised bank guarantees as collateral to CCPs.

c) Impact of EMIR on the use of, or access to, OTC derivatives by non-financial firms

Most non-financial firms and industry associations considered that EMIR impacts the use of, or access to, OTC derivatives by non-financial firms. A common impact observed by these respondents was a decrease in hedging activities. Nevertheless, a few respondents noted an increase in clearing of OTC derivatives as a result of the obligation, ahead of clearing obligations entering into force.

Other respondents, mainly non-financial firms, did not notice any particular change in the level of activity and some others noted that it was still too early to observe the impacts of the regulation.

1.2.1.3. CCP colleges

Respondents supported the introduction of supervisory colleges by EMIR as it ensures a strict level playing field amongst the European CCPs as well as homogeneity in the application of regulation across the European Union. They pointed out that colleges allow experience sharing and improve cooperation among relevant authorities, and are thus of importance for financial stability in the relevant Member States, striking the adequate balance between ensuring an appropriate role for the home national competent authorities. No respondents expressed objections to the establishment of supervisory colleges.

Respondents pointed out, however, that while colleges work well in general, there was still some room for improvement, in particular when it comes to the validation of models and parameters and the extension of services.

Some industry associations and one market infrastructure operator pointed out the need for more transparency in the functioning of colleges, in particular for the authorisation and extension of services processes towards CCPs but also towards CCPs' users in order to allow them to get more visibility of the authorisation process and its consequences (i.e. entry into force of EMIR requirements, potential clearing obligations, etc.). In particular, they suggested that EMIR should require the competent authority to publicly disclose when a CCP's authorisation application has been deemed complete.

Some authorities, industry participants, and market infrastructure operators suggested that EMIR should clarify the modalities for the college process, in particular the roles and responsibilities of different college members. Several authorities and industry participants, and market infrastructure operators also asked for more clarity in the process and timeframe for the authorisation and extension of services provided by CCPs.

In addition, two investment managers expressed the view that the number of national competent authorities (NCAs) within the college should be large, as many countries are concerned with the cross-border activities of CCPs.

1.2.1.4. Procyclicality

a) Adequacy of EMIR requirements to limit procyclical effects on CCPs' financial resources

The views of respondents to this question were split. About half of the respondents that expressed a clear view (mainly public authorities and market infrastructure operators) considered that the current requirements of EMIR were adequate to limit procyclical effects on CCPs' financial resources, even if some of them recognised that there was room for improving the anti-procyclicality requirements.

The other half (in particular investment managers and industry associations) considered that the current anti-procyclicality tools were not optimal to manage some specific products and suggested that EMIR allow some flexibility in the tools either by allowing additional tools or by adopting an outcome based approach.

Some public authorities and industry associations asked for more transparency in a CCP anti-procyclicality requirements notably in order to allow clearing members to anticipate changes and corresponding liquidity needs. Some of them suggested CCPs to have documented policies on their overall anti-procyclicality framework. Furthermore, some industry participants expressed concerns about sudden changes by a CCP of its eligibility criteria/margin levels and the need to avoid a sudden material increase of initial margin (or haircuts).

As to the range of collateral accepted, some industry associations pointed out that any limitation in the list of assets which are defined as eligible should be avoided and that a wider range of financial instruments should be allowed to be posted in addition to cash.

Some of these respondents added that some of the pro-cyclical effects were caused by clearing members and brokers themselves, as they often require higher margins than specified in the policies of the CCPs and increase haircuts and eligibility criteria at discretion. They suggested that the relationship between clearing and their clients should be managed by EMIR. Finally, some respondents pointed out the need for an internationally consistent framework in order to avoid regulatory arbitrage and competitive distortions.

b) Need to define additional capacity for authorities to intervene in this area

Views of the respondents were split on the need to define additional capacity for authorities to intervene in this area.

Around half of the respondents to this question including public authorities, investment managers, and industry associations supported the need for additional capacity for authorities to intervene in the area of the anti-procyclical effect of margining. Some of them pointed out that the collateral requirements imposed by clearing members in addition to those of CCPs maintain some form of procyclicality in the system. Others pointed out the need to allow ESMA to suspend the clearing obligations, to adopt a proposal for solid and clear recovery and resolution rules, or to coordinate macroprudential policies at EU level, including the potential introduction of time-varying minimum margin requirements and haircuts in order to address systemic risks.

The remainder of the respondents, including public authorities, industry associations and market infrastructures, were not in favour of introducing any additional capacity for authorities to intervene further as the current standards were already restrictive and did not allow for CCPs to have the necessary flexibility to efficiently address the procyclical nature of the products they clear and markets they serve. They insisted that CCPs should remain responsible for the establishment and application of their risk management process. Some respondents pointed that there was no evidence, at this stage, that existing requirements were insufficient to adequately limit procyclicality.

1.2.1.5. CCP margins and collateral

a) CCPs' policies on collateral and margin

The majority of respondents, mainly trade associations, investment managers, and market infrastructures, considered that CCPs' policies on collateral and margins were not developed in a balanced and effective way. The most commonly noted issues were the following:

- Non-financials from Nordic Member States and some industry associations pointed out that non-collateralised bank guarantees should be permitted as eligible collateral.
- Industry associations and banks asked for more transparency in the way that CCPs calculate margins and default fund contributions and asked CCPs to facilitate the use of non-cash variation margin.
- CCPs and industry associations asked for a revision of the provisions on portfolio margining. In particular, respondents asked for these provisions to be more model neutral and to ensure that the scope of instruments is less reliant on statistical criteria.

b) Spectrum of collateral eligible to be posted with CCPs

The majority of respondents, mainly CCP users (non-financials, trade associations, investment managers, pension companies, energy companies, banks) considered that the spectrum of eligible collateral did not strike the right balance between the liquidity needs of the CCP and its participants. The most commonly raised issue was that the variety of eligible collateral should be as wide as possible, with one common reason being that it is difficult for UCITS to access liquidity. More specifically, some respondents requested that warrants used for metal trading be added to the list of highly liquid financial instruments.

1.2.2. General questions

1.2.2.1. Definitions and scope

Most respondents, including mainly industry associations, companies, and public authorities, considered that some of the provisions and definitions contained within Article 1 and 2 of EMIR had created unintended consequences in terms of the scope of contracts or entities that are covered by the requirements. In particular, they pointed out the absence of a definition of an 'undertaking' for the determination of a non-financial counterparty, the external reference to MiFID for the definition of derivatives, the absence of clarity of the EMIR exemption for a "public sector entity", the application of EMIR to small non-financial and financial counterparties with the special consideration of Alternative Investment Funds, the absence of clarity of the definition of a 'group' (e.g. special treatment for securitisation special purpose vehicles), and the need for additional exemptions, in particular for the exemption of counterparties' transactions with exempted entities.

1.2.2.2. Clearing obligations

With respect to access to clearing for counterparties, a number of industry associations, companies and public authorities indicated that unforeseen difficulties had arisen with respect to establishing client clearing relationships in accordance with EMIR. In particular, respondents pointed out the absence of a sufficient and good offer for indirect clearing, amongst other things due to the leverage ratio. They questioned the necessity of the so-called frontloading requirements. They also mentioned the need to introduce exemptions from clearing and margining requirements for transactions resulting from risk reducing processes as well as for counterparties which are not systemically important, in particular small financial counterparties. Finally, they indicated that there

was a need to introduce a process to allow for a swift withdrawal or suspension of the clearing obligation.

1.2.2.3. Trade reporting

Trade reporting received a lot of attention. Most of the respondents considered that there were significant ongoing impediments or unintended consequences with respect to meeting trade reporting obligations. Respondents to this question were diverse and included industry associations, companies, public authorities, consultancies, NGOs, and a trade union. A large number of them asked to have double-sided reporting – which is considered as costly and burdensome – replaced with single sided reporting. They consistently asked for a reduction in the reporting requirements for non-financials. Both of these issues were raised by all categories of respondents.

In addition, industry associations and companies requested the removal of the requirement to report expired trades ('backloading'), as well as an exemption of exchange-traded derivatives and intragroup transactions from the reporting requirements.

Respondents identified several other points to be considered:

- simplification, reduction of the number, and improvement in the definitions of the reporting fields;
- resolution of problems with the use of the LEI ;
- alignment of reporting regimes and standardisation of data reporting formats;
- finalisation of work on the Unique Trade Identifier (UTI) and the Unique Product Identifier (UPI);
- improvement in trade reconciliation within trade repositories.

1.2.2.4. Risk mitigation techniques

Most respondents did not take a clear position on this question. However some companies and industry associations, mainly in banking, considered that there were significant ongoing impediments or unintended consequences with respect to meeting risk mitigation obligations. They indicated that longer timeframes should be provided for counterparties to confirm bespoke trades and to a lesser extent small transactions. In addition, some respondents in the field of investment management and banking indicated that EMIR should expressly recognise that not all gaps in portfolio reconciliation are disputes.

1.2.2.5. Exchange of collateral

Industry associations and companies considered the most significant ongoing impediments or unintended consequences with respect to meeting obligations to exchange collateral to be the treatment of transactions with third country jurisdictions that do not recognise netting. Some also called for the scope of affected entities to exclude non-financial and small financial counterparties.

1.2.2.6. Cross-border activity in the OTC derivatives markets

The majority of respondents to this question, including companies, industry associations, and public authorities considered that there were provisions or definitions within EMIR that pose challenges for EU entities when transacting on a cross-border basis.

Specifically, industry associations considered that the European Commission was taking too long to complete its equivalence assessments under EMIR. The same industry associations, as well as companies, indicated that further harmonisation of EMIR with

regulations in third countries was needed, noting the possibility of liquidity fragmentation as a result of differing rules.

Most respondents, mainly companies from the financial sector and industry associations, considered that some provisions within EMIR created a disadvantage for EU counterparties over non-EU entities. They principally indicated that the stringency of some EU requirements compared to requirements in other jurisdictions could lead to regulatory arbitrage.

1.2.2.7. Transparency

Most respondents to this question considered that there were significant ongoing impediments to ensuring that national competent authorities, international regulators, and the public have the envisaged access to data reported to trade repositories. The respondents were mainly companies, industry associations, and public authorities.

The main issues raised in response to this question (and the category of respondents which raised them) are as follows:

- i. companies and industry associations pointed out problems with or lack of consolidated / aggregated reporting by trade repositories;
- ii. public authorities indicated that EMIR should allow access to reported data by a broader range of authorities;
- iii. companies suggested that trade repositories should provide spreadsheet to highlight mismatches;
- iv. industry associations brought up difficulties with confidentiality/ bank secrecy rules;
- v. some companies and industry associations suggested that the use of UTI/UPI should become mandatory in line with the suggestion in response to finalise work on the development of the UTI and UPI.

In addition to the above, respondents raised several issues individually, such as: the need to oblige trade repositories to disclose data automatically and without restriction; allow access to more data; create a centralised data point for trade repositories; introduce controls and safeguards on trade repositories' pricing; clarify or standardise access requirements to trade repositories for public authorities; relax access requirements/withdraw the requirement for an international agreement; provide better guidance; or establish a single pan-European trade repository.

1.2.2.8. Requirements for CCPs

Most respondents considered there were significant ongoing impediments or unintended consequences with respect to CCPs' ability to meet EMIR requirements. In particular, some non-financials and industry associations from the Nordic Member States repeated their call for the acceptance of non-collateralised bank guarantees.

Investment managers called for more transparency or homogeneity on the different levels of client segregation available. CCPs asked not have to make additional contributions to loss absorbing resources, and some industry associations called for a mechanism to allow suspension of the clearing obligation.

Concerning the issues of risk management and client asset protection, respondents' views were split as to whether the EMIR requirements were sufficiently robust to ensure appropriate levels of risk management and client asset protection with respect to EU CCPs and their participants.

Some respondents called for further precision of CCP requirements to achieve a more consistent application by authorities across the Union. Public authorities called for more precision in how significant changes to CCPs' risk models are validated and on how limits to portfolio margining are applied. Industry associations requested a greater role in the risk committee's oversight of CCPs' risk management standards.

1.2.2.9. Requirements for trade repositories

Most respondents, mainly companies, industry associations and public authorities, considered that requirements for trade repositories raised significant ongoing impediments or unintended consequences. The respondents pointed to a very wide variety of issues, with none predominating.

Some companies and industry associations requested that access by end users to data reported on their behalf should be ensured. They also suggested that EMIR should ensure effective interoperability between trade repositories and that homogeneous validation rules between trade repositories are rigorously enforced. Several public authorities suggested that ESMA should validate and have the right to oppose material changes to the conditions for registration of a trade repository.

Additionally, there were a large number of items identified by one or two respondents. These include: introducing a requirement for trade repositories to rectify breaches within a specific time; modification of the method of trade repositories' fee calculation; making trade repositories more transparent; provision of a mandate to ESMA to harmonise trade repositories operations; improve the communication by trade repositories on key issues; making trade repositories subject to a periodic license renewal; and requiring porting.

1.2.2.10. Additional stakeholder feedback

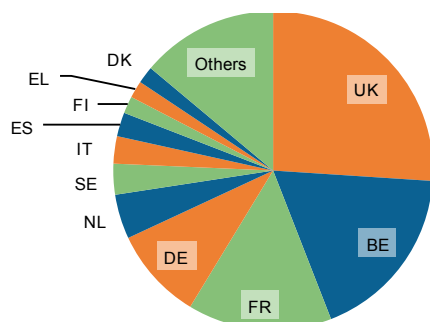
Some respondents indicated that there were impediments or unintended consequences with respect to requirements or provisions under EMIR not referenced in the preceding questions. The range of issues noted included the interaction of EMIR with other legislation (including CRR and MiFIR), possible financial stability risks introduced by the concentration of exposures in a small number of CCPs, and overreliance on Q&As published by ESMA to offer clarity on EMIR requirements.

2. Stakeholder consultation in the framework of the "Call for Evidence"

2.1. Overview

In a related area, on 30 September 2015 the European Commission launched a public consultation entitled "Call for Evidence". The purpose of the Call for Evidence was to consult all interested stakeholders on the benefits, unintended effects, consistency and coherence of the EU regulatory framework for financial services and the impact of the regulatory framework for financial services on the ability of the economy to finance itself and grow. In particular, the consultation sought feedback, concrete examples and empirical evidence on the impact of rules adopted to date. The Commission received 288 responses to the consultation from stakeholders in 25 different countries.

Chart –A3/1: **Respondents by country**



Source: Call for Evidence database

Table A-3/1: **Respondents by country**

Country of respondent	No.
United Kingdom	75
Belgium	52
France	42
Germany	27
The Netherlands	13
Sweden	9
Italy	8
Spain	7
Finland	5
Greece	5
Denmark	5
United States	4
Ireland	4
Croatia	4
Austria	4
Czech Republic	4
Norway	4
Switzerland	4
Malta	3
Luxembourg	3
Hungary	2
Slovakia	1
Poland	1
Guernsey and Jersey	1
South Africa	1
TOTAL	288

Source: Call for Evidence database

Table A-3/2: **Respondents by type**

Table A-3/3: **Respondents by sector**

Type of respondent	No.
Public Authority	29
Regulatory authority, Supervisory Authority or Central bank	15
Government or Ministry	13
Regional or local authority	1
Organisation	246
Industry association	218
Company, SME, micro-enterprise, sole trader	89
Consultancy, law firm	7
Consumer organisation	7
Non-governmental organisation	6
Think tank	4
Trade union	3
Academic institution	2
Private Individual	13
TOTAL	288

Sector of respondent	No.
Banking	100
Investment management	79
Insurance	50
Market infrastructure operator	39
Pension provision	30
Auditing	21
Consumer protection	20
Accounting	19
Civil society (advocacy, unions, NGOs)	19
Other Financial services	19
Credit rating agencies	11
Corporate (governance, issuers, treasuries)	11
Consultancy, law firm	8
Telecommunication	8
Social entrepreneurship	7
Academia	7
Energy	6
Auto	2
Real estate	2
News	1
Transport	1
TOTAL	288

Source: Call for Evidence database

2.2. Content of responses

Responses typically entailed multiple claims raised in relation to one or more of the 15 categories of potential issues on which the Commission had invited input. A total number of 708 claims raised involved EMIR; of these, 278 claims were single legislation claims, i.e. concerned only EMIR, the remaining 430 claims were cross-legislation claims, i.e. concerned the alleged cumulative effect of other pieces of legislation in conjunction with EMIR. The single legislation claims involving EMIR were largely identical to those raised in the consultation for the EMIR Review, which had been held roughly six months earlier, and were largely submitted by the same stakeholders.¹⁶⁴

Since cross-legislation claims concern the interaction of multiple pieces of legislation such claims were examined by dedicated Call for Evidence Task Forces and may be followed up in a separate process, where appropriate. It should be noted that such cross-legislation claims cannot be addressed by the present initiative that focusses on making targeted adjustments to EMIR only.

The consultation closed on 31 January 2016. It can be found at http://ec.europa.eu/finance/consultations/2015/financial-regulatory-framework-review/index_en.htm. The summary of contributions received is available at: http://ec.europa.eu/finance/consultations/2015/financial-regulatory-framework-review/docs/summary-of-responses_en.pdf

A public hearing was held in Brussels on 17 May 2016. Information can be found at http://ec.europa.eu/finance/events/2016/0517-call-for-evidence/index_en.htm.

