

# EMIR Factsheet

## Background

In response to the economic and financial market crisis, the heads of government and heads of state of the G20 countries proposed a reform of the derivative market back in 2008/2009 with the aim of improving the transparency of currency markets, of reducing systemic risks and to provide greater protection from market abuse. In this conjunction, the European Union (“EU”) issued the *Regulation (EU) No. 648/2012 concerning OTC<sup>1</sup> derivatives, central counterparties and transaction registers (known as “EMIR” – European Market Infrastructure Regulation)*, which came into force in all EU states on 16 August 2012 and has been directly applicable in all EU states ever since. Due to the inclusion of the EMIR in the European Economic Area Treaty (EEA Treaty), these provisions have also been directly applicable in EEA/EFTA states (Iceland, Liechtenstein and Norway) since 01 July 2017<sup>2</sup>. The corresponding EMIR enactment act simultaneously came into force in Liechtenstein. On 31 May 2018 all significant Level II legal instruments issued by the EU Commission on the basis of the EMIR were adopted by the EEA Treaty<sup>3</sup>. These new requirements have been applicable to EEA/EFTA states, taking account of various transitional periods, since 01 June 2018.

The present Factsheet is designed to inform you about the essential content of the EMIR. Please also note that the information contained in the present Factsheet is non-binding and does not claim to be complete and correct. In particular, it is no substitute for legal or expert advice in individual cases.

## Which transactions are affected by the EMIR?

The EMIR aims to make stockmarket and over-the-counter derivative trades more transparent and secure by settling standardised OTC derivatives via central counterparties, and by requiring all derivative contracts to be reported to transaction registers. The affected derivative contracts are defined in Art. 2 Para. 5, 6 and 7 EMIR. The definition of derivatives under the EMIR is very broad and covers derivatives traded on the stockmarket as well as OTC derivatives in the following classes:

- Credit derivatives (credit default swaps)
- Equity derivatives (e.g. OTC options on equities)
- Interest rate derivatives (e.g. interest swaps)
- Foreign exchange derivatives (e.g. currency future transactions)
- Commodity derivatives and other derivatives that are not listed above.

## Who is affected by the EMIR?

The Regulation directly affects all enterprises domiciled in the EEA that conclude derivative contracts. The term “enterprise” is not definitively defined by the EMIR. Pursuant to the established jurisprudence of the European Court of Justice (ECJ), the term “enterprise” is based on the activities of a party, and not on their legal form or type of financing. This means an enterprise is a unit that exercises an economic activity and is not solely a consumer or employee. Economic activity is moreover an activity that entails the offering of goods or services on a specific market. This means any market-related behaviour aimed at offering or requesting goods or services is deemed to constitute an enterprise. However, the lack of intention to make a profit is not an exclusion criterion.

Taking account of the purpose pursued by the EMIR for determining an enterprise, this must also entail a long-term element. This means an entrepreneurial activity can only be assumed if at least a longer-term or an indefinite economic activity exists. In addition, enterprises that engage exclusively in asset management are excluded from the scope of the EMIR, and this needs to be assessed on the basis of the circumstances of the specific individual case.

<sup>1</sup> OTC stands for over-the-counter, i.e. traded not on a stock exchange, but instead directly between the parties.

<sup>2</sup> Resolution of the Joint EEA Committee No. 206/2016 of 30 September 2016

<sup>3</sup> Resolutions of the Joint EEA Committee No. 112/2018 and No. 113/2018 of 31 May 2018

Taking account of the current legal situation, established European jurisprudence and the objectives pursued by the EMIR, an enterprise exists at least in the following cases (the list is not exhaustive):

- Agricultural enterprises
- Industrial, commercial and service enterprises, irrespective of their legal form
- Members of free professions, e.g. tax advisors, physicians, lawyers, architects in conjunction with the rendering of associated services
- Individual merchants

In the case of the following, no economic activity and consequently no enterprise within the meaning of the EMIR is to be assumed (the list is not exhaustive):

- Legal entities that are not commercially active, such as e.g. foundations and establishments under Liechtenstein law that engage exclusively in asset management;
- Natural persons who do not engage in an entrepreneurial activity;
- Persons exercising sovereign activities;
- Common interest entities, e.g. common-benefit foundations, church organisations or cultural and charitable associations;
- Entities that pursue social or conceptual purposes;
- Recognised religious communities;
- Investment/stock clubs, insofar as there is no obligation to obtain a financial services licence.

