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STAY CURRENT

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European Derivatives Regulation in a Post Brexit World:

Spotlight on the European Markets and Infrastructure Regulation ("EMIR")[1]– Part 3 Summer 2016 – What does Brexit mean for European derivatives regulation: Brexit aside, where are we now with EMIR implementation?

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"Firms must continue to abide by their obligations under U.K. law, including those derived from EU law and continue with implementation plans for legislation that is still to come into effect."[2]

Although three weeks have now passed following the widely unexpected outcome of the United Kingdom (the "**U.K.**") European Union ("**EU**") referendum of Thursday 23 June 2016, that the public had voted in favour of the U.K. to leave the EU (so called "**Brexit**"), the hot topic on the financial services community's lips remains what a post Brexit world will bring.

This Client Alert provides legal reaction to Brexit for European derivatives and derivatives regulation, focusing on EMIR. However, echoing the Financial Conduct Authority ("**FCA**") sentiments above and on the basis that the legal status quo is expected to remain unchanged for at least two years, this Client Alert, on the eve of EMIR's four year anniversary, serves as a general status update on the implementation of EMIR following our two previous related Stay Currents:

1. Autumn 2013 EMIR Stay Current ("European Derivatives Regulation: Spotlight on the European Markets and Infrastructure Regulation ("EMIR")") (the "**2013 EMIR Stay Current**"); and

2. July 2015 Stay Current ("European Derivatives Regulation: Spotlight on the European Markets and Infrastructure Regulation ("EMIR") - Where Are We Now? - Part 2 Summer 2015") (the "**2015 EMIR Stay Current**").

I. Brexit

Brexit and EMIR

"Brexit casts doubt on derivatives rules"[3]

How does the referendum result affect EMIR compliance?

It does not: until the Article 50 notice[4] has been served and then, only following the earlier of two years from the date of the notice and the date that the legal agreement (if any) entered into between the U.K. and the EU pursuant to which the U.K.'s Article 50 withdrawal takes effect (the "**Article 50 Agreement**"), the referendum result has no legal effect on the application of EMIR or indeed any other European legislation effective in the U.K. — **the legal position is the same today as it was prior to the referendum.**

How will or could Brexit affect EMIR?

As an EU regulation, EMIR takes direct effect across EU Member States. The terms of any U.K. Article 50 Agreement will dictate if and how EMIR will apply post Brexit. Hence, the exact effects of Brexit on EMIR and related legislation will be unknown until any such agreement or other withdrawal takes effect and possibly not until sometime after.

If the "Norwegian" (or similar) route is followed (i.e. if the U.K. joins the European Free Trade Association joining Iceland, Liechtenstein, Norway and Switzerland and becomes a member of the European Economic Area ("**EEA**") (Iceland, Liechtenstein and Norway only)), the U.K. would remain a member of the so called "EU single market" and continue to be subject to, and benefit from, ongoing EU regulations and directives. However, since EMIR has its genesis from the global intergovernmental commitments cemented at the 2009 G20 summit in Pittsburgh, even if the U.K.'s withdrawal follows an alternative route and ongoing EU legislation does not automatically apply it is unlikely that Brexit will result in any radical changes to the way in which derivatives activity is undertaken in the U.K. Indeed, we expect that the U.K. will adopt either identical or similar legislation to EMIR and the post Brexit analysis set out below assumes that this is the case.

Potential post Brexit EMIR analysis

Post Brexit, the key step for EMIR analysis will be ascertaining a U.K. incorporated entity's EMIR counterparty status and unless, following the U.K.'s withdrawal, there are no changes to the way EMIR applies to U.K. incorporated entities, we would expect that the U.K. will become a third country entity ("**TCE**") for the purposes of EMIR.

By way of reminder, EMIR's international reach and effect on TCEs emanates from two key aspects of EMIR, the first being those EMIR provisions which directly impose mandatory clearing obligations and risk mitigation techniques on certain transactions with entities that would be subject to EMIR if incorporated in the EU ("**Hypothetical Counterparties**") and between TCEs; and secondly, EMIR's "equivalence" concept: Should the European Commission declare that the "legal, supervisory and enforcement" arrangements of a third country are "equivalent" in relation to clearing, reporting and risk mitigation, the counterparties to a transaction shall be deemed to have fulfilled their corresponding EMIR obligations where at least one of the counterparties is established in that third country.

In summary, by virtue of being a TCE:

- Any U.K. counterparty otherwise amounting to an Financial Counterparty ("**FC**") or Non-Financial Counterparty ("**NFC**") would no longer automatically be subject to EMIR. Rather, EMIR would only apply in the limited circumstances prescribed by EMIR, being for clearing where either (i) one counterparty is an EMIR FC or NFC+ and the second counterparty is a Hypothetical Counterparty, or (ii) two TCEs transact and such contract is determined to have a "dire*ct, substantial and foreseeable effect*" in the EU or where imposing the clearing obligation is "*necessary or appropriate to prevent the evasion of any provisions of EMIR"*. Satisfying the latter standards will also trigger the so-called risk mitigation techniques for over the counter ("**OTC**") derivative contracts not cleared by a central counterparty ("**CCP**").