¹⁶⁴ No entirely new elements were raised. To avoid duplication, please refer to the section above detailing claims received in the context of the EMIR Review consultation.

3. Meeting of the Derivatives and Market Infrastructures Member States Working Group

3.1. Overview

On 7 December 2016, the European Commission convened a meeting of the Derivatives and Market Infrastructures Member States Working Group to present the main findings of the Commission's report on EMIR published on 23 November 2016 and to seek the views of the members of this expert group on the issues identified in the report. The meeting was not public. Participants in the meeting included representatives of Member States (e.g. Ministries, National Competent Authorities and Central Banks), representatives of EU institutions and authorities (e.g. European Parliament, Council of the European Union, ECB, and European Securities and Markets Authority), as well as the Secretariat of the European Free Trade Area (EFTA). The summary below provides a full list of participants.

3.2. Summary of the meeting

The Commission services briefly introduced the main findings of the EMIR report, highlighting that the main message is that EMIR appears to be meeting its objective to increase transparency and mitigate systemic risk in the OTC derivatives market. No fundamental change is required to its core requirements. Nevertheless, the report identified a number of areas where targeted action could help meet the objectives of EMIR in a more effective, efficient and proportionate way.

The Commission services explained that the need (i) to eliminate disproportionate costs and burdens to small companies in the financial sector, and (ii) to simplify rules without putting financial stability at risk is why the EMIR review was included in the 2016 Commission's Regulatory Fitness and Performance programme (REFIT). Consequently, the Commission will present a proposal to amend targeted aspects of EMIR during Q1 2017, as announced in the 2016 Commission's work programme.

The Commission services invited the expert group members to provide their views on the issues identified in the EMIR report, on the basis of short issue papers circulated in advance of the meeting.

3.2.1 Targeted amendments to certain EMIR requirements

The majority of the expert group members who took the floor explicitly supported the targeted REFIT approach of the review, focussing on simplification and better calibration of specific requirements. Two Member State representatives suggested adding issues linked to potential CCP market concentration. Another Member State representative proposed to consider portfolio compression. One Member State delegation suggested going beyond the scope of the REFIT approach and making more fundamental changes to EMIR, including i) stricter rules on third-country CCP equivalence, ii) the introduction of an obligation to clear in the EU euro-denominated derivatives. A representative from a European authority seconded point i).

The Commission services took note of the general support for a targeted approach. On CCP market concentration, the Commission services said that it would take into account ongoing developments in relevant international standards, in the context of the Commission's proposal on CCP Recovery and Resolution, published in November 2016.

On the third-country regime, it was highlighted that EMIR already provides room for a proportionality approach in the assessment of third countries. In addition, any possible modification of the third-country regime should be considered at horizontal level, as it is not specific to EMIR. On the last issue, the Commission services recalled that the EMIR review is based on two consultations and aimed at simplifying and improving the existing rules. Issues relating to the broader context will be further assessed and developed in due time taking into consideration future developments.

3.2.2. Pension scheme arrangements (PSAs) – calibrating the clearing exemption

The majority of the expert group members who took the floor supported a new transitional exemption on the ground that no solution facilitating the participation of PSAs is expected to emerge in the short term and taking into account the specific risk profile of PSAs. One member State representative raised the need to maintain a level playing field between PSAs and other financial end-users, such as insurers, UCITS and AIFs which face the same constraints as PSAs. Member State representatives highlighted that incentives should be created for CCPs and clearing members to offer the right solutions. In particular, several Member State representatives considered that the proposed amendment to the Capital Requirement Regulation on the calculation of the leverage ratio (not including the provision of clearing services) might help in the development of solutions for central clearing. Representatives of Union bodies and authorities called for caution on any solution requiring CCPs to accept non-cash collateral.

3.2.3. Non-financial counterparties (NFCs) – calibrating the clearing and bilateral margining requirements

All the expert group members who took the floor expressed support for improving the proportionate approach applied to NFCs under EMIR so that it captures only the NFCs that are systemically important. Several possible amendments were discussed on how to reach this goal. A number of Member State representatives expressed support for removing the hedging exemption and increasing the thresholds to facilitate the enforcement of the rules. Other representatives expressed support for maintaining the hedging definition in order to identify the purpose of the transaction considered (i.e. hedging or speculative purpose), while exploring additional ways to improve the proportionality of the requirement, including adjustments to the existing clearing threshold that differentiates NFCs that are subject to the clearing obligation (NFCs+) from those that are not (NFC-, e.g. below €1bn in gross notional value for credit and equity derivatives and below €3bn for IRS, FX or commodity derivatives), according to the volume of derivative contracts transacted by the NFC. One member state suggested to consider narrowing the definition by excluding “quasi-financials”.

3.2.4. Small financials – calibrating the clearing obligation

Most expert group members were in favour of adjusting the scope of the clearing obligation applying to financial counterparties (FCs) in order to make the clearing requirement more proportionate. This could involve exempting from mandatory clearing only the very small financial counterparties, in order not to compromise EMIR's objective to increase financial stability. A number of Member State representatives highlighted the need to consider the consequences of removing very small financials on the NFC regime and to limit the exemption to very small financials in order to avoid the

development of a two-tiered market for standardised derivative contracts, with on the one hand centrally cleared contracts and on the other hand bilaterally cleared contracts.

3.2.5. Intragroup transactions – simplifying reporting requirements

All the expert group members who took the floor expressed support for simplifying the reporting requirement of intragroup transactions (IGTs). A few possible ways forward were discussed, highlighting the need to capture only IGTs that carry systemic risk. Several representatives of Member States considered that the obligation could be removed for the NFC- category. One Member State representative mentioned that it should be removed for all NFCs, while another said that IGTs should be reported by only one of the counterparties. Representatives of Union bodies and authorities called for caution not to eliminate access to the related reported data for supervisors.

3.2.6. Exchange-traded derivatives – reducing the reporting obligation

All expert group members agreed that there was room for simplifying reporting requirements on exchange-traded derivatives (ETDs). Several possible amendments were discussed. One Member State representative considered that the reporting should be done by the trading venue and not the counterparties, while another was open to remove ETD reporting under EMIR (to trade repositories) and leave it to MiFIR (to National Competent Authorities). Representatives of Union bodies and authorities called for keeping the data in trade repositories as it facilitates monitoring of the overall market. Several Member State representatives mentioned that the solution could be single-sided reporting for ETD transactions.

3.2.7. Simplifying double-sided reporting

There was general support for simplifying double-sided reporting, with several possible amendments put forward. There was consensus that dual-sided reporting aims at providing accurate and valuable data to be used by regulators. A number of Member State representatives supported the approach of the Securities Financing Transactions Regulation (SFTR) to introduce single-sided reporting only for NFCs-. A couple of Member State representatives voiced support for exploring the possibility of single-sided reporting for all NFCs. One expert group member was open to single-sided reporting for all counterparties; this was also a long term goal for another Member State representative and a Union body, but only once the quality of data could be ensured. A couple of Member State representatives suggested reducing the number of fields to be reported to alleviate the administrative burden.

3.2.8. Trade Repositories – improving the quality of data

All the expert group members who took the floor stressed that the common goal is to keep pace with international standards (e.g. development of Unique Product Identifier and Unique Transaction Identifier); a representative from an EU authority explained the related ongoing work in that direction and called for more effective and efficient supervisory powers.

3.2.9. Client and indirect client clearing - addressing lack of access to clearing

Expert group members voiced support for addressing the lack of access to clearing. Some encouraged further reflection on direct clearing models. Some considered that the

Commission's proposal to amend the Capital Requirement Regulation on the calculation of the leverage ratio, published in November 2016, might help facilitate access to clearing. A couple of Member State representatives were open to considering targeted amendments to EMIR to clarify the interaction between EMIR's default management tools and national insolvency laws in order to better protect clients. The Commission noted that one Member State had introduced this clarification in national law. In addition, there was general support from expert group members for applying fair, reasonable and non-discriminatory commercial terms (FRAND terms) to the provision of clearing offerings.

3.2.10. Increasing transparency of CCP margin requirements

A majority of representatives from Member States, Union bodies and authorities expressed support for increasing the transparency of CCP margin requirements. One Member State suggested introducing CCP margin caps to increase predictability; several representatives of Member States, Union bodies and authorities cautioned against such an approach, as it could lead to CCPs being not sufficiently collateralised.

3.2.11. Other issues

A majority of expert group members expressed support for the need to remove the obligation to report historical trades, i.e. derivative transactions concluded before the start of the reporting obligation in February 2014 (referred to as 'backloading') to simplify the reporting requirements.

A consensus emerged from the expert group on a number of additional issues, including on (i) the need to increase the basic amount of fines that ESMA can impose on trade repositories to make these fines more efficient and dissuasive, (ii) the need to remove the obligation to clear certain OTC derivative contracts concluded before the clearing obligation takes effect (referred to as the frontloading obligation) to simplify the clearing obligation, (iii) the need to introduce a mechanism to suspend the clearing obligation in specific cases, and (iv) the need to provide a mandate for initial margin model approval for uncleared contracts.

3.3. Meeting conclusions

The Commission's services thanked the expert group members for the exchange of views and invited them to provide further input via written comments. The Commission's services indicated that the views from the representatives of Member States, Union bodies and authorities would feed into the impact assessment report that will accompany the legislative proposal. The impact assessment will further explore the issues identified in the Commission's EMIR report and assess various policy options to address them.

3.4. List of participants

1. Permanent Representation of Belgium
2. Financial Services and Markets Authority (FSMA), Belgium
3. National Bank of Belgium
4. Financial Supervision Commission, Bulgaria
5. Ministry of Finance, Czech Republic
6. Danish Financial Supervisory Authority, Denmark
7. Federal Financial Supervisory Authority (BaFin), Germany
8. Deutsche Bundesbank, Germany

9. Bundesministerium der Finanzen, Germany
10. Permanent Representation of Germany
11. Ministry of Finance, Estonia
12. Central Bank of Ireland
13. Department of Finance, Ireland
14. Comisión Nacional del Mercado de Valores (CNMV), Spain
15. Banco de España, Spain
16. Treasury and Financial Policy General Secretary, Spain
17. Banque de France
18. Direction générale du Trésor, France
19. Autorité de Contrôle Prudentiel et de Résolution, France
20. Autorité des Marchés Financiers, France
21. Permanent Representation of Croatia
22. Banca d'Italia
23. Ministry of economy and finance Treasury Department, Italy
24. CONSOB, Italy
25. Cyprus Securities and Exchange Commission, Cyprus
26. Ministry of Finance, Latvia
27. Ministry of Finance, Lithuania
28. Commission de Surveillance du Secteur Financier (CSSF), Luxembourg
29. Banque centrale du Luxembourg (BCL)
30. Ministry of Finance, Luxembourg
31. Permanent Representation of Hungary
32. Ministry for National Economy, Hungary
33. Financial Services Authority, Malta
34. Ministry of Finance, The Netherlands
35. Financial Market Authority, Austria
36. Federal Ministry of Finance, Austria
37. Ministry of Finance, Poland
38. Ministry of Finance, Portugal
39. Banco de Portugal
40. Securities Market Commission (Comissão do Mercado de Valores Mobiliários), Portugal
41. Financial Supervisory Authority, Romania
42. National Bank of Romania
43. Ministry of Finance, Slovak Republic
44. Ministry of Finance, Finland
45. Ministry of Finance, Sweden
46. HM Treasury, United Kingdom
47. Financial Conduct Authority, United Kingdom
48. Bank of England
49. ECON Committee Secretariat, European Parliament
50. Council Secretariat, Council of the European Union
51. European Central Bank (ECB)
52. European Securities and Markets Authority (ESMA)
53. European Free Trade Association (EFTA)

ANNEX 5: EVALUATION**Section 1 Executive Summary**

The European Market Infrastructure Regulation (EMIR – Regulation 648/2012) aims to reduce systemic risk by increasing the transparency of the over-the-counter (OTC) derivatives market, by limiting the counterparty credit risk and by reducing the operational risk associated with OTC derivatives.

EMIR implements the commitment by G20 leaders in Pittsburgh in September 2009 that all standardised OTC derivatives contracts should be cleared through central counterparties, and that OTC derivatives contracts should be reported to trade repositories. EMIR entered into force on 16 August 2012.

EMIR has been included in the 2016 Commission's Regulatory Fitness and Performance programme (REFIT). Inclusion in the REFIT programme was justified by the need to simplify targeted areas of EMIR and make them more proportionate, as evidenced by the contributions to the public consultation on EMIR and the Call for Evidence on financial regulation, as well as by the Commission's review of the application of EMIR, carried out in accordance with Article 85(1) of EMIR.

In this context, the purpose of this evaluation is to assess to what extent specific policy requirements in EMIR have met their objectives and in particular whether these requirements have done so in an efficient and effective way, while at the same time being coherent, relevant and providing EU added-value.

Given that some of the core requirements of EMIR have only recently become applicable or are not applicable yet, this assessment does not constitute a full evaluation of EMIR, due to the lack of adequate evidence and as it is too early to draw a firm conclusion on long-term impacts. Instead, the evaluation assesses whether the core requirements of EMIR to report OTC derivatives, to centrally clear standardised OTC derivatives, and to subject uncleared OTC derivatives to risk-mitigation techniques and margins rules have met the operational requirements to: i) obtain complete and comprehensive information on OTC derivatives positions, ii) increase the use of CCP clearing, and iii) improve bilateral clearing practices. To the extent possible, the evaluation analysed the performance of the relevant EMIR requirements in the context of the five evaluation criteria, in accordance with the Better Regulation guidelines.

Given that the evaluation has been conducted in parallel with the EMIR review, it has fed into the problem definition of the impact assessment (IA) accompanying the EMIR REFIT initiative, and is presented as an annex to the IA.

This evaluation is based primarily on the results of consultations with stakeholders, regular exchanges with Members of the European Parliament and experts from the Member States, reports from the European Securities and Markets Authority (ESMA), the European Systemic Risk Board (ESRB), and the European System of Central Banks

(ESCB), and additional desk research of the Commission services. More specific sources included:

- The EMIR review report¹⁶⁵;
- Two public consultations: (i) a public consultation on the implementation of EMIR¹⁶⁶, and (ii) the Call for evidence on the EU regulatory framework for financial services in the framework of the CMU initiative¹⁶⁷;
- A public hearing on the review of EMIR Regulation held on 29 May 2015¹⁶⁸;
- Reports from ESMA¹⁶⁹, ESRB¹⁷⁰, and ESCB¹⁷¹ (European System of Central Banks) on the implementation of EMIR, as required by Article 85(1) of EMIR;
- A report adopted in February 2015 assessing the progress and effort made by CCPs in developing technical solutions for the transfer of non-cash collateral by pension scheme arrangements (PSAs)¹⁷²;
- Statistics and reports published by the Financial Stability Board (FSB)¹⁷³ and the Bank of International Settlements (BIS)¹⁷⁴.

On the basis of the above-mentioned evidence, this evaluation has considered the following five criteria to assess the core requirements of EMIR:

- Efficiency
- Effectiveness
- Relevance
- Coherence
- Added-value of EU action

On the **effectiveness and efficiency** of the core requirements of EMIR, the evaluation indicates that, while i) the volume of reported trades has improved, ii) the use of central clearing has increased and iii) the introduction of risk-mitigation techniques and margin requirements for uncleared trades has been completed, preliminary findings suggest that **(i) the reporting requirement applying to transactions may be simplified to increase transparency in the OTC derivatives market**. The evaluation also highlights that **(ii) obstacles to access central clearing, affecting in particular smaller counterparties, may limit the effectiveness of the clearing obligation**. Initial results also indicate that **(iii) EMIR may impose in certain areas disproportionate costs/burdens for certain counterparties that sit on the periphery of the derivatives trading network (e.g.**

¹⁶⁵ http://ec.europa.eu/finance/financial-markets/docs/derivatives/161123-report_en.pdf

¹⁶⁶ http://ec.europa.eu/finance/consultations/2015/emir-revision/index_en.htm

¹⁶⁷ http://ec.europa.eu/finance/consultations/2015/financial-regulatory-framework-review/index_en.htm

¹⁶⁸ http://ec.europa.eu/finance/events/2015/0529-emir-revision/index_en.htm

¹⁶⁹ ESMA provided several reports on the EMIR review in August 2015: see [ESMA review report no 1](#) (use of OTC derivatives by non-financial counterparties); [ESMA review report no 2](#) (efficiency of margining requirements to limit procyclicality); [ESMA review report no 3](#) (segregation and portability requirements); and [ESMA review report no 4](#) (input as part of the Commission's public consultation on EMIR).

¹⁷⁰ [ESRB Report](#) on the efficiency of margining requirements to limit pro-cyclicality and the need to define additional intervention capacity in this area, July 2015.

¹⁷¹ ESCB, [Report of the ESCB on the need for any measure to facilitate the access of CCPs to central bank liquidity](#).

¹⁷² <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52015DC0039>

¹⁷³ In particular, [FSB OTC Derivatives Market Reforms - 11th progress report](#), August 2016.