The EMIR is essentially applicable to financial counterparties as well as to non-financial counterparties:

#### I. Financial counterparties ("FC")

Pursuant to Art. 2 Para. 8 EMIR, these include banks/credit institutions, securities companies, insurance and reinsurance companies, investment funds (UCITS funds and alternative investment funds (AIF) managed by an authorised or registered alternative investment fund manager) and specific occupational pension schemes that are regulated by the respective European statutory instruments.

#### II. Non-financial counterparties ("NFC")

Pursuant to Art. 2 Para. 9 EMIR, these are all enterprises domiciled in the EEA that are not considered to be FC. NFC are also categorised into NFC below and above a specific clearing threshold:

- a) NFC- (below the clearing threshold)
- b) NFC+ (above the clearing threshold)

The term clearing threshold is described in detail below under clearing obligations.

#### III. Parties not affected by the EMIR

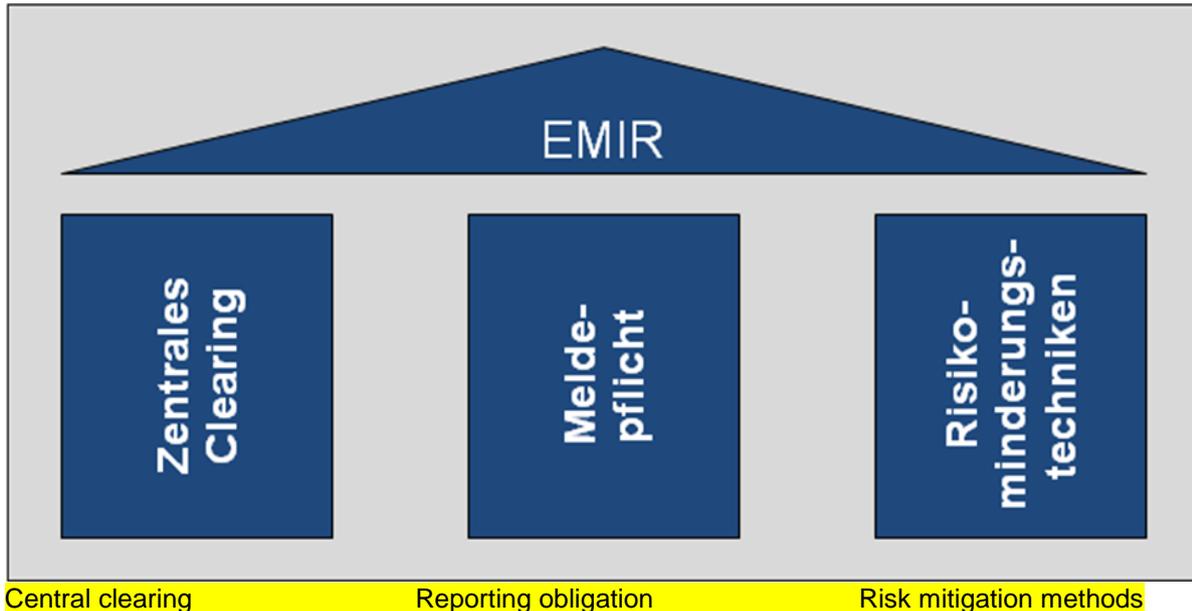
EMIR provisions do not apply to natural persons or legal entities that do not pursue an entrepreneurial activity. Despite the fact that this group of persons is not necessarily covered by the scope of the EMIR, these persons may be indirectly affected by the EMIR, specifically if they engage in derivative transactions with their counterparty (e.g. their bank) and their counterparty is subject to reporting obligations pursuant to the EMIR.

#### IV. Counterparties from third-party countries

Counterparties domiciled in the EEA are also obliged to enforce or adhere to certain EMIR requirements vis-à-vis counterparties in third-party countries that would be categorised as FC or NFC if they were domiciled in the EEA. Such third-country counterparties are correspondingly affected by the EMIR if they conclude derivative contracts with counterparties domiciled in the EEA.

**Which obligations does the EMIR entail?**

EMIR is based on three pillars:



**1) Central clearing - clearing obligation**

Certain OTC derivatives must be settled through a central counterparty (“clearing house”) if both counterparties are subject to clearing obligations. NFC are affected by this clearing obligation only if the total volume of their OTC derivatives exceeds certain clearing thresholds.

