

MACFARLANES

European Market Infrastructure Regulation (EMIR 3.0)

Impact on credit funds

September 2024

Background

We provide a brief summary of EMIR 3.0 below, with a particular focus on the impact for credit funds.

It should be noted that the rules are likely to evolve and the full scope of several of the obligations is not yet clear. We provide further detail on the impact of EMIR 3.0 more broadly in our article published here: [EMIR 3.0 – obligations on the buy-side](#).

Timing

EMIR 3.0 will come into force 20 days after publication in the Official Journal. Market participants therefore expect EMIR 3.0 to come into force during the next six months or so.

Certain provisions will technically be in force while details as to how EMIR 3.0 should be complied with have yet to be published. There is, therefore, a risk that EMIR 3.0 comes into force without counterparties having the full information available to them to ensure compliance. Previously, ESMA has addressed this by effectively requesting that the relevant supervisory entities do not enforce the relevant provisions until such later date as all the information is available and a similar approach may be taken here.

EU EMIR lays down rules on OTC derivatives, CCPs and trade repositories. Updates to EU EMIR after the UK's departure from the EU (including EMIR 3.0) do not apply automatically to UK EMIR, though the UK may choose to follow some of them.

EMIR 3.0 update

Classification and scoping

Clearing threshold calculations

Currently, entities may calculate their derivatives exposures to determine whether they are above or below each of the clearing thresholds (colloquially known as being a “+” or a “-”, respectively). An entity's status as a “+” or a “-” has an impact on the scope and depth of its regulatory obligations.

EMIR 3.0 amends the calculation methodology and changes the scope of derivatives that must be included in the calculation.

Financial counterparties

An FC is considered an FC+ if the results of either of the below calculations exceed a threshold (to be specified) or if the FC does not perform both of the calculations.

Uncleared Positions Calculation – this involves calculating the aggregate month-end average “uncleared positions” for the previous 12 months. This includes all OTC derivative contracts that are not cleared at an EU authorised or recognised CCP entered into by the FC or by other entities within the FC's group (including NFCs).

Aggregate Positions Calculation - this involves calculating the “aggregate month-end average positions in cleared and uncleared derivative contracts for the previous 12 months”. This includes all OTC derivative contracts entered into by the FC or by other entities within the FC's group (including NFCs).

Non-financial counterparties

An NFC is considered an NFC+ if the results of the Uncleared Positions Calculation exceed a threshold (to be specified). Note that, for NFCs:

- this calculation includes all OTC derivative contracts that are not cleared at an EU authorised or recognised CCP entered into by the NFC which are not objectively measurable as reducing risks directly relating to the commercial activity or treasury financing activity of the NFC or its group;
 - NFCs will no longer need to include in the calculation (i) those derivatives that are cleared at an EU authorised or recognised CCP, nor (ii) any derivatives entered into by other NFCs in its group; and
 - if the calculation is not undertaken, the entity is considered to be a “+”.
-

Timing

The above changes to the clearing threshold calculations will only come into force once regulatory technical standards setting out the updated clearing thresholds come into force. ESMA has 12 months from the date on which EMIR 3.0 comes into force to develop regulatory technical standards setting out the updated clearing thresholds.

Intragroup transactions

EMIR 3.0 updates the definition of intragroup transactions, which is relevant to certain exemptions under EU EMIR regarding margining and clearing.

The change means that, for a counterparty established in a third country, rather than its jurisdiction having to benefit from an equivalence decision in order for its transactions to be considered intragroup transactions; instead, its jurisdiction needs only to not be identified as:

- having strategic deficiencies in its anti-money laundering and counter-terrorist financing regime; or
 - being non-cooperative for tax purposes.
-

Clearing obligation	Active Account Obligation	Scope	<p>A counterparty that:</p> <ul style="list-style-type: none"> ▪ is subject to the clearing obligation (i.e. is an FC+ or NFC+); and ▪ exceeds the clearing threshold in respect of the Relevant Derivatives, <p>in respect of those Relevant Derivatives, may need to hold at least one active account at an EU authorised CCP (the “Account”), and clear at least a “representative number of trades” in this account (the “Active Account Obligation”).</p> <p>If a counterparty is subject to the Active Account Obligation, it should ensure (unless it benefits from an exemption) that it meets:</p> <ul style="list-style-type: none"> ▪ the Active Account Functionality Requirements; ▪ the Active Account Reporting Requirement; and ▪ the Active Account Representative Clearing Requirement (provided the threshold is met).
		Active Account Functionality Requirements	<p>The Active Account Functionality Requirements are:</p> <ul style="list-style-type: none"> ▪ the Account must be permanently functional; ▪ the Account and systems must have the capacity to be used for large volumes of Relevant Derivatives at all times; and ▪ the counterparty must be able to clear all new trades in Relevant Derivatives in the Account at all times.
		Active Account Reporting Requirement	<p>The Active Account Reporting Requirement provides that relevant counterparties must calculate their activities and risk exposures in the Relevant Derivatives and report the necessary information to the competent authority every six months.</p>
		Active Account Representative Clearing Requirement	<p>This applies to counterparties with a notional clearing volume outstanding of at least €6 billion in Relevant Derivatives. If applicable, a counterparty must clear in the Account a “Relevant Number” per sub-category of the “Representative Derivatives” during a “Reference Period”.</p>
		Exemptions	<p>Counterparties that are subject to the Active Account Obligation and already clear at least 85% of their Relevant Derivatives at an EU authorised CCP are exempt from the Active Account Functionality Requirements, the Active Account Representative Clearing Requirement and parts of the Active Account Reporting Requirement.</p>
		Timing	<p>If a counterparty becomes subject to the Active Account Obligation, it must establish the Account within six months and notify ESMA and its competent authority.</p>
		Penalties for breaches	<p>If a counterparty breaches the Active Account Obligation, its competent authority is required to impose administrative penalties or periodic penalty payments (subject to certain conditions).</p>
	Post-trade risk reduction services clearing exemption	<p>EMIR 3.0 introduces a complex exemption that the clearing obligation does not apply to “OTC derivative contracts that are initiated and concluded as the result of an eligible post-trade risk reduction exercise”.</p>	