¹⁷⁴ In particular, BIS, [Triennial Central Bank Survey of foreign exchange and OTC derivatives markets in 2016](#); [Semiannual OTC derivatives statistics](#); and [Quarterly Review](#), December 2016.

small financials and NFCs). The asymmetric distribution of the derivatives market amongst counterparties, with smaller counterparties accounting for a limited share of the OTC derivative transactions, suggests that such adjustments, while making EMIR more proportionate, would not affect financial stability.

In terms of **coherence**, EMIR is aligned with international efforts to reform the global OTC derivatives market. At an internal level, EMIR is coherent with other pieces of EU legislation, as outlined in the follow-up to the Call for Evidence, in the Commission's proposed amendment to the Capital Requirement Regulation, and in the proposal for a recovery and resolution framework for CCPs. In terms of the **EU added value**, EMIR covered a gap that existed in legislation by introducing a new framework aiming to address in a uniform process at EU level the lack of transparency of the OTC derivatives market and the related systemic risks.

Section 2 Introduction

Regulation 648/2012 on OTC derivatives, central counterparties and trade repositories (EMIR) entered into force on 16 August 2012. EMIR aims to reduce systemic risk by increasing the transparency of the over-the-counter (OTC) derivatives market, by limiting the counterparty credit risk and by reducing the operational risk associated with OTC derivatives.

In accordance with Article 85(1) of EMIR, the Commission was mandated to carry out a review of the application of EMIR and to present any appropriate legislative proposals. In this context, the Commission has carried out an extensive assessment of the rules currently in place, based in particular on a public consultation on EMIR and the Call for Evidence on financial regulation, both carried out by DG FISMA in 2015-2016. In November 2016, the Commission adopted a report on the review of EMIR (the EMIR review report)¹⁷⁵. The report identified areas for which targeted action is necessary to ensure fulfilment of the EMIR objectives in a more proportionate, efficient and effective manner.

In accordance with the EMIR review report and further analysis conducted in this evaluation, the Commission considers proposing in 2017 a targeted legislative initiative on EMIR. This initiative is part of the 2016 Commission's Regulatory Fitness and Performance programme (REFIT).

In this context, the purpose of this evaluation is to assess to what extent specific policy requirements in EMIR have met their objectives and in particular whether these requirements have done so in an efficient and effective way, while at the same time being coherent, relevant and providing EU added-value. The evaluation has fed into the problem definition of the impact assessment (IA) and is presented as an annex to the IA.

EMIR establishes core requirements for the OTC derivatives market. These include reporting requirements, clearing obligations, margin and operational risk-mitigation

¹⁷⁵ COM(2016) 857 final of 23.11.2016.

requirements for non-cleared OTC derivatives transactions and requirements for trade repositories (TRs) and Central Counterparties (CCPs).

However, certain of these core requirements have not yet been implemented or the implementation is incomplete. In particular, at this stage, clearing obligations and margin requirements in respect of non-cleared OTC derivatives transactions are not yet fully applicable. Therefore, due to the lack of adequate evidence, the evaluation cannot assess holistically the impact of EMIR.

Nevertheless, the EMIR review report identifies a number of issues relating to the implementation of those requirements that already apply (namely, reporting to TRs and operational risk mitigation requirements), as well as issues encountered in preparing for the clearing and margin requirements.

For these reasons, the evaluation will focus on whether the following operational requirements of EMIR have been met: i) obtain complete and comprehensive information on OTC derivatives positions, ii) increase the use of CCP clearing, and iii) improve bilateral clearing practices. The evaluation will also assess whether these EMIR requirements could be fine-tuned in order to simplify and increase the efficiency of the policy framework and reduce disproportionate costs and burdens, without putting financial stability at risk.

Section 3 Background to the initiative

Description of the initiative and its objectives

EMIR was published in the Official Journal of the European Union on 27 July 2012, and entered into force on 16 August 2012. Most of the requirements did not immediately become applicable, as EMIR empowered the Commission to adopt secondary legislation specifying the technical practicalities and the phase-in schedule of the core requirements. As a result, the main elements of EMIR, such as mandatory clearing and margin requirements for uncleared derivatives, have either only recently come into operation or will soon start to apply.

Recital (4) of EMIR provides a description of the objectives of the Regulation:

"Over-the-counter derivatives ('OTC derivative contracts') lack transparency as they are privately negotiated contracts and any information concerning them is usually only available to the contracting parties. They create a complex web of interdependence which can make it difficult to identify the nature and level of risks involved. The financial crisis has demonstrated that such characteristics increase uncertainty in times of market stress and, accordingly, pose risks to financial stability. This Regulation lays down conditions for mitigating those risks and improving the transparency of derivative contracts."

EMIR seeks to promote transparency and standardisation in the OTC derivatives market as well as reduce systemic risk through the application of its six core requirements:

1. Central clearing of standardised OTC derivative contracts;
2. Margin requirements for OTC derivative contracts that are not centrally cleared;

3. Operational risk mitigation requirements for OTC derivative contracts that are not centrally cleared;
4. Reporting of all derivative contracts;
5. Requirements for CCPs; and
6. Requirements for TRs.

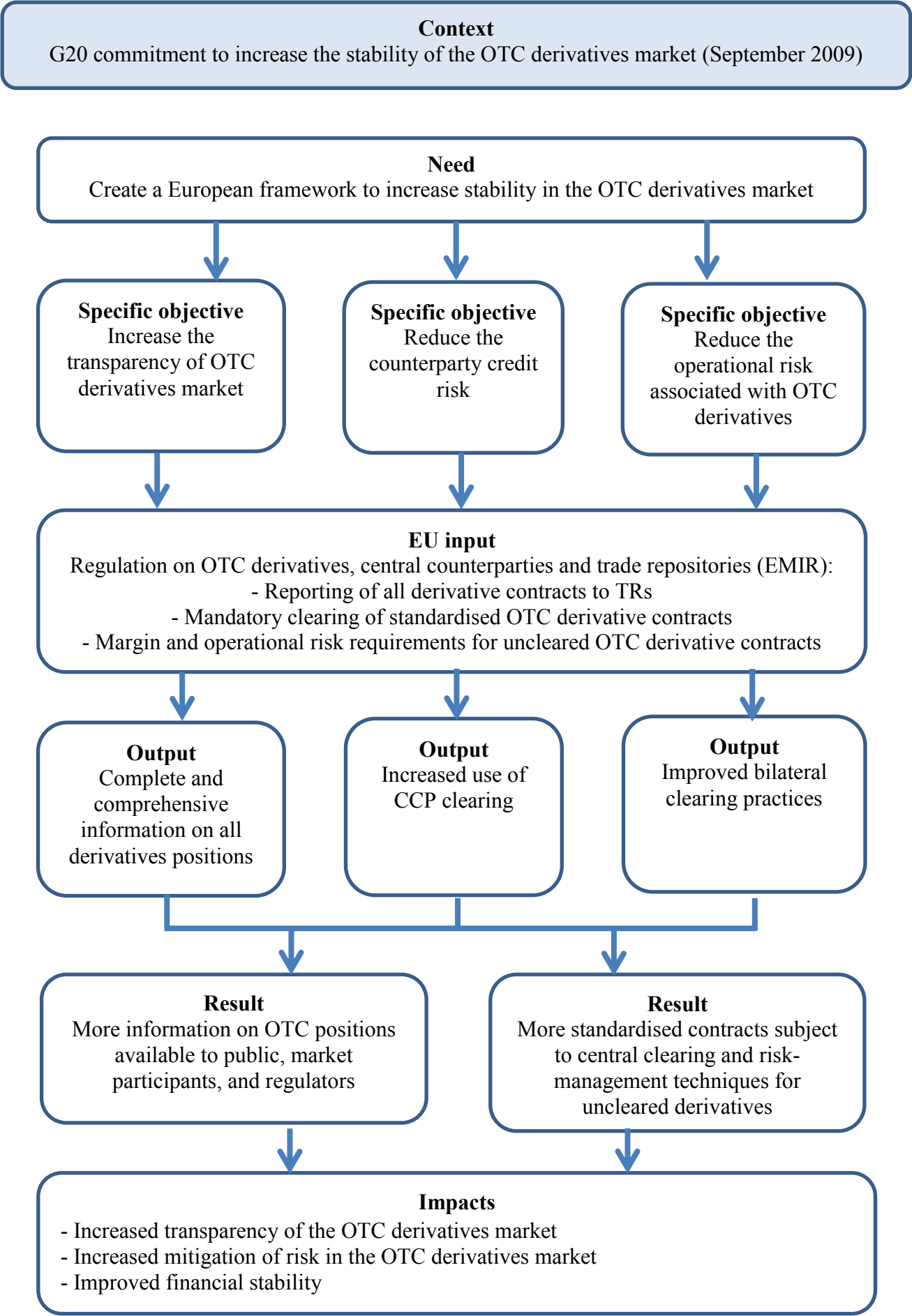
EMIR seeks to address the three main problems identified in the IA that accompanied the EMIR proposal in 2010 (the 2010 IA) related to the functioning of the OTC derivatives market: i) the lack of transparency on positions and exposures, ii) insufficient mitigation of counterparty credit risk, and iii) insufficient mitigation of operational risks.

The general policy objective of EMIR is to reduce systemic risk by increasing the safety and efficiency of the OTC derivatives market.

The specific policy objectives of the EMIR Regulation are:

- 1) to increase the transparency of the OTC derivatives market for regulators, market participants and the public;
- 2) to reduce the counterparty credit risk associated with OTC derivatives; and
- 3) to reduce the operational risk associated with OTC derivatives.

The intervention logic below provides a description - in a summarised diagram format - on how the EMIR Regulation is expected to work. It is also used to carry out the evaluation and answer specific questions.



Description of the situation before the adoption of EMIR

The financial crisis brought the OTC derivatives market to the forefront of regulatory attention. The near collapse of Bear Sterns in March 2008, the default of Lehman Brothers on 15 September 2008 and the bail-out of AIG the following day highlighted the shortcomings in the functioning of this market.

According to the 2010 IA, in late 2009, the size of the OTC derivatives market by notional value amounted to approximately \$615 trillion, a 12% increase with respect to the end of 2008. Zooming in on market segments, the IA highlighted that, in 2007, the EU accounted for 63% of the interest rates derivatives market and 54% of the foreign exchange derivatives market, while the US accounted for 24% and 15%, respectively.

In spite of the volume of the OTC derivative market, prior to EMIR, the OTC derivatives market was not regulated at EU level. The 2010 IA also indicated that the Commission services were not aware of legislative initiatives specifically targeting OTC derivatives at the level of individual Member States.

Since October 2008, however, the Commission had been working actively to tackle the shortcomings that the financial crisis brought to light. In the short term, the Commission focused on the credit default swaps ('CDS') market and obtained a commitment from the major dealers to start clearing European-referenced CDS transactions through a CCP. In the medium term, it focused on an in-depth review of derivatives markets that resulted in the publication of two Communications on derivatives markets, respectively in July and October 2009.

Given the global nature of the OTC derivatives market, the importance of an internationally coordinated approach was crucial. In September 2009 in Pittsburgh, the G20 leaders agreed that: *"All standardised OTC derivatives contracts should be [...] 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 requirements"*¹⁷⁶.

EMIR responded to the G20's commitment to increasing the stability of the OTC derivatives market. Similar initiatives were undertaken across G20 jurisdictions, such as in certain Asian countries (Hong Kong, Japan, Singapore and South Korea), and in the US via the Dodd-Frank Wall Street Reform and Consumer Protection Act, which was signed into law in July 2010.

The 2010 IA identified several problems relating to the functioning of the OTC derivatives market. Those included:

- The lack of information available to regulators and market participants on positions and exposures of individual firms in OTC derivatives;
- The insufficient mitigation of counterparty credit risk associated with OTC derivatives; and
- The insufficient mitigation of the operational risk associated with OTC derivatives.

¹⁷⁶ <http://www.g20.utoronto.ca/2009/2009communique0925.html>

EMIR was adopted to address these problems, by increasing the transparency of the OTC derivatives market, by limiting the counterparty credit risk and by reducing the operational risk associated with OTC derivatives.

Section 4 Evaluation Questions

This section summarises the review questions addressed in this evaluation.

Question 1: How effective has the EU intervention been?

- To what extent have the operational objectives of EMIR to i) obtain complete and comprehensive information on OTC derivatives positions, ii) increase the use of CCP clearing, and iii) improve the management of risk in bilateral clearing practices, have been achieved and what factors influenced the achievements observed?

Question 2: How efficient has the EU intervention been?

- To what extent have EMIR's core requirements on reporting, clearing, and risk-mitigation techniques for uncleared derivatives been cost-effective for market participants given the effects they have achieved in promoting transparency in the OTC derivatives market and in mitigating systemic risk?

Question 3: How relevant is the EU intervention?

- To what extent are EMIR's requirements on reporting, clearing and risk-mitigation techniques for uncleared derivatives still relevant nearly a decade after the 2009 G20's commitment to increase the stability of the OTC derivatives market and in light of current developments in this market?

Question 4: How coherent is the EU intervention?

-To what extent are EMIR's requirements on reporting, clearing and risk-mitigation techniques for uncleared derivatives coherent with other pieces of EU financial legislation, such as the Commission's proposal to amend the Capital Requirements Regulation, the Commission's proposal to establish a framework for the recovery and resolution of CCPs, and the second Markets in Financial Instruments Directive and the related Regulation?

Question 5: What is the EU-added value of the intervention?

- To what extent EMIR's requirements on reporting, clearing and risk-mitigation techniques for uncleared derivatives have helped increase the stability of the OTC derivatives market, taking into account its inherent cross-border nature, and to what extent do the risks related to the lack of transparency in the OTC derivatives market and to counterparty credit risks in cleared and uncleared derivatives markets continue to require action at EU level?

Section 5 Methodology

This evaluation is based primarily on the results of consultations with stakeholders, reports from the European Securities and Markets Authority (ESMA), the European

Systemic Risk Board (ESRB), and the European System of Central Banks (ESCB), and additional desk research of the Commission services. More specific sources included:

- The EMIR review report¹⁷⁷;
- Two public consultations:
 - a public consultation on the implementation of EMIR for the purposes of the review mandated under Article 85(1) of EMIR¹⁷⁸. 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; and
 - the Call for evidence on the EU regulatory framework for financial services¹⁷⁹ that took place from September 2015 to January 2016 in the framework of the CMU initiative. 278 respondents raised claims focused on provisions of EMIR. A detailed summary of the responses to the two consultations is provided in the respective feedback statements;
- A public hearing on the review of EMIR Regulation held on 29 May 2015¹⁸⁰;
- Reports from ESMA¹⁸¹, ESRB¹⁸², and ESCB¹⁸³ (European System of Central Banks) on the implementation of EMIR, as required by Article 85(1) of EMIR;
- A report assessing the progress and effort made by CCPs in developing technical solutions for the transfer by pension scheme arrangements (PSAs) of non-cash collateral as variation margin, as well as the need for any measures to facilitate such solution, adopted on 3 February 2015¹⁸⁴;
- Statistics and reports published by the Financial Stability Board (FSB) and the Bank of International Settlements (BIS).

In addition to these sources, the Commission services also considered input from the European Parliament and the Member States.

In particular, the Commission services took into account a resolution by the European Parliament on stocktaking and challenges of the EU Financial Services Regulation: impact and the way forward towards a more efficient and effective EU framework for Financial Regulation and a Capital Markets Union, adopted in January 2016¹⁸⁵. The Commission services also engaged in regular exchanges with MEPs from the ECON Committee involved in the EMIR review, including via meetings in December 2016.

The Commission services also held an exchange of views in December 2016 with experts from the Derivatives and Market Infrastructures Member States Working Group.

¹⁷⁷ [Commission report](#) COM(2016) 857 of 23.11.2016.

¹⁷⁸ http://ec.europa.eu/finance/consultations/2015/emir-revision/index_en.htm

¹⁷⁹ http://ec.europa.eu/finance/consultations/2015/financial-regulatory-framework-review/index_en.htm

¹⁸⁰ http://ec.europa.eu/finance/events/2015/0529-emir-revision/index_en.htm

¹⁸¹ ESMA provided several reports on the EMIR review in August 2015: see [ESMA review report no 1](#) (use of OTC derivatives by non-financial counterparties), [ESMA review report no 2](#) (efficiency of margining requirements to limit procyclicality), [ESMA review report no 3](#) (segregation and portability requirements), and [ESMA review report no 4](#) (input as part of the Commission's public consultation on EMIR).

¹⁸² [ESRB Report](#) on the efficiency of margining requirements to limit pro-cyclicality and the need to define additional intervention capacity in this area, July 2015.

¹⁸³ [Report of the ESCB on](#) the need for any measure to facilitate the access of CCPs to central bank liquidity.

¹⁸⁴ <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52015DC0039>

¹⁸⁵ European Parliament [Resolution 2015/2106 \(INI\)](#) of 19 January 2016.

Limitations – robustness of findings

While EMIR entered into force in August 2012, certain core requirements (including clearing obligations and bilateral margin requirements) provided for the Regulation are yet to be implemented or completed. This has a number of consequences.

First, it means that a full evaluation of the effectiveness and efficiency of EMIR in meeting its objectives is not possible.

Second, there is only a limited amount of quantitative evidence available to carry out the evaluation, as the experience drawn from the requirements that are applicable only spans a couple of years. In the specific instance of margin requirements, there is no data available, as margins rules only started to apply as of February 2017.