The clearing threshold is calculated on the basis of the gross nominal of the existing derivative contract. Different clearing thresholds exist, depending on the derivative category:

Derivative category	Clearing threshold (EUR or equivalent)
Credit derivatives	1,000,000,000
Equity derivatives	1,000,000,000
Interest derivatives	3,000,000,000
Foreign exchange derivatives	3,000,000,000
Commodity derivatives and other derivatives	3,000,000,000

To calculate the clearing threshold, NFC must also take account of all OTC derivative contracts that were concluded by other NFC that are part of their group of companies and whose purpose is not to hedge the risks of the current business or to hedge treasury risks. The average gross nominal of the previous 30 business days is used to determine the threshold. If the clearing threshold for a derivative category is exceeded, the clearing obligation applies to all derivative categories.

In the EU, the clearing obligation is specified in greater detail in so-called technical regulatory standards (RTS). The clearing obligation for different OTC derivative categories is moreover being continuously expanded. Depending upon the particular counterparty category, different transitional periods are applicable. In particular, the example of the obligation to “clear derivative contracts retrospectively” for certain market participant categories (“front-loading”) should be mentioned at this juncture. The following transitional periods for particular categories of involved counterparties are currently applicable in EEA/EFTA states for certain interest (IRS) and credit derivatives (CDS):

Status of the counterparty	IRS <sup>4</sup> in EUR, GBP, JPY, USD, NOK, PLN and SEK	CDS <sup>5</sup>
<i>Category 1:</i> FC that clearing members for a category of OTC derivatives that is subject to the clearing obligation at a clearing house that is licensed for this category.	01 Dec. 2018	01 June 2019
<i>Category 2:</i> FC or AIF (AIF, that is not an FC), not in category 1, member of a group whose aggregate average gross nominal volume of all held OTC derivatives for the months of January, February and March exceeds EUR 8 billion.	01 June 2019	01 Dec. 2019
<i>Category 3:</i> FC / AIF and not in category 1 and 2	21 June 2019	21 June 2019
<i>Category 4:</i> NFC+, if not in category 1, 2 or 3	01 June 2020	01 Sept. 2021

ESMA prepares and maintains a public register that lists the categories of OTC derivatives that are subject to clearing obligations ([www.esma.europa.eu/regulation/post-trading/otc-derivatives-and-clearing-obligation](http://www.esma.europa.eu/regulation/post-trading/otc-derivatives-and-clearing-obligation)).

In order to settle OTC derivative transactions through central counterparties, counterparties must affiliate themselves to a clearing house or member of a clearing house in good time. If you are subject to the clearing obligation and are planning to trade in derivatives that are subject to clearing, we recommend you consider affiliating to a clearing house or to one of its members without delay. .... is not a member of a clearing house and therefore cannot offer its clients any clearing services.

## 2) Reporting obligation

In the case of FC and NFC domiciled in the EEA, the EMIR Regulation establishes a reporting obligation<sup>6</sup> for all derivative contracts (i.e. those traded on a stock exchange and OTC). In EEA/EFTA states, the following derivative contracts are subject to reporting obligations:

- a) Those that were concluded before the day on which the EMIR came into force within the EEA (01 July 2017) and were still outstanding on this date,
- b) Those that were concluded on or after the day on which the EMIR came into force within the EEA (01 July 2017).

The transactions must be reported at the latest on the business day following the conclusion of the contract to an authorised or recognised transaction register (TR). The technical regulatory and reporting obligation standards were adopted by the EEA Treaty on 31 May 2018. There is a transitional period for the start of reporting. Contracts subject to the reporting obligation must be reported for the first time by the deadlines specified in the EEA adoption resolution (within six months up to or from 01 December 2018).

<sup>4</sup> IRS pursuant to Delegated Regulations (EU) No. 2015/2205 and 2016/1178 in each case amended by Delegated Regulation (EU) No. 2017/751

<sup>5</sup> CDS pursuant to Delegated Regulation (EU) No. 2016/592 amended by Delegated Regulation (EU) No. 2017/751

<sup>6</sup> See Art. 9 of the Regulation (EU) No. 648/2012

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In addition to key information about the derivative contract, such as for example the nature, the maturity, the nominal value, the price and the settlement date of the contract, the stipulated TR report also includes the identity of the parties. In addition, amendments as well as the ending of the derivative contracts must also be reported to the transaction register. In the interim, identification of the contracting parties involved in a derivative contract has been standardised globally. FC and NFC are identified with the Legal Entity Identifier (“LEI”) in the report. In the case of private individuals (without an entrepreneurial activity), by contrast, an anonymised client identification number (“Client Code”) is used for identification.