Clearing Activity Reporting	<p>Clearing members and clients which clear at a recognised CCP must provide to their competent authorities an annual report specifying the following:</p> <ul style="list-style-type: none"> ▪ the type of financial instruments or non-financial instruments contracts cleared; ▪ the average values cleared over one year per EEA currency and per asset class; ▪ the amount of margins collected; ▪ the default fund contributions; and ▪ the largest payment obligation. 	
CCP collateral	<p>CCPs may accept public guarantees, public bank guarantees or commercial bank guarantees as collateral to cover their exposure to NFC clearing members, subject to certain conditions.</p>	
Increased clearing and CCP transparency	<p>EMIR 3.0 will increase the level of information to be provided to the buy-side regarding the activities of CCPs and their clearing arrangements. ESMA is developing further legislation on this.</p>	
Trade reporting	Reporting requirements	<ul style="list-style-type: none"> ▪ Counterparties that are required to report the details of derivative contracts must ensure that such details are reported correctly, including where the reporting obligation has been delegated. ▪ Counterparties that are subject to the reporting obligation must have appropriate procedures and arrangements to ensure the quality of the data they report.
	Reporting requirements by NFC+s that benefit from the intragroup reporting exemption	<p>For NFC+s that are part of a group which benefits from the intragroup reporting exemption, the EU parent undertaking of that counterparty must report the net aggregate positions by class of derivatives of that counterparty to its competent authority on a weekly basis.</p> <p>For a counterparty established in the EEA, the competent authority of the parent undertaking must share the information with ESMA and with the competent authority of that counterparty.</p>
	Mandatory Reporting	<p>An NFC- that concludes an OTC derivative contract with a third-country entity is not required to report it under EU EMIR if:</p> <ul style="list-style-type: none"> ▪ the third-country entity would be qualified as an FC if it were established in the EEA; and ▪ the third-country FC has reported the information pursuant to its relevant legal regime for reporting to a trade repository that is subject to a legally binding and enforceable obligation to grant various entities direct and immediate access to the data. <p>It will no longer be necessary for the third-country legal regime for reporting to be declared equivalent.</p>
	Penalties	<p>EMIR 3.0 maintains the broad discretion held by Member States as to the rules for penalties; however, it also provides that competent authorities must impose administrative penalties or periodic penalty payments on the entities subject to the reporting obligation where the details reported repeatedly contain "manifest errors".</p> <p>Specifically, a periodic penalty payment:</p> <ul style="list-style-type: none"> ▪ must not exceed a maximum of 1% of the average daily turnover for the preceding financial year; and ▪ may be imposed for up to six months from the date set out in the competent authority's decision.

Risk mitigation and margin**Implementation period for NFCs – daily valuation and exchange of margin**

An NFC that becomes an NFC+ will have four months to put in place arrangements to comply with the requirement to:

- mark-to-market on a daily basis the value of outstanding contracts; and
- have in place risk management procedures that require the timely, accurate and appropriately segregated exchange of collateral with respect to OTC derivative contracts.

During this four-month period, an NFC that becomes an NFC+ is exempted from the above obligations.

Stock options and equity index options margin exemption

- Single-stock options and equity index options that are not cleared by a CCP will continue to be exempted from the requirement to exchange collateral.

Model validation

Any pro-forma initial margin model (such as ISDA SIMM) should be validated by the EBA and then authorised by competent authorities. The EBA can charge an annual fee per pro-forma model to counterparties.

Definitions

CCP	Central counterparty
EBA	European Banking Authority
EMIR 3.0	the current proposed update to EU EMIR
ESMA	European Securities and Markets Authority
EU EMIR	European Market Infrastructure Regulation
OTC	over-the-counter
Relevant Derivatives	interest rate derivatives denominated in EUR and Polish zloty and short-term interest rate derivatives denominated in EUR
UK EMIR	EU EMIR and its updates forming part of EU retained law following Brexit

Macfarlanes LLP | 20 Cursitor Street London EC4A 1LT

T +44 (0)20 7831 9222 | F +44 (0)20 7831 9607 | DX 138 Chancery Lane macfarlanes.com

This content is intended to provide general information about some recent and anticipated developments which may be of interest. It is not intended to be comprehensive nor to provide any specific legal advice and should not be acted or relied upon as doing so. Professional advice appropriate to the specific situation should always be obtained. Macfarlanes LLP is a limited liability partnership registered in England with number OC334406. Its registered office and principal place of business are at 20 Cursitor Street, London EC4A 1LT. The firm is not authorised under the Financial Services and Markets Act 2000, but is able in certain circumstances to offer a limited range of investment services to clients because it is authorised and regulated by the Solicitors Regulation Authority. It can provide these investment services if they are an incidental part of the professional services it has been engaged to provide. © Macfarlanes 2024 (0824) 05.009