Third, the building of consistent data sets took time to be created and research on this data has only just begun. Obtaining complete and comprehensive information about the OTC derivatives market by requiring market participants to report trades was in itself one of the operational objectives of EMIR. The reporting obligation has been in application only since 2014. While the proportion of trades covered by the reporting obligation is broad, the evaluation highlights that there are concerns with regards to the quality and the usability of the data collected. There is therefore a limited set of EU-wide data available to carry out the evaluation. Nevertheless, the evaluation draws from the data collected by European public authorities and bodies (i.e. ESMA, ESRB, ESCB) on the basis of rules which are already in place as well as the responses to the public consultations and developments in third country jurisdictions. In addition, it is important to highlight that the market for OTC derivatives is global and highly interconnected. Therefore, the relevance of EU-focused data is limited. Where there is no data available at EU level, the evaluation will rely on data provided by international institutions involved in the monitoring of the G20 reform of the OTC derivatives reform, such as the Financial Stability Board (FSB) and the Bank for International Settlements (BIS).

Fourth, the assessment of the extent to which the central clearing obligation has reduced systemic risk raises methodological challenges. These come on top of the data issues mentioned before. The nature of EMIR data requires new tools and innovation in the field of network analysis, statistical physics and certain mathematical concepts. How to assess systemic risk using transaction-based reporting data is an active and open field of research.

Section 6 Implementation state of play (Results)

Overview of requirements in place

EMIR has been directly applicable since 16 August 2012. A regulation was deemed to be the most suitable policy instrument to ensure the application of uniform requirements throughout the EU with exactly the same scope, without any gold-plating and without allowing residual powers to Member States. In addition, EMIR empowered the Commission to adopt delegated acts in accordance with Article 290 of the TFEU to spell out the details of some requirements. EMIR also required ESMA to draft regulatory technical standards for these delegated acts and carry out appropriate impact assessments.

While EMIR entered into force in August 2012, not all of the requirements it sets out already apply. The provisions of EMIR, together with the deadlines included within the different technical standards, imply a phased-in application of the legal framework.

This section focuses on the application of those rules that are relevant to achieve EMIR's operational objectives to i) obtain complete and comprehensive information on OTC derivatives positions, ii) increase the use of CCP clearing, and iii) improve bilateral clearing practices. These rules include: trade reporting of OTC derivatives; central clearing; and minimum margin and risk-mitigation requirements for non-centrally cleared derivatives (NCCDs). The following key obligations have started to apply:

- i. the reporting of all derivatives contracts to TRs to improve oversight of the derivatives market and assessment of systemic risk has been in force since 2014;
- ii. the mandatory clearing through CCPs of the most standardised OTC derivatives contracts to reduce systemic risk has started to apply since June 2016 to certain asset classes and to certain counterparties; and
- iii. operational risk-management techniques have started to apply to uncleared OTC derivatives since 2013, through a gradual schedule. The exchange of collateral (margins) for non-centrally cleared contracts to protect against counterparty credit risk has started phased-in from 4 February 2017 for the largest counterparties and in accordance with internationally agreed timelines for other counterparties.

The FSB regularly monitors the implementation of OTC derivatives reforms agreed by the G20 in its 24 member jurisdictions. The table below is an extract from the latest FSB progress report, published in August 2016. It highlights that, as of end-June 2016, the EU had implemented all of the G20 commitments on OTC derivatives reforms, except margin requirements for non-centrally cleared derivatives (NCCDs). Since the publication of the FSB progress report however, the EU adopted in October 2016 regulatory standards on margin requirements for uncleared derivatives. This means that the EU has completed the implementation of the G20 OTC derivatives reforms with regard to trade reporting, central clearing and margins requirements.

Table A-5/1 - Summary of Jurisdictional Progress of OTC Derivatives Market Reforms – EU focus (Reforms to jurisdictional frameworks, as at end-June 2016)

			Trade Reporting	Central Clearing	Capital	Margin	Platform Trading
E U	France	FR				2	
	Germany	DE				2	
	Italy	IT				2	
	The Netherlands	NL				2	
	Spain	ES				2	
	United Kingdom	UK				2	

2	<i>Capital and margins for NCCDs:</i> Legislative framework or other authority is in force and, with respect to at least some transactions, standards / requirements have been published for public consultation or proposal .
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	<p><i>Trade reporting:</i> Legislative framework or other authority is in force and, with respect to over 90% of transactions, standards / requirements are in force.</p> <p><i>Central clearing and platform trading:</i> Legislative framework or other authority is in force and, with respect to over 90% of transactions, standards / criteria for determining when products should be centrally cleared / platform traded are in force. An appropriate authority regularly assesses transactions against these criteria.</p> <p><i>Capital for NCCDs:</i> Legislative framework or other authority is in force and, with respect to over 90% of transactions, standards / requirements are in force.</p>
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Source: FSB OTC Derivatives Market Reforms - 11th progress report, August 2016

What is the current situation?

An overview of the structure of the OTC derivatives market and of the type of counterparties is available in Annex 2A.

1. Reporting obligation

EMIR requires that all derivatives contracts be reported to Trade Repositories (TR). In practice, counterparties entering into a derivative contract must report certain variables to a TR authorised by ESMA. Currently, there are six authorised TRs in the EU.

Table A-5/2 – List of trade repositories registered by ESMA, as of May 2015

Trade Repository	Derivative asset class	Effective date
DTCC Derivatives Repository Ltd. (DDRL)	All asset classes	14 November 2013
Krajowy Depozyt Papierów Wartościowych S.A. (KDPW)	All asset classes	14 November 2013
Regis-TR S.A.	All asset classes	14 November 2013
UnaVista Limited	All asset classes	14 November 2013
CME Trade Repository Ltd. (CME TR)	All asset classes	5 December 2013
ICE Trade Vault Europe Ltd. (ICE TVEL)	Commodities, credit, equities, interest rates Foreign exchange	5 December 2013 4 June 2015

Source: European Securities and Markets Authorities

These TRs provide daily data to over 60 institutions in the EU, which have access to the data pertaining to their respective jurisdiction¹⁸⁶. EMIR grants ESMA and the ESRB with exclusive access to the full EU-wide asset.

The reporting requirement applies to all derivatives classes (including credit, commodity, equity, interest rates, foreign exchange and "other") and encompasses trades cleared by CCPs. Both OTC and exchange-traded contracts are covered. Furthermore, the reporting obligation applies to all counterparties. The reporting obligation aims to provide a full picture of the EU derivatives market to address the lack of transparency of the OTC

¹⁸⁶ ESRB, [Occasional Paper Series No11/ September 2016](#), Shedding light on dark markets: First insights from the new EU-wide OTC derivatives dataset.

derivatives market, in order to provide complete and comprehensive information on OTC derivatives positions. The reporting requirement became applicable in February 2014.

Today, a substantial share of new OTC derivative transactions is estimated to be covered by reporting requirements. In the EU, where authorised TRs are available in all asset classes, requirements are estimated to cover 80–100% of new transactions in all asset classes, as illustrated in the table below.

Table A-5/3 – Estimated regulatory coverage of reporting requirements (Percent of all new transactions that are required to be reported to comply with regulations, as at March 2016)¹⁸⁷

	Commodity					Credit					Equity					FX					Interest Rate				
	0 20	20 40	40 60	60 80	80 100	0 20	20 40	40 60	60 80	80 100	0 20	20 40	40 60	60 80	80 100	0 20	20 40	40 60	60 80	80 100	0 20	20 40	40 60	60 80	80 100
EU	-	-	-	-	●	-	-	-	-	●	-	-	-	-	●	-	-	-	-	●	-	-	-	-	●

Source: FSB OTC Derivatives Market Reforms - 11th progress report, August 2016

Table A-5/4 – Aggregate availability of trade repositories by asset class – EU focus (TRs and TR-like entities authorised as at end-June 2016)¹⁸⁸

	Commodity	Credit	Equity	FX	Interest Rate
EU	6	6	6	6	6

Source: FSB OTC Derivatives Market Reforms - 11th progress report, August 2016

2. Clearing obligation

The operational objective of the clearing obligation is to increase the use of CCP clearing, in order to reduce systemic risk.

The scope of the clearing obligation is far-reaching and includes all financial counterparties¹⁸⁹ and the biggest non-financial counterparties (NFCs). This is because EMIR intends to cover all relevant market participants in order to cover all risks linked to derivatives transactions.

¹⁸⁷ According to the FSB categorisation of asset classes. The asset classes used in the FSB report are those established under IOSCO classification, and do not exactly match those applicable under EMIR. In particular, it should be noted that emission allowance derivatives are classified under the “Other derivatives” asset class for EMIR, but under “Commodity derivatives” under IOSCO.

¹⁸⁸ *Ibid.*

¹⁸⁹ Article 2(8) of EMIR provides a definition of financial counterparty. It refers to an investment firm authorised in accordance with Directive 2004/39/EC, a credit institution authorised in accordance with Directive 2006/48/EC, an insurance undertaking authorised in accordance with Directive 73/239/EEC, an assurance undertaking authorised in accordance with Directive 2002/83/EC, a reinsurance undertaking authorised in accordance with Directive 2005/68/EC, a UCITS and, where relevant, its management company, authorised in accordance with Directive 2009/65/EC, an institution for occupational retirement provision within the meaning of Article 6(a) of Directive 2003/41/EC and an alternative investment fund managed by AIFMs authorised or registered in accordance with Directive 2011/61/EU.

EMIR does however only aim at 'systemic' NFCs: it acknowledges that NFCs use OTC derivative contracts in order to cover themselves against, i.e. hedge, commercial risks directly linked to their commercial or treasury financing activities. NFCs are subject to the clearing obligation where their positions in non-hedging OTC derivatives exceed certain thresholds defined in regulatory technical standards drafted by ESMA¹⁹⁰. Once an NFC surpasses one of these thresholds in any asset class, it becomes subject to the clearing obligation across all asset classes. These NFCs are commonly referred to as 'NFC+' as opposed to NFCs below the threshold which are known as 'NFC-'.

Today, the EU has adopted three central clearing determinations, on the basis of draft regulatory technical standards drafted by ESMA, following analysis carried out according to criteria set out in EMIR. The determinations cover two different asset classes: OTC interest rate derivatives and OTC credit derivatives.

Interest rates derivatives are by far the largest segment of outstanding derivatives. As at end-June 2016, the notional amounts of outstanding OTC interest rate derivatives rose to USD 438 trillion (80% of global outstanding derivatives)¹⁹¹. In April 2016, the EU accounted for 47% of the global interest rates derivatives market¹⁹². By contrast, the size of the credit derivatives market has declined steadily, from \$25 trillion at end-June 2013 and a peak of \$51 trillion in 2007, to \$11.8 trillion at end-June 2016 (amounting to 2.2% of global outstanding derivatives)¹⁹³.

Today, the central clearing determination covering OTC interest rate swaps (IRS) related to the Euro, the USD, the Yen, and the British Pound has started to apply to clearing members (as of 21 June 2016) and to financial counterparties above the EUR 8 billion threshold (as of 21 December 2016). For other IRS in European currencies (Norwegian Krone, Polish Zloty, and Swedish Krona) and Credit Default Swaps (CDS), the application has started phasing-in as of February 2017 for clearing members. The compliance deadlines for the central clearing determination applying to various asset classes and to different types of counterparties are summarised in the tables below.

¹⁹⁰ The thresholds are EUR 1 bn in gross notional value for credit and equity derivatives and EUR 3 billion for interest rate, foreign exchange, and commodity or other derivatives.

¹⁹¹ [OTC derivatives statistics at end-June 2016](#), Statistical release, BIS, November 2016, p. 5.

¹⁹² [Triennial Central Bank Survey of Foreign Exchange and OTC derivatives markets](#) in 2016, Statistical Annex, BIS, p. 18.

¹⁹³ [OTC derivatives statistics at end-June 2016](#), Statistical release, BIS, November 2016.

Table A-5/5 - First Commission Delegated Regulation covering interest rate derivatives in the G4 currencies

Category of counterparty	Short description of the category	Date of taking effect for new contracts	Minimum remaining maturity		
Category 1	Clearing Members in the classes subject to the clearing obligation		21 June 2016	6 months (as of 21 June 2016) for contracts entered into or novated on or after 21 February 2016	
	The CCPs listed below have published the lists of their clearing members in Category 1 ⁶ :				
	BME	Spain			Clearing Members in Category 1 - BME Clearing
	CME CE	UK			Clearing Members in Category 1 - CME Clearing Europe
	Eurex	Germany			Clearing Member in Category 1 - Eurex Clearing AG
	LCH Ltd	UK			Clearing Members in Category 1 - LCH Ltd
	Nasdaq	Sweden			Clearing Members in Category 1 - Nasdaq OMX Clearing
	JSCC	Japan			Clearing Members in Category 1 - JSCC
OTC HK	Hon-Kong	Clearing Members in Category 1 - OTC Clearing HK			
Category 2	<ul style="list-style-type: none">— Financial counterparties above the EUR 8bn threshold— Alternative investment funds that are non-financial counterparties and above the EUR 8bn threshold	21 December 2016	6 months (as of 21 December 2016) for contracts entered into or novated on or after 21 May 2016		
Category 3	<ul style="list-style-type: none">— Financial counterparties below the 8bn threshold— Alternative investment funds that are non-financial counterparties and below the 8bn threshold	21 June 2017	Not applicable		
Category 4	Non-financial counterparties not included in Categories 1, 2 or 3	21 December 2018	Not applicable		

Source: European Securities and Markets Authority

Table A-5/6– Second Commission Delegated Regulation covering European index CDS

Category of counterparty	Short description of the category	Date of taking effect for new contracts	Minimum remaining maturity			
Category 1	Clearing Members in the classes subject to the clearing obligation The CCP listed below has published the list of its clearing members in Category 1 ⁹ : <table><tr><td>LCH SA</td><td>France</td><td>Clearing Members in Cat 1 - LCH SA</td></tr></table>	LCH SA	France	Clearing Members in Cat 1 - LCH SA	9 February 2017	6 months (as of 9 February 2017) for contracts entered into or novated on or after 9 October 2016
LCH SA	France	Clearing Members in Cat 1 - LCH SA				
Category 2	<ul style="list-style-type: none">Financial counterparties above the EUR 8bn thresholdAlternative investment funds that are non-financial counterparties and above the EUR 8bn threshold	9 August 2017	6 months (as of 9 August 2017) for contracts entered into or novated on or after 9 October 2016			
Category 3	<ul style="list-style-type: none">Financial counterparties below the 8bn thresholdAlternative investment funds that are non-financial counterparties and below the 8bn threshold	9 February 2018	Not applicable			
Category 4	Non-financial counterparties not included in Categories 1, 2 or 3	9 May 2019	Not applicable			

Source: European Securities and Markets Authority

Table A-5/7 - Third Commission Delegated Regulation covering interest rate derivatives in NOK, PLN and SEK

Category of counterparty	Short description of the category			Date of taking effect for new contracts	Minimum remaining maturity
Category 1	Clearing Members in the classes subject to the clearing obligation The CCPs listed below have published the list of their clearing members in Category 1 ¹⁰ :			9 February 2017	6 months (as of 9 February 2017) for contracts entered into or novated on or after 9 October 2016
	CME Clearing Europe	UK	Clearing Members in Cat 1 – CME CE		
	KDPW_CCP	Poland	Clearing Members in Cat 1 - KDPW_CCP		
	LCH Ltd	UK	Clearing Members in Cat 1 – LCH Ltd		
	Nasdaq OMX	Sweden			
	Chicago Mercantile Exchange Inc	US			
Category 2	— Financial counterparties above the EUR 8bn threshold — Alternative investment funds that are non-financial counterparties and above the EUR 8bn threshold			9 August 2017	6 months (as of 9 August 2017) for contracts entered into or novated on or after 9 October 2016
Category 3	— Financial counterparties below the 8bn threshold — Alternative investment funds that are non-financial counterparties and below the 8bn threshold			9 February 2018	Not applicable
Category 4	Non-financial counterparties not included in Categories 1, 2 or 3			9 August 2019	Not applicable

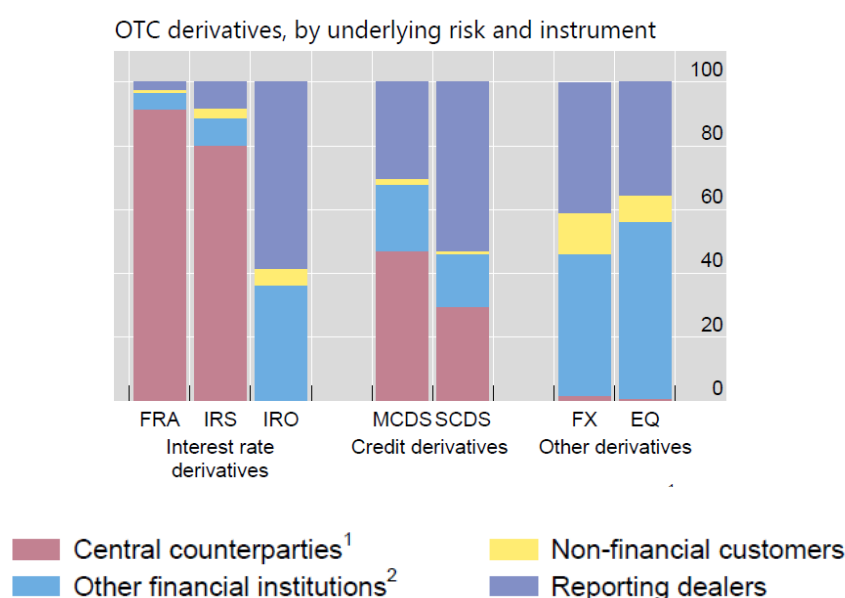
Source: European Securities and Markets Authority

In spite of the recent phase-in of the central clearing obligation in the EU, evidence shows that a substantial share of OTC derivatives is now centrally cleared. As of end-June 2016, on average 62% of the \$544 trillion in outstanding notional amounts reported by dealers was centrally cleared by CCPs across all types of derivative contracts¹⁹⁴.