The LEI must be requested from an approved Local Operating Unit, such as for example CICI Utility or WM Datenservice. You will find further information and providers under [www.leiroc.org](http://www.leiroc.org).

Companies domiciled outside the EEA are essentially not subject to any reporting obligations under the EMIR. They are, however, indirectly affected by the reporting obligation of (...), as the EMIR establishes a reporting obligation for Banks domiciled within the EEA to report any possible derivative contracts (i.e. those traded on a stock exchange and OTC derivatives), including with counterparties from third-party countries.

The reporting process can be delegated to the bank. If you require any further information about the reporting obligation, please contact your client advisor. The ESMA provides further information about the reporting obligation on the following website: [www.esma.europa.eu/trade-reporting](http://www.esma.europa.eu/trade-reporting)

### 3) Risk mitigation methods

Art. 11 EMIR obliges market participants to apply certain risk mitigation methods for OTC derivative contracts that are not cleared by a central counterparty. The relevant obligations and measures are outlined below:

#### 3.1. Obligation to confirm derivative contracts within defined deadlines

OTC derivatives that are not cleared centrally must be reconfirmed within specific deadlines. Insofar as agreed between the parties, a corresponding reconfirmation can also be performed tacitly. OTC derivative contracts between FC or NFC+ must be confirmed by both counterparties on the business day following the execution of the transaction<sup>7</sup>. OTC derivative contracts that are concluded with an NFC- must be confirmed by both counterparties within two business days following the date of execution<sup>8</sup>. For EEA/EFTA states, the specific obligations have been applicable since 01 June 2018 with the following transitional periods up to 01 December 2018:

#### OTC derivative contracts between FC or NFC+

Derivative category	Date of conclusion	Confirmation obligation
Interest derivatives	by 30 November 2018	by the end of the second business day following the date of the execution of the OTC derivative contract
Equity derivatives, foreign exchange derivatives, commodity derivatives and all other derivatives	by 31 October 2018	by the end of the third business day following the date of the execution of the derivative contract
Equity derivatives, foreign exchange derivatives, commodity derivatives and all other derivatives	between 01 November 2018 and 30 November 2018	by the end of the second business day following the date of the execution of the derivative contract
All derivative categories	from 01 December 2018	by the end of the business day following the date of the execution of the derivative contract

<sup>7</sup> See Art. 12 of the Delegate Regulation (EU) No. 149/2013.

<sup>8</sup> See Art. 12 of the Delegate Regulation (EU) No. 149/2013.

OTC derivative contracts with NFC-

Derivative category	Date of conclusion	Confirmation obligation
Interest derivatives	by 31 October 2018	by the end of the fifth business day following the date of the execution of the OTC derivative contract
Interest derivatives	between 01 November 2018 and 30 November 2018	by the end of the third business day following the date of the execution of the OTC derivative contract
Equity derivatives, foreign exchange derivatives, commodity derivatives and all other derivatives	by 31 October 2018	by the end of the seventh business day following the date of the execution of the derivative contract
Equity derivatives, foreign exchange derivatives, commodity derivatives and all other derivatives	between 01 November 2018 and 30 November 2018	by the end of the fourth business day following the date of the execution of the derivative contract
All derivative categories	from 01 December 2018	by the end of the second business day following the date of the execution of the derivative contract

3.2. Obligation to agree suitable procedures to clarify differences of opinion (dispute settlement procedure)

Counterparties of a derivative contract must have suitable procedures at their disposal to settle disputes concerning individual transactions as quickly as possible. The duration of the dispute and the contested sum must be recorded. Disputes that cannot be solved within 5 working days must be reported to the competent supervisory authority each month.

3.3. Portfolio reconciliation and compression obligation

In order to identify discrepancies that may occur between counterparties in relation to significant terms and conditions of an OTC derivative contract, the counterparties of an OTC derivative contract must conduct a portfolio reconciliation<sup>9</sup>.

The portfolio reconciliation covers the contract valuation of both counterparties as well as central transaction terms and conditions, for example the counterparty reference number, the product name, the maturity date, the planned payment or settlement data, the nominal sum or quantity, the currency, the underlying security, the business day convention, possibly relevant fixed or variable interest rates as well as counterparty positions. The frequency of the portfolio reconciliation is dependent on the number of outstanding transactions and the counterparty classification.