In terms of notional amounts, without adjusting for double counting arising from novation, BIS estimated that the volume of cleared OTC transactions at the end of June 2016 totalled USD 337.28 trillion, of which USD 328.5 trillion was attributable to interest rate derivatives and USD 4 trillion to credit OTC derivatives.

In the EU, there are currently 17 CCPs that have been authorised to offer services and activities in the Union¹⁹⁵. They clear a significant proportion of USD 544 trillion of derivatives outstanding.

Figure A-5/8: Significance of central clearing - Types of counterparties, as a percentage of notional amounts outstanding at end-June 2016



FRA = forward rate agreements; FX = foreign exchange derivatives; IRS = interest rate swaps; IRO = interest rate options; EQ = equity-linked derivatives; MCDS = multi-name credit default swaps; SCDS = single-name credit default swaps.

¹ Contracts between reporting dealers that are subsequently novated to CCPs are recorded twice (reported once by each dealer). See footnote 4 on page 6 of the main text. ² Excluding central counterparties and reporting dealers.

Source: BIS derivatives statistics, November 2016

3. Margin and operational risk management requirements for uncleared OTC derivative contracts

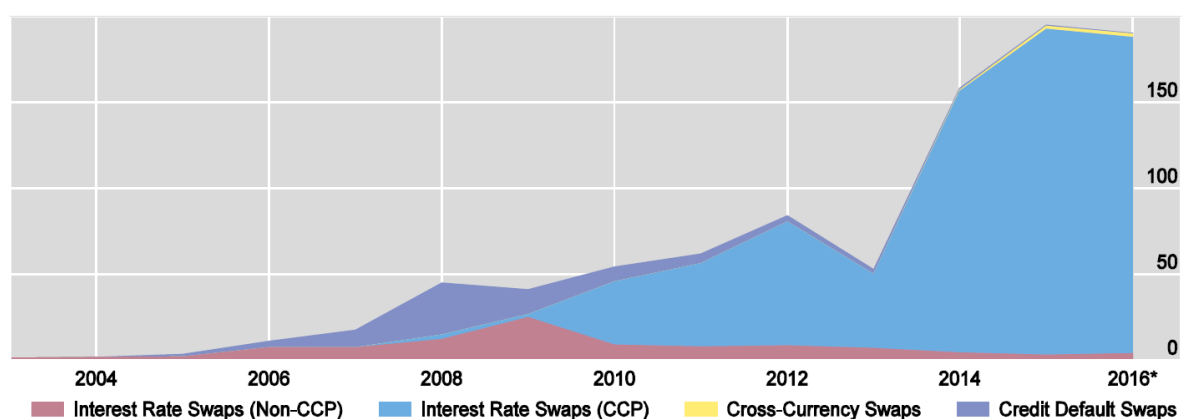
In spite of the significance of central clearing, a material proportion of OTC derivative transactions remain bilateral. EMIR introduced requirements on operational risk management and margins in order to improve risk management in bilateral clearing.

¹⁹⁴ BIS, Statistical release, [OTC derivatives statistics at end-June 2016](#), November 2016.

¹⁹⁵ ESMA, in accordance with Article 88(1) of EMIR, publishes [a list](#) of the CCPs that are authorised to offer services and activities in the Union.

Rules on risk-mitigation techniques for OTC derivative contracts not cleared by a CCP started to phase-in in 2013. All NCCDs are subject to requirements on timely confirmation, portfolio reconciliation, portfolio compression, dispute resolution and daily valuation requirements (above a certain portfolio size threshold). The requirements are in line with international standards developed by the International Organization of Securities Commissions (IOSCO), prepared in consultation with the Basel Committee on Banking Supervision (BCBS) and the Committee on Payments and Market Infrastructures (CPMI) and finalised in January 2015¹⁹⁶. As far as risk-mitigation techniques are concerned, the figure below shows developments in the use of portfolio compression at one prominent service provider, for some asset classes of both NCCDs and cleared OTC derivatives.

Figure A-5/9 – Use of portfolio compression services (triReduce compression metrics, in USD trillions, from 2003 to 2016)



Volume of trades compressed annually, measured by overall reduction in gross notional outstanding effected by compression cycles. Figures quoted are single-counted, apart from CCP, which are double-counted in line with market convention.

Sources: TriOptima, FSB OTC Derivatives Market Reforms - 11th progress report

In addition to operational risk mitigation techniques, the Commission adopted new regulatory technical standards on margins requirements¹⁹⁷ in October 2016 to further mitigate risk in bilateral clearing and strengthen the incentive to move to central clearing, based on criteria set out in EMIR. These requirements follow international standards developed by the BCBS and IOSCO.

The scope of the margin requirements reflects the one of the clearing obligation and applies to all financial counterparties and 'NFC+'. The margin rules require them to exchange two types of collateral in the form of margins. The first type is variation margin (VM), which protects counterparties against exposures related to the current market value of their OTC derivative contracts. The second type is initial margin (IM), which protects counterparties against potential losses which could stem from movements in the market value of the derivatives position occurring between the last exchange of variation margin before the default of a counterparty and the time that the OTC derivative contracts are replaced or the corresponding risk is hedged. The initial margin requirement applies to financial counterparties and NFCs above a threshold of EUR 8bn in gross notional amounts of outstanding contracts.

¹⁹⁶ IOSCO (2015), Risk Mitigation Standards for Non-centrally Cleared OTC Derivatives, January.

¹⁹⁷ [Commission Delegated Regulation \(EU\) 2016/2251 of 4 October 2016](#), OJ L 340, 15.12.2016, p. 9–46.

The entry into application of the requirements follows a phase-in schedule, starting on 4 February 2017 for clearing members and as of 1 March 2017 for other counterparties.

Section 7 Answers to the evaluation questions

Question 1: How effective has the EU intervention been?

- To what extent have the operational objectives of EMIR to i) obtain complete and comprehensive information on OTC derivatives positions, ii) increase the use of CCP clearing, and iii) improve the management of risk in bilateral clearing practices have been achieved and what factors influenced the achievements observed?

One of EMIR's key operational objectives was to ensure complete and comprehensive information on OTC derivative positions, by introducing a requirement to report all trades to TRs. It is too early to fully assess the extent to which EMIR has met this operational objective, as the reporting requirement has only been in application since February 2014.

Nevertheless, initial results indicate that progress has been achieved and that this objective has been partially met. Indeed, the reporting requirement generates huge data volumes about the derivatives market. It is estimated that, by the end of 2015, 27 billion records have been received and processed by the six TRs in the EU, averaging around 330 million records per week¹⁹⁸. This corresponds to FSB's estimates that 80–100% of new transactions in all asset classes are covered by the EMIR reporting requirements¹⁹⁹. According to the ESRB, *'derivatives markets are thus in the process of becoming one of the most transparent markets for regulators'*²⁰⁰.

However, there are teething issues with the reporting requirements. In the EMIR public consultation, numerous respondents (in particular companies and industry associations) indicated that the data produced by trade repositories is of low quality and not sufficiently transparent, and therefore difficult to use.

In particular, market participants and authorities noted that many reports by the two counterparties pertaining to the same transaction are not accurately matched within TRs. This is attributed in part to a lack of clarity around what needs to be reported and how. It is also attributed to differences in requirements between TRs.

There are also concerns about the quality of the reported data. The EMIR review report indicated that, as a result of the difficulty in submitting accurate data and matching, the data was not as reliable and usable as it should be.

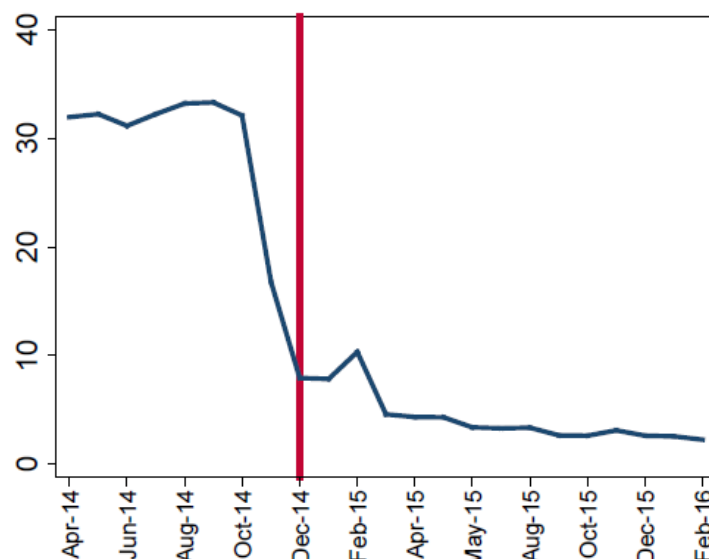
¹⁹⁸ European Securities and Markets Authority. "ESMA's supervision of credit rating agencies and trade repositories: 2015 annual report and 2016 work plan."

¹⁹⁹ See figure A-5/3 above.

²⁰⁰ *Shedding light on dark markets: First insights from the new EU-wide OTC derivatives dataset*, ESRB, Occasional Paper Series No11/ September 2016.
https://www.esrb.europa.eu/pub/pdf/occasional/20160922_occasional_paper_11.en.pdf

Those concerns can be grouped into two main categories, as outlined by the ECB in a recent article on the OTC derivative reforms²⁰¹. First, there are issues related to misreporting by the counterparties or the TRs. There are indications that there are positive developments on that front. For instance, the ESRB indicated in September 2016 a downward trend in the share of missing observations on several key variables that need to be reported, as illustrated by the following figure.

Figure A-5/10: Percentage of missing observations for selected variables²⁰²



Source: European Systemic Risk Board, Occasional Paper Series No11/September 2016

The second category includes problems that are caused by a lack of standardisation and harmonisation. ESMA, the ECB and the ESRB are involved in various work streams at international and EU level to improve the quality of data.

In addition, ESMA suggested in its input to the Commission's consultation on the EMIR review that fines for TRs may need to be increased in order to ensure effective supervision and provide further incentives to increase data quality²⁰³.

Another of EMIR's key operational objectives was to increase the use of CCP clearing, by requiring that standardised OTC derivatives be cleared through CCPs, according to criteria established by EMIR. As intended, the market use of CCPs has increased since the adoption of the delegated regulation on central clearing for interest rate derivatives in August 2015²⁰⁴. According to BIS data, the clearing rate for OTC interest rate derivatives is estimated to have more than doubled between 2009 and 2016. While the percentage of

²⁰¹ ['Looking back at OTC derivative reforms – objectives, progress and gaps'](#), ECB, 20 December 2016, pp. 21-22.

²⁰² This chart depicts the time series of missing observations, computed as the mean percentage of missing variables across four variables: beneficiary ID, notional amount, effective date, and price multiplier.

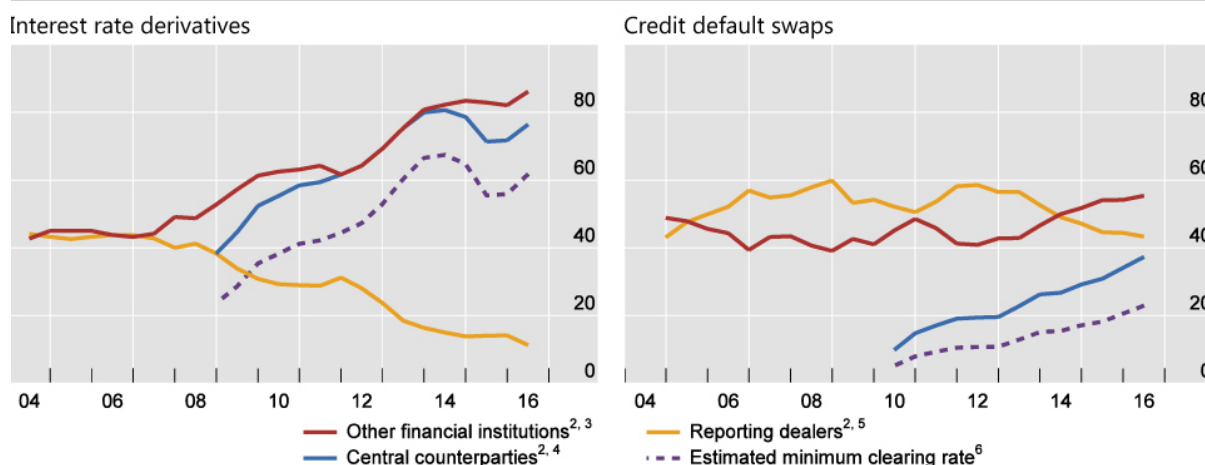
²⁰³ EMIR Review Report no.4, ESMA input as part of the Commission consultation on the EMIR Review, https://www.esma.europa.eu/sites/default/files/library/2015/11/esma-2015-1254_-_emir_review_report_no.4_on_other_issues.pdf

²⁰⁴ [Commission Delegated Regulation \(EU\) 2015/2205](#) of 6 August 2015, OJ L 314, 1.12.2015, p. 13–21.

interest rate OTC derivatives centrally cleared was about 36% at the end of 2009, it reached about 60% at the end of 2015.

Likewise, central clearing has gained in importance in the credit derivatives market. The proportion of outstanding CDS cleared through CCPs has increased steadily since these data were first reported, from 10% at end-June 2010 to 37% at end-June 2016²⁰⁵.

Figure A-5/11 – Growth of central clearing (notional amounts outstanding by counterparty in percent)



Further information on the BIS derivatives statistics is available at www.bis.org/statistics/derstats.htm.

¹ As reported in the semiannual survey of OTC derivatives markets, excluding the positions of dealers that report only in the Triennial Survey. ² As a percentage of notional amounts outstanding against all counterparties. ³ Including central counterparties but excluding reporting dealers. ⁴ For interest rate derivatives, data for CCPs prior to end-June 2016 are estimated by indexing the amounts reported at end-June 2016 to the growth since 2008 of notional amounts outstanding cleared through LCH's SwapClear service. ⁵ Adjusted for the double-counting of positions between dealers (that are not novated to CCPs). ⁶ Proportion of trades that are cleared, estimated as $(CCP / 2) / (1 - (CCP / 2))$, where CCP represents the share of notional amounts outstanding that dealers report against CCPs. CCPs' shares are halved to adjust for the potential double-counting of inter-dealer trades novated to CCPs.

Sources: LCH.Clearnet Group Ltd; BIS OTC derivatives statistics.

Source: BIS derivatives statistics, November 2016

This confirms that EMIR is on track to achieve the objective to increase the use of CCPs. However, according to FSB data, there is scope for further uptake of central clearing. The 11th progress report on the OTC derivatives markets reforms²⁰⁶ indicates that the gross notional outstanding amount of centrally cleared positions across all sub-product types represented in 2015 around 56% of all estimated notional outstanding amount that could theoretically be centrally cleared.

There are also **obstacles in accessing central clearing** to meet upcoming clearing obligations. The EMIR review report highlighted that smaller counterparties in particular are struggling to access clearing, in particular due to legal and commercial challenges posed by EMIR with respect to the level of client asset segregation that has to be offered by clearing members. In addition, there are concerns that EMIR does not explicitly override inconsistencies in Member States' national insolvency regimes²⁰⁷. Furthermore,

²⁰⁵ [OTC derivatives statistics at end-June 2016](#), Statistical release, BIS November 2016.

²⁰⁶ [FSB OTC Derivatives Market Reforms](#) - 11th progress report, FSB, August 2016.

²⁰⁷ EMIR Review report n°3 - Review on the segregation and portability requirements, ESMA/2015/1253, ESMA, 13 August 2015, <https://www.esma.europa.eu/sites/default/files/library/2015/11/esma-2015->

as set out in the EMIR review report, many respondents to the EMIR consultation, notably industry associations and banks, consider that it can be difficult to predict the levels of margin that they will be required to post to CCPs for centrally cleared transactions. Reports from ESMA²⁰⁸ and ESRB²⁰⁹ suggested increasing the transparency of margin requirements in order to improve the treatment of procyclicality. Finally, a broad range of public authorities, investment managers, and industry associations also highlighted the absence of a mechanism under EMIR for the clearing obligation to be suspended promptly where the market situation so requires (e.g. sharp change in volumes cleared or liquidity).

Another of EMIR's operational objectives was to improve risk management in bilateral clearing practices and to strengthen the incentive to move to central clearing, by introducing operational risk management techniques and margins requirements for uncleared OTC derivative contracts. As margins requirements have just started to phase-in in February 2017, their impact on the market structure and on risk-mitigation will only become clear in future data.

Question 2: How efficient has the EU intervention been?

- To what extent have EMIR's core requirements on reporting, clearing, and risk-mitigation techniques for uncleared derivatives been cost-effective for market participants given the effects they have achieved in promoting transparency in the OTC derivatives market and in mitigating systemic risk?

Even if we cannot yet assess the impact on systemic risk for the entire system due to the methodological and data challenges mentioned in section 5, input from ESMA, ESRB, ESCB, as well as submissions to the EMIR consultation and the Call for Evidence, highlighted that reporting, clearing, operational risk mitigation and margin requirements remained integral to achieving in a cost-effective manner EMIR's objectives of promoting transparency in derivatives markets and mitigating risks.

The EMIR review report also identified a number of areas where the core EMIR requirements could be adjusted to reduce disproportionate costs and burdens on market participants, without compromising its overall objectives.

In particular, it seems that the scope of transactions covered by the **reporting** requirements of EMIR could be made more proportionate, in order to alleviate excessive burdens on counterparties, without putting financial stability at risk. On the reporting requirement, respondents, including both market participants as well as ESMA, questioned the utility 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 and is considered as less and less useful since it concerns historical data that is not of

[1253 - emir review report no.3 on segregation and portability.pdf](#). ESMA reports in paragraph 32 of that report, that some CCPs found discrepancies between some Member States insolvency laws and EMIR because of which the EMIR default management tools are not enforceable under the current legal framework.

²⁰⁸ ESMA's EMIR Review Report no.2 - Review on the efficiency of margining requirements to limit procyclicality

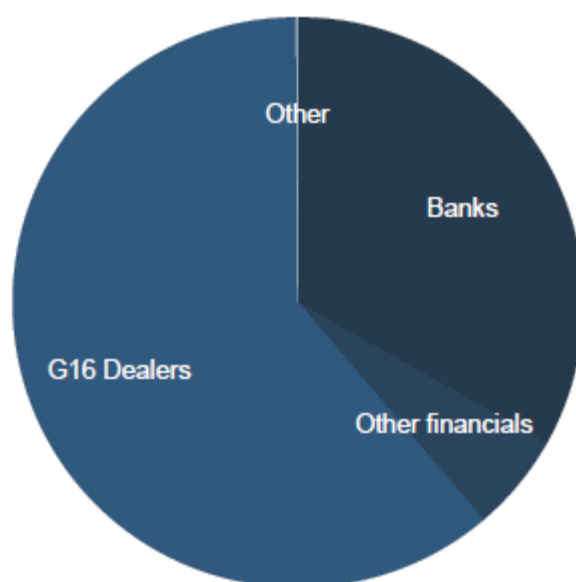
²⁰⁹ ESRB Report on the efficiency of margining requirements to limit pro-cyclicality and the need to define additional intervention capacity in this area

critical importance for regulators. Similar concerns were expressed with respect to exchange traded derivatives.

With regard to the **clearing** obligation, ESMA and respondents raised questions on whether the burden related to 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.

In addition to the transactions covered by EMIR, there are questions on whether **the scope of entities covered** by some of the key requirements could be better calibrated, taking into account their systemic importance vis-à-vis the rest of the economy. Figure A-5/12 provides a sense of the relative share of various market participants in cleared contracts, on the basis of an analysis carried out by the ESRB.

Figure A-5/12 – Share of total notional of centrally cleared contracts by type of market participant (DTCC OTC interest rate derivatives dataset, based on the 02/11/15 trade state report)²¹⁰



Source: European Systemic Risk Board, Occasional Paper Series No11/September 2016

For instance, both respondents to the public consultations and ESMA noted that non-financial counterparties (NFCs) face significant challenges in meeting requirements, in particular reporting requirements, due to limited resources and experience. According to the ESMA, non-financial counterparties that are active in derivatives markets are numerous (64.295) and represent 72% of the number of counterparties. ESMA confirmed that only 2% of the notional value of the OTC derivatives markets is made up by NFC

²¹⁰ This chart includes only trades which are centrally cleared. The group of G16 dealers includes Bank of America, Barclays, BNP Paribas, Citigroup, Crédit Agricole, Credit Suisse, Deutsche Bank, Goldman Sachs, HSBC, JPMorgan Chase, Morgan Stanley, Nomura, Royal Bank of Scotland, Société Générale, UBS, and Wells Fargo.

activity and that NFCs tend to transact with less than 6 other market participants, which suggests a lack of interconnectedness across the system as far as NFCs are involved²¹¹.

This suggests that **the systemic relevance of most of the NFCs is limited** and that EMIR's core requirements could be better calibrated so as not to impose an unnecessary or disproportionate burden on NFCs which do not pose significant risks to financial stability. For instance, initial industry estimates suggest that the annual costs of reporting could range between €2.4 and €4.6 billion²¹² for NFCs.

Likewise, companies and industry associations questioned whether it is proportionate to apply the reporting requirements to intragroup transactions to NFCs, given that these transactions are undertaken within the same corporate groups where coordination between the counterparties is inherent in the nature of the transactions.

Likewise, **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 Regulation, which are perceived as having the potential to make client clearing services too costly for them to offer.

The network structure of the OTC derivatives market suggests that the trade-off between, on the one hand, the costs of complying with certain EMIR requirements such as those relating to clearing and reporting, and, on the other hand, increased financial stability, may be disproportionate for those market participants that are active at the periphery of the OTC derivatives market and thus present a relatively lower systemic risk for financial stability.

The ESRB has illustrated in a recent paper published in September 2016 the network structure of the market through the visualisation of the outstanding bilateral IRS positions. This provides a sense of "who trades with whom" and of the degree of interconnectedness between market participants.

Figure A-5/13 below illustrates that CCPs, clearing members (referred to as G16 dealers), and banks, which appear in the core of the chart, are connected to a large number of counterparties, with many connections between them, suggesting a high degree of systemic risk. By contrast, counterparties in the periphery, including NFCs and other financials, tend to be connected to only one intermediary, suggesting limited systemic risk.

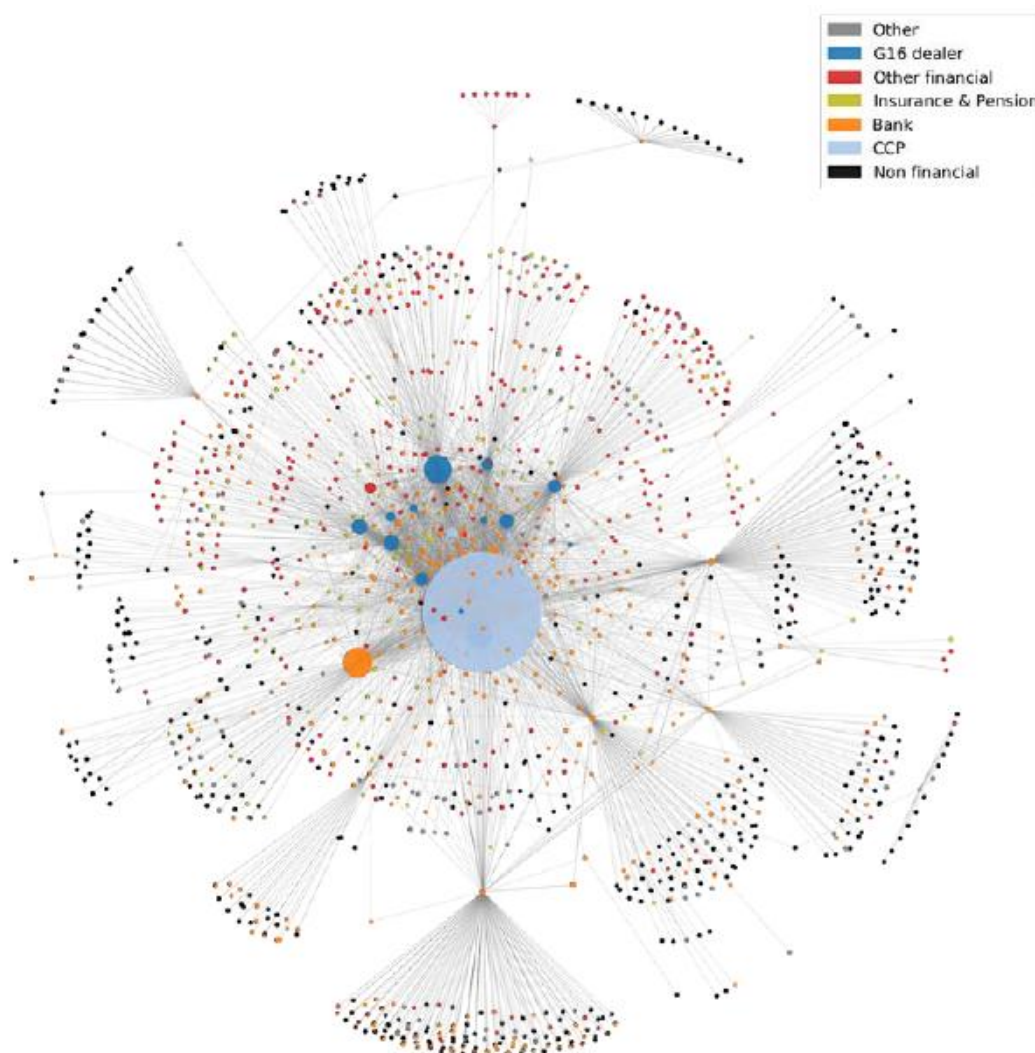
In addition, the figure below points to several layers of intermediation between core and non-core market participants. Peripheral counterparties, which represent a lower share of trades, tend to access CCPs only indirectly, via an intermediary. This highlights that

²¹¹ ['EMIR Review report n°1](#) – Review of the use of OTC derivatives by non-financial counterparties, August 2015.

²¹² According to industry study based on ISDA survey estimates and available information in July 2016. See: <http://www.eact.eu/wordpress/wp-content/uploads/2016/12/EACT-EMIR-review-Corporate-end-user-comments-EC-non-papers-Dec16.pdf>

above-mentioned obstacles to central clearing may have a disproportionate impact on these non-core counterparties.

Figure A-5/13 Network of gross notional links between counterparties in a subset of the interest rate swap (IRS) market



Source: Jorge Abad, Jorge Abad, Iñaki Aldasoro, Christoph Aymanns, Marco D'Errico, Linda Fache Rousová, Peter Hoffmann, Sam Langfield, Martin Neychev, Tarik Roukny, Shedding light on dark markets: First insights from the new EU-wide OTC derivatives dataset, ESRB, Occasional Paper Series No 11, September 2016, p. 18.

In addition, the Commission's report of February 2015²¹³, together with contributions to the public consultations, also suggest that applying the clearing obligation to PSAs could generate disproportionate costs. PSAs are currently exempt from clearing under EMIR

²¹³ [Commission Report](#) assessing the progress and effort made by CCPs in developing technical solutions for the transfer by PSAs of non-cash collateral as variation margin, as well as the need for any measures to facilitate such solution (COM(2015)39 final of 3.2.2015).

through a Commission Delegated Regulation²¹⁴, as they face structural difficulties in clearing their OTC derivative transactions through a CCP. This exemption will expire on 16 August 2018 at the latest and the clearing obligation will apply to PSAs. There is a genuine risk that no viable technical solution will be available by then to allow PSAs to post non-cash collateral to meet their variation margin calls. According to a Commission report of February 2015, PSAs would then have to increase their cash holdings relative to their non-cash asset holdings. This would trigger a cumulated reduction in the retirement income of beneficiaries of PSAs, estimated by a baseline study ordered by the European Commission to be up to 3.66% across the EU over 40 years²¹⁵.

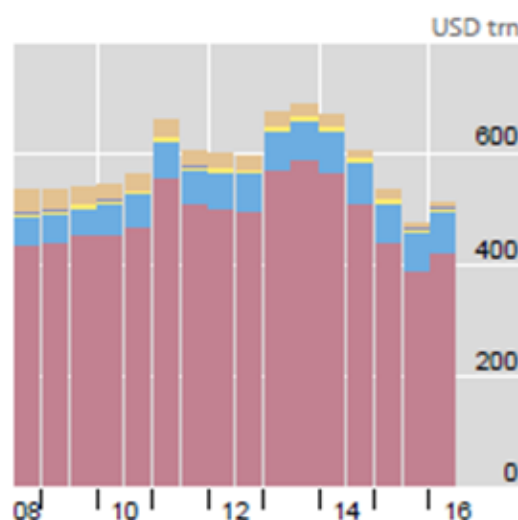
Question 3: How relevant is the EU intervention?

- To what extent are EMIR's requirements on reporting, clearing, and risk-mitigation techniques for uncleared derivatives still relevant nearly a decade after the 2009 G20's commitment to increase the stability of the OTC derivatives market and in light of current developments in this market?

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 requirements"*.

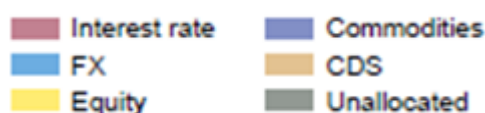
Since the G20 commitment, the size of the OTC derivatives market has decreased. However, activity in the OTC derivatives market remains in the trillions. It has picked up in the first half of 2016, after several years of decline since end-2013. At the end of June 2016, the size of the OTC derivatives market by notional value rose to \$544 trillion, a 10% increase with respect to the end of 2015.

Figure A-5/14: Global OTC derivatives markets at end-June 2016 (notional principal)



²¹⁴ [Commission Delegated Regulation C\(2016\)8542](#) of 20 December 2016.

²¹⁵ Baseline report on solutions for the posting of non-cash collateral to central counterparties by pension scheme arrangements, Europe Economics and Bourse Consult, p.10 - 25 July 2014.

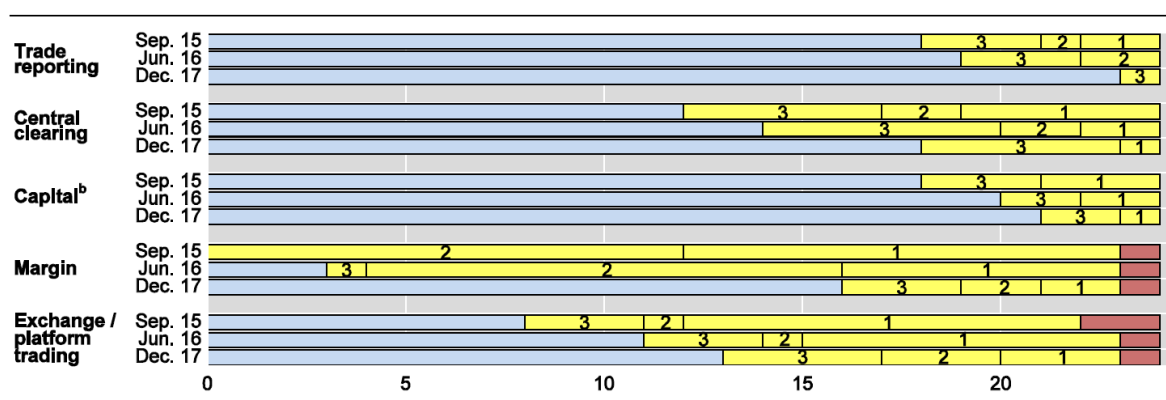


Source: BIS derivatives statistics, December 2016

Therefore, in light of the high volumes of transactions across the OTC derivatives market and of the global nature of the market, an internationally coordinated approach is crucial. It is therefore important to continue the coordination of the reforms at FSB level to keep up the momentum on the OTC derivatives reforms, notably to avoid the risk of regulatory arbitrage and to prevent cross-border issues.

While progress has been made by regulators with adopting the relevant frameworks transposing the G20 commitment, not all relevant requirements are in application. The FSB continue to monitor and report on OTC derivatives reform implementation progress. The figure below indicates progress since September 2015 and where further progress is currently anticipated by end-2017.

Figure A-5/15 – Regulatory reform progress (a) (Status across all FSB member jurisdictions)



(a) Reforms to jurisdictional frameworks; Dec.17 is jurisdictions' anticipated status at that date based on current information.

(b) Adoption of Basel III standards for NCCDs.

Source: FSB OTC Derivatives Market Reforms - 11th progress report, August 2016

In this context, the objectives of EMIR to reduce systemic risk by increasing the transparency of the OTC derivatives market, by limiting the counterparty credit risk and by reducing the operational risk associated with OTC derivatives, remain valid. As discussed above, the initial results of the core requirements of EMIR show that EMIR is achieving these objectives, but that those have only been partially achieved and that they could be achieved in a more effective and efficient manner.

In addition, four years after the entry into force of EMIR, the EU has just completed the implementation of the G20 requirements with the adoption of margin requirements for uncleared derivatives in October 2016²¹⁶. This means that the phase-in application of the core requirements of EMIR remains crucial to ensure that the general objectives of EMIR are achieved.

²¹⁶ [Commission Delegated Regulation \(EU\) 2016/2251 of 4 October 2016](#), OJ L 340, 15.12.2016, p. 9–46.

Question 4: How coherent is the EU intervention?

- To what extent are EMIR's requirements on reporting, clearing and risk-mitigation techniques for uncleared derivatives coherent with other pieces of EU financial legislation, such as the Commission's recent proposal to amend the Capital Requirements Regulation, the Commission's recent proposal to on the recovery and resolution of CCPs, and the second Markets in Financial Instruments Directive and the related Regulation?