The following rule applies to FC and NFC+:

- daily portfolio reconciliation in the event of 500 or more than 500 outstanding transactions, or
- weekly portfolio reconciliation in the event of 51 to 499 outstanding transactions, or
- quarterly portfolio reconciliation in the event of 50 or fewer outstanding transactions

The following rule applies to the NFC- category:

<sup>9</sup> See Art. 13 of the Delegate Regulation (EU) No. 149/2013.

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- quarterly in the event of over 100 outstanding transactions; or
- annually in the event of 100 or fewer outstanding transactions

EEA counterparties of OTC derivative contracts are generally also obliged to check on a regular basis, at least twice per annum, whether a portfolio compression can be conducted in respect of each individual counterparty. This regulation, however, only applies if you have at least 500 outstanding OTC contract positions at the bank.

### 3.4. Obligation to value the transactions on a daily basis

An FC or NFC+ domiciled in the EEA is obliged to determine the value of outstanding derivative contracts daily on the basis of current prices<sup>10</sup>.

### 3.5. Obligation to provide collateral for derivative contracts that have not been centrally cleared

FC and NFC+ are also subject to the obligation to establish risk management procedures for the timely and reasonable exchange of collateral<sup>11</sup>. In addition, an FC must have suitable and reasonable equity capital to hedge risks that are not covered by a corresponding exchange of collateral.

For FC and NFC+ domiciled in an EEA/EFTA state, the corresponding obligations are not yet directly applicable, as the Delegate Regulation (EU) No. 2016/2251 ("*Margin RTS*") has not yet been adopted by the EEA Treaty.

The margin RTS defines the amount of collateral to be provided and the type of eligible collateral. Variation Margin ("*VM*") and Initial Margin ("*IM*") are provided as collateral instruments. VM is used to regularly offset fluctuations in the value of derivative contracts. IM, on the other hand, is intended to cover current and expected future fluctuations in value that may occur between the last exchange of collateral and the re-coverage of the risk or sale of the position if one of the counterparties is unable to meet its contractual obligations.

It is not yet known when the margin RTS will be incorporated into the EEA Agreement and which possible transitional periods will apply. However, it is already certain that a phased introduction of IM is also planned in EEA/EFTA states through falling threshold values, analogously to the EU. The following table shows the phased introduction in the EU:

from 1 September	Threshold value
<b>2016</b>	EUR 3 trillion
<b>2017</b>	EUR 2.25 trillion
<b>2018</b>	EUR 1.5 trillion
<b>2019</b>	EUR 0.75 trillion
<b>2020</b>	EUR 8 billion

The obligation to exchange IM applies only if both counterparties belong to a group of companies whose gross nominal of open, non-centrally cleared OTC derivative contracts exceeds the respective valid threshold value. The IM must be exchanged at the time of the conclusion of the contract, while the market value offset by means of the VM must be performed on a daily basis with the effect of a premature, daily fulfilment of the contract.

The collateral obligation is, however, applicable only if both counterparties are FC or NFC+. As soon as an NFC- or private individual is involved, there is no obligation to exchange the IM or VM.

Further detailed information about the risk mitigation methods that need to be observed is provided by ESMA under: <https://www.esma.europa.eu/regulation/post-trading/otc-derivatives-and-clearing-obligation>.

<sup>10</sup> See Art. 11 (2) of the Regulation (EU) No. 648/2012.

<sup>11</sup> See Art. 11 (3) of the Regulation (EU) No. 648/2012 in conjunction with Resolution of the Joint EEA Committee No. 206/2016

**Summary of the obligations:**

	Central clearing 1)	Reporting obligation 2)	Risk mitigation methods 3)				
			Confirmation 3.1.	Dispute settle- ment 3.2.	Portfolio reconcil- iation 3.3.	Valua- tion 3.4.	Collateral 3.5.
FC	✓	✓	✓	✓	✓	✓	✓
NFC+	✓	✓	✓	✓	✓	✓	✓
NFC-	x	✓	✓	✓	✓	x	x
Private individual	x	x*	x	x	x	x	x

\* However, private individuals may be indirectly affected by the EMIR if they trade in derivative contracts with their counterparty (e.g. their bank) and their counterparty is subject to reporting obligations pursuant to the EMIR.

We recommend you familiarise yourself with the EMIR requirements and, if necessary, also engage an advisor to assess your personal situation. Further information about the EMIR is available on the website of the European Securities and Markets Authority (ESMA): [www.esma.europa.eu](http://www.esma.europa.eu).

If you have any questions about the content of this Factsheet or about the EMIR, please do not hesitate to contact your client advisor.

Yours sincerely,

**VOLKSBANK AG**