EMIR is related to several pieces of EU legislation, including the Capital Requirements Regulation (CRR), the second Markets in Financial Instruments Directive and the related Regulation, and the Commission's proposal on the recovery and resolution of CCPs.

In their responses to the EMIR consultation, a large number of stakeholders have mentioned that the leverage ratio framework under Basel III and CRR may have an unintended negative effect on access to clearing for smaller counterparties under EMIR. This hurdle to the access to clearing has been addressed in the Commission's legislative proposal to amend Regulation (EU) No 575/2013 as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements and amending Regulation (EU) No 648/201. Within that proposal, the Commission aims to exclude from the calculation of the leverage ratio the initial margins on centrally cleared derivative transactions received by institutions in cash from their clients and that they pass on to CCPs. It will, therefore, ease the access to clearing as the capital requirements to offer client or indirect clearing services will diminish.

EMIR is also related to the Markets in Financial Instruments Directive I and II (MiFID I and II) and the related Regulation (MiFIR), which provide a basis for the definition of derivatives and of financial counterparties. In this regard, the upcoming application in January 2018 of MiFID II and MiFIR will have an impact on the scope of counterparties considered as financial counterparties and on the harmonisation of the definition of foreign exchange (FX) contracts that will fall under EMIR. The MiFID II framework aims at reclassifying large non-financial commodities traders as financial counterparties, putting an 'ancillary activity test' that determines how much non-hedging (or speculative) commodity derivative trading non-financial firms can conduct before this activity is no longer deemed 'ancillary to the main business' of the firm and the firm be obliged to seek a MiFID authorisation. Hence the largest NFCs active on commodity markets will be obliged to seek a MiFID authorisation. This development will lead to the largest NFCs being subject to the clearing obligation under EMIR, potentially limiting the usefulness of the EMIR clearing thresholds as a residual tool for picking up 'systemic' NFCs. Concerning the harmonisation of the definition of FX derivatives contracts, it will allow a uniform and consistent application of the EMIR rules to these contracts within the Union.

Another related regulatory development concerns the systemic risks attached to CCPs themselves. The obligation to clear standardised OTC derivatives is set to increase the scale and importance of CCPs in Europe and beyond. CCPs manage the risks inherent in financial markets (e.g. counterparty risk, liquidity risk and market risk), and therefore improve the overall stability and resilience of financial markets. In the process, they

become critical nodes in the financial system, linking multiple financial actors and concentrating significant amounts of their exposure to diverse risks. Effective risk management of the CCP and robust supervisory oversight is therefore key to ensure that such exposures are adequately covered. EMIR does regulate CCPs in terms of making sure that CCPs are sufficiently resilient, but does not regulate the recovery and resolution scenarios. In order to do so, the Commission proposed in November 2016 a proposal for a framework for the recovery and resolution of central counterparties.

More broadly, the core requirements of EMIR are consistent with the broader objectives of the Capital Markets Union. Efficient and resilient post-trading systems and collateral markets are essential elements for a well-functioning CMU.

Question 5: What is the EU added value of the intervention?

- To what extent EMIR's requirements on reporting, clearing and risk-mitigation techniques for uncleared derivatives have helped increase the stability of the OTC derivatives market, taking into account its inherent cross-border nature, and to what extent do the risks related to the lack of transparency in the OTC derivatives market and to counterparty credit risks in cleared and uncleared derivatives markets continue to require action at EU level?

In terms of the EU added-value, EMIR covered a gap that existed in legislation by introducing a new framework to increase stability in the OTC derivatives market at EU level. EMIR introduced for the first time a uniform approach throughout the EU to increase the transparency of the OTC derivatives market, to reduce counterparty credit risk, and to reduce the operational risk associated with OTC derivatives.

As presented above, the OTC derivatives market is, by its very nature, a cross-border and interconnected market, which is inherently complex. Action at EU level has enabled to capture a large portion of the OTC derivatives market and helped coordinate action at global level, making the EMIR requirements more effective. A consistent EU approach has also contributed to increase stability in the OTC derivatives market. Given the systemic impact of some of the problems EMIR aimed to tackle, uncoordinated action may have proven counterproductive.

The regulation of the reporting requirement at EU level and the empowerment of ESMA with both the registration and the supervision of TRs have helped ensure that all competent authorities have the same degree of access under the same conditions to the information reported to a TR, as this information is of interest to all competent authorities. The EU-wide data set will in turn help increase the understanding of the functioning of the derivatives market, facilitate the identification of possible sources of systemic risk, and inform the development of macro-prudential policies.

EMIR has also established a uniform process at EU-level to determine which OTC derivatives are eligible for mandatory clearing through CCPs. Action at EU level avoided a fragmented application of the clearing obligation throughout the EU, by giving a central role given to the European Commission and ESMA in identifying the eligible class of derivatives that must be centrally cleared.

Section 8 Conclusions

The objectives of EMIR to increase transparency in the OTC derivatives market and to mitigate counterparty credit risk remain relevant, and the systemic risks associated with the OTC derivatives market persist. Whereas not all of the key EMIR requirements have entered into application, the analysis shows that, based on the evidence available, the initial results of EMIR are delivering on the general objective to promote transparency and standardisation in derivatives markets. The impact on the reduction of systemic risk has not become fully measurable, including due to methodological challenges that need to be addressed.

On the **effectiveness and efficiency** of the core requirements of EMIR, the evaluation indicates that, while i) the volume of reported trades has improved, ii) the use of central clearing has increased and iii) the introduction of risk-mitigation techniques and margining for uncleared trades has been completed, preliminary findings suggest that **(i) the reporting requirement applying to transactions may be simplified to increase transparency in the OTC derivatives market**. The evaluation also highlights that **(ii) obstacles to access central clearing, affecting in particular smaller counterparties, may limit the effectiveness of the clearing obligation**. Initial results also indicate that **(iii) EMIR may impose in certain areas disproportionate costs/burdens for certain counterparties that sit on the periphery of the derivatives trading network (e.g. small financials and NFCs)**. The asymmetric distribution of the derivatives market amongst counterparties, with smaller counterparties accounting for a limited share of the OTC derivative transactions, suggests that such adjustments, while making EMIR more proportionate, would not affect financial stability.

In terms of **coherence**, EMIR is aligned with international efforts to reform the global OTC derivatives market. At an internal level, EMIR is coherent with other pieces of EU legislation, as outlined in the follow-up to the Call for Evidence, in the Commission's proposed amendment to the Capital Requirement regulation, and in the proposal for a recovery and resolution framework for CCPs. In terms of the **EU added value**, EMIR covered a gap that existed in legislation by introducing a new framework aiming to address in a uniform process at EU level the lack of transparency of the OTC derivatives market and the related systemic risks.

ANNEX 6: OTHER CHANGES TO THE EXISTING FRAMEWORK THAT ARE OUTSIDE OF THE ASSESSMENT SCOPE

1. Frontloading

I. Description

Article 4(1)(b)(ii) of EMIR requires the clearing of certain OTC derivative contracts concluded before the clearing obligation takes effect (between the first authorisation of a CCP under EMIR and the later date on which the clearing obligation actually takes effect), unless they have a remaining maturity lower than the minimum remaining maturities which are to be laid down in the relevant delegated act²¹⁷ (so called 'frontloading' requirement).

According to Recital (20) of EMIR, the frontloading requirement aims to ensure a uniform and coherent application of EMIR and a level playing field for market participants. The effective application of this requirement is however proving burdensome and has raised a degree of uncertainty amongst market participants.

II. Analysis

As pointed out by ESMA in a letter to the Commission, the application of the frontloading requirement does not ensure in all cases the achievement of the goals pursued by it. On the contrary, the application of the frontloading requirement to certain OTC derivatives may have substantial negative effects on the functioning of the market, financial stability and systemic risk. Indeed, the frontloading requirement causes uncertainties, inconsistencies, pricing issues, monitoring and operational issues.

This is why, in a letter to ESMA, the Commission considered that the frontloading of OTC derivatives should be avoided in cases where it would not ensure the achievement of those objectives and that the determination of remaining maturities should not result, in particular, in the application of the frontloading requirement to OTC derivatives concluded before counterparties could reasonably foresee that those contracts would need to be cleared as a consequence of the frontloading requirement. Such application could jeopardize the principle of legal certainty. In this respect, the Commission considered that before ESMA submits the RTS to the Commission, counterparties cannot reasonably foresee the terms of the frontloading obligation. In light of the above, ESMA adjusted the application of the frontloading requirements by imposing it only after the entry into force of the corresponding clearing obligations and after a certain period of time allowing counterparties to reorganise their derivatives portfolios.

With this limitation, a significant number of transactions now fall outside the scope of this requirement. When the clearing obligations will be fully in application, frontloading will have a very limited application.

²¹⁷ Commission Delegated Regulation (EU) 2015/2205 of 6 August 2015 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on the clearing obligation, OJ L 314, 1.12.2015, p. 13.

III. Impact

Stakeholders have complained about the legal uncertainties that the frontloading requirement is causing that can have an impact on additional risks and costs for counterparties. The benefits of frontloading are thus undermined by issues faced by the counterparties (timing, potentially need to backload trades, need to determine if the said counterparties are in the scope of the requirement, etc.). Even limited in scope and timing, the frontloading requirement creates legal uncertainty and operational complications for limited benefits.

Member States and EU regulators have also expressed negative views about this requirement. In addition, the international standards do not require frontloading.

Therefore, the removal of this obligation will not have any negative impact on financial stability.

2. Mechanism to suspend the clearing obligation

I. Description

Under EMIR, clearing obligations take effect in accordance with the delegated regulations adopted for that purpose. Therefore, the only way of removing a clearing obligation, either permanently or temporarily, is by repealing the relevant regulation – a process involving the co-legislators and therefore inevitably time-consuming. This is detrimental to EMIR's objectives because there may be scenarios where the temporary suspension of a clearing obligation is desirable on financial stability grounds. There are two broad potential causes for this:

1. The class of derivatives is largely cleared by a CCP that is in distress. The CCP may be subject to recovery or resolution measures (as envisaged in the Commission's proposal for CCP recovery and resolution), in which case there may be a risk in financial institutions having exposures to it.
2. The class of derivatives may have since become unsuitable for central clearing. This is most obviously the case where there has been a material change to one of the criteria on the basis of which the obligation took effect (degree of standardisation, volume and liquidity, and the availability of fair and reliable pricing).

The solution that several public authorities, investment managers, and industry associations requested was to introduce a mechanism whereby a clearing obligation could be temporarily suspended where one of the scenarios described above is fulfilled.

II. Analysis

A broad range of public authorities, investment managers, and industry associations advocated this mechanism, for which there are three strong arguments.

First, if an asset class no longer has the characteristics that justified its clearing, then there is a *prima facie* case for the obligation to be lifted. Central clearing is often unsuitable for illiquid asset classes as these contracts cannot be easily risk managed by CCPs, and if there is a sharp decrease in liquidity then the time taken to fully repeal the decision would be too long.

Second, if clearing for a specific asset class is largely reliant on a distressed CCP then the maintenance of a clearing obligation would require participants to use a distressed CCP. This exposes the user to enhanced counterparty credit risk, and opens them to the risk of their positions and/or assets being expropriated through the CCP's loss allocation mechanisms. Allowing a derivatives end user to hedge its positions using uncleared derivatives, where it would pay more initial margin but would have a more predictable exposure, may be more prudent.

Third, if a CCP is in distress then public authorities may want it to unwind its positions to reduce the probability of entering resolution. In this case, if the clearing obligation remained in situ, then this CCP would be accepting new contracts.

The most persuasive case against a suspension mechanism in this scenario is that it could exacerbate a CCP's distress as it would no longer receive effectively guaranteed custom and will therefore lose revenue. However, a decision to suspend a clearing obligation should always be designed to be temporary and to remain in the hands of public authorities at Union level, which are equipped to decide whether the risks of greater CCP distress outweigh the benefits of suspending clearing in a given scenario.

III. Impact

The mechanism for the suspension of the clearing will enable to accelerate the current procedure for such an action, which requires today the amendment of the relevant Regulatory Technical Standard establishing the clearing obligation, a process that would take around 12 months. Therefore, it is necessary to provide for a mechanism that would be flexible enough to allow for a decision to temporarily suspend the clearing obligation in due time. This decision should be taken at European level.

3. Initial margin model approval

I. Description

EMIR contains risk mitigation requirements for uncleared derivatives contracts. One of these requirements is for the bilateral exchange of initial margin (collateral). In calculating initial margin, counterparties have the choice of using an initial margin model or using the standardised approach which is set out in the RTS on margin requirements for uncleared derivatives (and is based on international standards). There is however no legal requirement for competent authorities to approve the initial margin model before counterparties use it to calculate margins.

The fact that a prior approval for initial margin models does not exist, though, does not mean that market participants in the EU may use the model they want. They have to comply at all times with EMIR and the relevant delegated acts and with the requirements included therein.

The only fully developed model so far is the 'SIMM' model developed by ISDA. The ISDA SIMM has been analysed by a Joint Assessment Team (JAT) set up by the Joint Committee of the ESAs and comprised of experts from national European regulators as well as the ESAs. Although the final JAT report on ISDA SIMM is not public, it includes a complete assessment of the core of the ISDA model. But there is no legal certainty for EU counterparties that use of this model will be accepted by their supervisors.

II. Analysis

There are some arguments that plead in favour of introducing a specific requirement to approve the model before it can be used by counterparties. Without it, there might be legal uncertainty for market participants in whether a model is suitable. In addition, the relevant international standard on margins requires such a prior approval.

III. Impact

The introduction of an explicit a priori approval procedure will allow for additional legal certainty for counterparties and give EU regulators the opportunity to discuss the relevant criteria for such a procedure. Therefore, the impact on financial stability will be positive.

4. Increasing transparency of margin requirements

I. Description

EMIR contains only limited requirements on CCPs to disclose details of their initial margin methodologies to their clearing members. Article 38 of EMIR contains requirements for CCPs to disclose *inter alia* the prices, fees and risks associated with the services they provide. Similarly, Article 39 requires the CCP to disclose the cost and level of protection associated with each model of segregation it offers. But since EMIR was published, CPMI-IOSCO has developed more granular standards on margin transparency.

Principle 23, Key Consideration 5 of the PFMI sets out the minimum disclosure standards expected of CCPs. This Principle states that an FMI should provide sufficient information to "enable participants to have an accurate understanding of the risks, fees, and other material costs they incur by participating in the FMI". This has been augmented in 2012 with the publication of the *Disclosure framework* and in February 2015 with the publication of *Public quantitative disclosure standards for central counterparties*. These disclosures are intended to allow participants, authorities and other stakeholders to assess a CCP's risk controls including their resources to withstand potential losses.

When the EU was assessed as part of the CPMI-IOSCO level 2 monitoring report, the EMIR framework was assessed as partly compliant with Principle 23. The monitoring report identified the EU's gap as the absence of a requirement that a CCP completes regularly and discloses publicly its response to the Disclosure Framework.

Similarly, several respondents (particularly banks but also public authorities) to the EMIR review public consultation stated that EMIR could be improved by requiring greater transparency of CCPs' margin requirements to their members (i.e. distinct from the issue of public disclosure). In particular, there is concern that anti-procyclicality measures that CCPs have in place, and that are required under EMIR, may cause margin requirements to change unpredictably in response to market developments.

There are some provisions in EMIR and the delegated/implementing acts that address this point. CCPs must disclose price information used to calculate their end of day exposures and must make public information regarding their risk management and margin models. However, they do not provide information that allows their members to calculate hypothetical margin requirements for simulated positions and parameters.

II. Analysis

In practice, EU CCPs currently voluntarily disclose the data specified by CPMI-IOSCO. This data is useful to clearing members, as it allows them to more accurately capture the risks they face by participating in the CCP. It's also useful to public authorities in order to compare relative riskiness and risk management practices of all EU CCPs to identify anomalies and outliers.

III. Impact

The cost of making this disclosure mandatory is expected to be minimal, as CCPs are tending to comply with the disclosure framework anyway. This change would however give CCP supervisors a legal hook to make CCPs disclose this information in cases where they would otherwise refuse. As all EU CCPs comply with this requirement, the single market would be strengthened as full comparability of EU CCPs would be guaranteed. In addition, this change would mean that the EMIR framework would fully comply with Principle 23 of the PFMIIs. Conversely, it could be argued that as voluntary compliance is currently effective, there is no need for a legal mandate. Putting disclosure on a legislative footing also has the downside of having to make a legislative change in future if the disclosure framework is amended.

The issue of clearing members accessing margin requirements is more complex. Any dissemination of information to a CCP's clearing membership cannot impede the commercial viability of the CCP or incentivise clearing members to risky behaviour. However, clearing members have a responsibility to understand the risks they face by participating in CCPs and the corollary is that CCPs must provide the information that allows clearing members to do this. As ESMA said in its EMIR review report on margins and procyclicality: "In order for margin requirements to be predictable, the participants need to understand the methodologies used to calculate margin requirements and parameters, have access to all relevant data required to partially predict such changes and also be able to replicate these calculations."

If CCPs were obliged to provide their clearing members with margin requirement simulation abilities, based on potential price and parameter changes, then clearing members could ensure that they had sufficient liquid resources to meet a future margin call. This would reduce the probability of the clearing member being unable to meet a margin call as market volatility increases, and so would have an anti-procyclical effect. In addition, if CCPs gave their clearing members information on the procyclicality of their margin models then their clearing members would again be better able to manage their exposures to the CCP.

In addition, the impact on financial stability will be positive as clearing members will be able to better forecast the requests for additional margins by CCPs.

ANNEX 7: WHO IS AFFECTED BY THE INITIATIVE AND HOW?

Pension Scheme Arrangements, and indirectly policy holders, will benefit from a new transitional clearing exemption on the grounds that no viable technical clearing solution has emerged to date. It would give CCPs and PSAs more time to explore technical solutions and measures to facilitate them and be consistent with EMIR's objective that the ultimate aim for PSAs is central clearing as soon as this is feasible.

All counterparties will benefit from the lightening of reporting requirements, to the extent they would otherwise have to report the type of transactions concerned by the envisaged policy action: The removal of the backloading obligation will benefit all counterparties that would otherwise have to backload historic trade data and reduce their administrative burden. The exemption of intragroup transactions involving NFCs from the reporting obligation will benefit NFCs. Transferring the obligation to report exchange-traded transactions from counterparties to CCPs will reduce administrative costs borne by those counterparties.

On the other hand, **CCPs** could be subject to higher administrative costs if the obligation to report exchange-traded derivative transactions is transferred from counterparties to them. As CCPs already have a significant amount of data concerning these transactions in their possession and are already required to report all centrally-cleared derivative transactions under EMIR, the additional burden placed on CCPs would however be limited. Due to the economies of scale involved the overall administrative costs should be considerably lower if CCPs report the data of all transactions concerned centrally instead of many counterparties reporting a small number of transactions each.

Non-Financial Counterparties would benefit from greater proportionality in the application of rules. On the one hand, the envisaged measures would ensure a better level-playing field in the qualification of NFCs subject to clearing and margining requirements. On the other hand the introduction of an additional higher threshold would only place the largest NFCs in scope of clearing requirements. **Smaller NFCs+** would not be subject to the clearing obligation, but the bilateral margin requirement would still apply. With regard to reporting, in addition to the general lightening of requirements referred to above, small non-financial counterparties will also benefit from the reporting obligation of their trades falling on financial counterparties, which are better equipped to fulfil this obligation.

The impact on **small financial counterparties** would depend on their actual size. A recalibration of what constitutes a small financial counterparty that would be subject to the clearing obligation will allow lightening the burden of those (very) small financial counterparties for which central clearing is not economically feasible because of their small volume of activity while keeping the bigger firms inside the clearing obligation after the phase-in period ends.

Trade Repositories would benefit from measures to simplify and streamline requirements for reporting counterparties and to further harmonise reporting rules and procedures since the quality of the data reported to them should improve, facilitating their work. On the other hand, increased requirements on trade repositories to ensure the quality of data could be considered an additional burden on them. However, trade

repositories will have to implement adequate procedures in any case to meet requirements pursuant to the Securities Financing Transactions Regulation, so the policy action under EMIR considered in this impact assessment would not create a (considerable) additional burden. The adjustment of fines considered would mostly act as a deterrent and only affect trade repositories that infringe the relevant EMIR provisions.

Counterparties trading OTC derivatives subject to the clearing obligation that encounter difficulties in having access to clearing will benefit from the envisaged policy actions to improve access to clearing that tackle the legal (related to insolvency rules) and commercial obstacles to the provision of clearing services.

ANNEX 8: APPROACH TO ESTIMATE COST REDUCTIONS

This Annex presents the approach and the calculations that support Table 9 on cost reductions presented in section 6 of the impact assessment.

It sets out under which assumptions the cost reductions apply in order to better put them in perspective and highlight the limitations inherent to their calculations. It focuses on cost reductions for NFCs and SFCs that the application of the preferred options relating to the scope of the clearing obligation and access to clearing would avoid them incurring. Details on the methodology followed to estimate the costs avoided for PSAs and NFCs with regard to the reporting obligation are presented directly in section 6.

8.1. Caveats

The figures provided below were estimated solely for the purpose of this impact assessment, in order to quantify the cost reductions that the package of preferred measures would represent, under the REFIT framework, and in accordance with the Better Regulation Guidelines. As such, they focus on the reduction of costs and administrative burdens, in order to provide a sense of the magnitude of cost reductions that could be achieved with the preferred options. The figures are based on data that is publicly available, and on the expected impact of the preferred options.

As the application of EMIR follows a phased-in schedule, the estimated cost reductions presented in this impact assessment are valid only at the current point in time. Requirements that will apply at a later stage, such as the phased-in application of margin requirements, have not been taken into account in the calculations.

With regard to the timeline considered, while some of the preferred options are expected to have an immediate impact (e.g. those relating to the removal of a limited number of NFCs and SFCs from the scope of the clearing obligation), others (e.g. those facilitating access to clearing for small counterparties) will deliver their benefits only over a mid-term period. Likewise, while the clearing obligation has become applicable for some counterparties (e.g. Category 1 and Category 2 counterparties as introduced in section 2), it has not yet become applicable for other counterparties (e.g. Category 3 counterparties as described in section 2). The cost estimates include therefore both costs that will be avoided and costs that will be effectively reduced.

The estimates below represent fixed costs attached to clearing. Providing estimates for the operational costs of clearing would be unrepresentative, as there is no average price for the cost of clearing a transaction. The price depends on the package of clearing services that NFCs and SFCs have entered into, which itself depends on the asset class considered and on the commercial relationship between the clearing member and the each NFCs and SFCs considered.

The estimates below rely on the limited amount of data that is publicly available and on anecdotal market intelligence, which may not accurately capture the diversity and the specificity of the counterparties at play.

Finally, the calculations are based on the assumption that the cost reductions generated by the preferred options will be entirely passed on to end-users, namely the NFCs and the SFCs.

8.2. Calculations

8.2.1. On cost reductions related to the narrower scope of clearing

8.2.1.1. Non-Financial Counterparties subject to the clearing obligation (NFC+)

8.2.1.1.1. Estimated cost reduction

First, the objective is to identify the population of NFC+ that will no longer be subject to the obligation to clear in all the asset classes in which they are active once they exceed the threshold in one asset class, according to the preferred option presented in Table 9 of Section 6 (Option 2).

According to ESMA review report n°1 on the review of the use of OTC derivatives by non-financial counterparties, 22% of NFCs+ are active in more than one asset classes²¹⁸. More precisely, 20% are active in 2 asset classes and 2% are active in 3 asset classes.

As indicated in Table 4 on the classification of NFC+, 424 counterparties qualify as NFC+²¹⁹. We can deduce from this that:

- i) $424 \times 0.20 = 85$ NFC+ counterparties are active in 2 asset classes; and
- ii) $424 \times 0.02 = 8$ NFC+ counterparties are active in 3 asset classes.

For the benefit of the analysis, we assume that these NFC+ will not exceed the thresholds in more than one asset class.

Second, the objective is to estimate the cost reductions that each of these NFC+ will benefit from due to the removal of the obligation to centrally clear derivatives in those asset classes where they do not exceed the threshold.

As NFC+ sit in the periphery of the OTC derivatives market (see explanations in section 3 of the impact assessment), we assume that NFCs+ will need to go through an intermediary to access clearing services.

On the basis of ISDA estimates²²⁰ on the minimum clearing fees for users of clearing brokers, we assume that each NFC+ counterparty has to pay minimum fees ranging from

²¹⁸ ESMA, *EMIR Review report n°1 – Review of the use of OTC derivatives by non-financial counterparties*, Figure 2, p. 16. https://www.esma.europa.eu/sites/default/files/library/2015/11/esma-2015-1251_-_emir_review_report_no.1_on_non_financial_firms.pdf

²¹⁹ Ibid, Table 4, p.13.

EUR 95 000 to EUR 265 000 to access clearing in each asset class in which it is active. For the benefit of the analysis, we also assume that these NFC+ need to access different asset classes via different clearing members/CCPs.

Assuming that the 85 NFC+ are below the clearing threshold for the second asset class, this means that NFCs+ active in two asset classes will not have to face additional clearing fees of a magnitude of:

- i) Lower range: $85 \times 95\,000 = 8.1$ million; and
- ii) Upper range: $85 \times 265\,000 = 22.5$ million.

Assuming that the 8 NFC+ are below the clearing threshold for the second and third asset classes, and assuming they would face two different sets of clearing fees for those asset classes, this means that NFCs+ active in three asset classes will not have to face additional CM clearing fees of a magnitude of:

- i) Lower range: $8 \times (95\,000 \times 2) = 1.5$ million; and
- ii) Upper range: $8 \times (265\,000 \times 2) = 4.24$ million.

On this basis, the total cost avoidance of option 2 can be estimated as follows:

- i) Lower range: $8.1 + 1.5 = 9.6$ million; and
- ii) Upper range: $22.5 + 4.24 = 26.74$ million.

It should be noted that these estimates do not take into account the additional cost reductions resulting from the reduced operational costs of clearing. The total cost reduction is thus expected to be even higher than the figures presented here, provided that the estimate on minimum clearing fees accurately reflects market prices. It should however also be considered that the minimum clearing fees are expected to decrease slowly over time given the measures proposed in this area (see section 8.2.2 below).

8.2.1.1.2. Estimated impact on financial stability

We can estimate the proportion of transactions that will no longer be captured by the clearing obligation, in order to provide a sense of the systemic risk they represent and their impact on financial stability.

Based on the general figures provided in Table 4, we know that 221 005 trades relate to 424 counterparties. We also know that the average number of trades per counterparty is 521 and that 93 NFC+ are active in more than one asset class. We can therefore deduct the average amount of transactions that would no longer be captured by the clearing obligation, as follows:

Number of transactions: $93 \times 521 = 48\,453$ transactions.

²²⁰ Philip Stafford, OTC markets, Derivatives 'Big Bang' catches market off guard, Financial Times, 02.02.2017, <https://www.ft.com/content/086ec02a-e6fc-11e6-967b-c88452263daf>

Those transactions can be associated with a certain notional amount, based on the fact that the total notional amount for NFC+ presented in Table 4 amounts to EUR 1 568 375 million, for a total number of trades of 221 005:

Number of transactions	Notional amount (million)
221 005	1 568 375
48 453	6 827

Out-of-scope transactions would therefore amount to EUR 6 827 million notional amount. This represents 0.001% of the total outstanding volumes for NFCs and FCs as measured by total notional amount²²¹.

8.2.1.2. Small Financial Counterparties (SFCs)

8.2.1.2.1. Estimated cost reduction

First, the objective is to identify the population of small financials – SFCs - that will no longer be subject to the obligation to clear, according to the preferred option presented in Table 9 of section 6 (Option 2).

For the purpose of this impact assessment, the estimates will rely only on the interest rate derivative asset class, as there is no public data available to provide estimates for all the asset classes. In addition, solely for the benefit of reaching a cost estimate, SFCs are defined as financials with a volume of activity below 5bn, as identified in Table 1 of ESMA's Consultation Paper on the clearing obligation for financial counterparties with a limited volume of activity²²². This means that we assume, due to the constraints of the data publicly available, that the clearing threshold beyond which FCs would be required to clear is 5bn for the interest rate derivatives asset class. This does not prejudice of the final threshold fixed by the legal framework. On the basis of these assumptions, the calculated estimates will help provide a sense of the magnitude of the cost reductions for SFCs.

We can deduce from Table 1 that there are 5 365 SFCs with a volume of activity below 5bn (i.e. 5 855 – 490). This means that those 5 365 SFCs would not be required to clear, assuming the clearing threshold is at 5bn for the interest rate derivatives asset class.

Second, the objective is to estimate the cost reduction that each of these SFCs would benefit from the removal of the obligation to centrally clear derivatives in the interest rate derivatives asset class.

²²¹ See grand total in column E, line 7 of Table 2, p.8 of ESMA, *EMIR Review report n°1 – Review of the use of OTC derivatives by non-financial counterparties*.

²²² See ESMA, Consultation Paper on the clearing obligation for financial counterparties with a limited volume of activity, 13 July 2016, table 1, p.13.

On the basis of ISDA estimates²²³ on the minimum clearing fees for users of clearing brokers, we assume that each of the SFCs has to pay minimum fees ranging from EUR 95 000 to EUR 265 000 to access clearing in the interest rate derivatives asset class. This means that the 5 365 SFCs active in the interest rate derivatives asset class will not have to face additional clearing fees of a magnitude of:

- i) Lower range: $5\,365 * 95\,000 = 509.7$ million; and
- ii) Upper range: $5\,365 * 265\,000 = 1.4$ billion.

On this basis, the total cost avoidance of option 2 can be estimated to range from EUR 509.7 million to EUR 1.4 billion.

It should be noted that these estimates do not take into account the additional cost reductions resulting from the reduced operational costs of clearing. The total cost reductions are thus expected to be even higher than the figures presented here, provided that the estimate on minimum clearing fees accurately reflects market prices. It should however also be considered that the minimum clearing fees are expected to decrease slowly over time given the measures proposed in this area (see section 3).

8.2.1.2.2. Impact on financial stability

We can also deduce from the above-mentioned Table 2 that they represent 91.6% of the total number of FCs active in the interest rate derivative asset class, and that they amount for 0.59% of the cumulated notional amounts.

The total cumulated notional amount in the interest rate derivative asset class amounts approximately to EUR 337 trillion. This means that the corresponding notional amount of the SFCs that will no longer be captured by the clearing obligation in that asset class amounts to approximately 2 trillion (0.59% of 337 trillion). This represents 0.32% of the total outstanding volumes for NFCs and FCs as measured by total notional amount²²⁴.

8.2.3. On cost reductions related to improved access to clearing

The purpose of this section is to provide estimates on the cost reductions that the preferred option presented in Table 9 of section 6 (option 2) will trigger both for NFCs and small financials, as peripheral counterparties that face obstacles in accessing clearing.

For the purpose of the impact assessment only, and without drawing conclusions on the structure of the clearing market, we will use ISDA estimates²²⁵ indicating that minimum

²²³ Philip Stafford, OTC markets, Derivatives 'Big Bang' catches market off guard, Financial Times, 02.02.2017, <https://www.ft.com/content/086ec02a-e6fc-11e6-967b-c88452263daf>

²²⁴ See grand total in column E, line 7 of Table 2, p.8 of ESMA, *EMIR Review report n°1 – Review of the use of OTC derivatives by non-financial counterparties*.

²²⁵ Philip Stafford, OTC markets, Derivatives 'Big Bang' catches market off guard, Financial Times, 02.02.2017, <https://www.ft.com/content/086ec02a-e6fc-11e6-967b-c88452263daf>

clearing fees for counterparties with a limited volume of OTC derivative activities can range from EUR 95 000 to EUR 265 000.

Solely for the purpose of providing a sense of the magnitude of the cost reductions that NFCs and small financials would benefit from, we assume that, as a result of the application of the preferred option, the minimum fee will decrease from EUR 95 000 to EUR 20 000. This figure is based on a conservative estimate of market intelligence on current clearing offerings in the EU for a small financial that has access to clearing²²⁶. It is therefore purely indicative. For the purpose of calculating cost reductions, we will use this figure as a reference, with the caveat that it does not constitute an average price of clearing offerings and does not aim to represent an ideal price. On this basis, we can therefore estimate a reduction of EUR 75 000 of the minimum fee. Likewise, we apply the same reduction factor to the upper fee, meaning a decrease from 265 000 to 55 000. This amounts to a cost reductions of EUR 210 000 of the maximum fee.

We then need to estimate the proportion of smaller counterparties that will be subject to these clearing fees. They include NFC+ and small financials that remain subject to the clearing obligation following the application of the preferred options.

For NFCs, we consider those NFC+ that are active in only one asset class²²⁷. They represent 78% of the total number of counterparties, i.e. $0.78 * 424 = 331$. This means that those NFC+ that remain subject to the clearing obligation would benefit from a cost reduction of:

- i) Lower range: $331 * 75\,000 = 24.8$ million; and
- ii) Upper range: $331 * 210\,000 = 69.5$ million.

For financial counterparties (FCs), we need to consider FCs that are i) small enough to require an intermediary to clear and ii) big enough not to be exempted from the requirement to centrally clear, namely SFCs (following the application of the preferred option described in section 8.2.1.2).

On the assumption that all FCs²²⁸ will require an intermediary to access clearing, minus dealers and SFCs, we calculate that about 435 small financials would benefit from a cost reduction of:

- i) Lower range: $435 * 75,000 = 32.6$ million; and
- ii) Upper range: $435 * 210\,000 = 91.3$ million.

²²⁶ This figure was provided by a European association as an example of the minimum costs to access clearing for a small bank in the EU.

²²⁷ ESMA, *EMIR Review report n°1 – Review of the use of OTC derivatives by non-financial counterparties*, Table 4, p. 13.

²²⁸ As defined in line 2 of table 2 of ESMA, *EMIR Review report n°1 – Review of the use of OTC derivatives by non-financial counterparties*, Table 4, p. 8.

On this basis, the total cost avoidance of option 2 can be estimated to range from EUR 57.4 million to 1.5 billion.