- If, post Brexit, the EU makes any equivalence determinations in relation to the U.K., usual business with entities directly subject to EMIR should be possible. Given the U.K.'s current derivatives regulatory regime has been established in accordance with EMIR, and we expect this to continue, any equivalence determination should not be difficult to achieve. However, as the United States ("**U.S.**") and EU CCP equivalence discussions are testament to, the question of equivalence can become politicised and in practice therefore any decision may take longer than expected.

- Any U.K. incorporated CCP would have to be formally recognised by the European Securities and Markets Authority ("**ESMA**") as a third country CCP (Article 25, EMIR). Such registration could not occur until the U.K.'s CCP regulatory and supervisory regime first receives an equivalence determination, which, on the basis that the U.K.'s framework is already EMIR compliant should be a formality for a CCP or indeed a trade repository (to which an analogous analysis applies[5]) incorporated in the U.K.

- To facilitate their own EMIR compliance and as is often the case for current TCEs, it is likely that any EU based FC will insist, as a prerequisite to trade, that the U.K. entity (irrespective of its TCE status) comply with EMIR related requirements.

Brexit and ISDA documentation

- In the absence of any bilaterally agreed provisions, the occurrence of the referendum should not require or trigger any immediate changes or events to standard ISDA documentation. EMIR related provisions now widely included in ISDA Schedules as standard should not be immediately effected either. Market events that have followed could however now (and in the future) trigger credit related events, for example linked to the credit worthiness of a counterparty or exposure issues requiring more collateral to be posted.

- Governing law and jurisdiction: Once any Article 50 Agreement becomes effective, it may be the case that neither Rome I nor Rome II in relation to governing law nor the Brussels Convention related references in Section 13(b) of the ISDA Master Agreement apply in the same way as today.

- Entities will also need to consider an approach for other European legislative references that may become obsolete post Brexit including for example references now becoming more widespread in ISDA Schedules in relation to the European Banking Resolution and Recovery Directive.

For a general discussion of the implications of Brexit, please see our June 2016 Stay Current, "**U.K. votes for Brexit – Key Considerations for International Businesses**".

II. The Implementation of EMIR

Current Status of key EMIR obligations

	LIVE?	KEY OUTSTANDING
1. MANDATORY CLEARING	✓ (partially since 21 June 2016)	Ongoing implementation and process: See tables below. Further products expected to be covered in the future.
2. REPORTING	✓ (since 12 February 2014)	
3. RISK MITIGATION TECHNIQUES FOR UNCLEARED OTC DERIVATIVES	✓ (partially since 13 March 2013)	Go-live date for final draft regulatory technical standards ("RTS") relating to margin requirements for uncleared OTC derivatives.

A. Key new document releases and resources

1. ISDA Regulatory Margin Self-Disclosure Letter (30 June 2016)

2. Updated ESMA Q&A paper (6 June 2016)[6]

3. ISDA 2016 Variation Margin related new Credit Support Annexes and draft Protocol (from 14 April 2016)

4. ISDA (updated) EMIR Classification Letter and accompanying Guidance Note (13 April 2016)

B. Progress on the EMIR obligations

1. The mandatory clearing obligation

There has been progress since the 2015 Stay Current and the first EMIR go-live clearing date has now passed: From 21 June 2016, Category 1 entities were required to clear certain G4 denominated interest rate derivatives.

Following closely behind are the go-live dates for certain index credit default swaps and interest rate swaps denominated in certain non-G4 European currencies (Swedish Krona ("**SEK**"), Polish Zloty ("**PLN**") and Norwegian Krone ("**NOK**")). The latter RTS are not yet published and remain subject to a period of scrutiny by the European Parliament and the Council and will then take effect over a three-year period similar to the two RTS already published, i.e. six months after entry into force of the RTS for Category 1 entities, 12 months after entry into force of the RTS for Category 2 entities, 18 months after entry into force of the RTS for Category 3 entities and three years after entry into force of the RTS for Category 4 entities.

Set out below are two tables providing key information in relation to the EMIR clearing obligation:

- **TABLE 1**: Based on a table extracted from the ESMA website[7] this table shows the current status for those classes of derivatives that ESMA has proposed are subject to the clearing obligation.
- **TABLE 2**: This table shows key dates for those two clearing related RTS that have now been published.

TABLE 1:

	Asset Class	Classes	Consultation Paper	Final Report	Other documents	Status of RTS	Last Update	Complete?
1.	**Interest Rate (1)**	Basis, fixed-to-float, forward rate agreements ("**FRA**") and overnight index swaps in Euro ("**EUR**"), British Pound Sterling, Japanese Yen and U.S. Dollar	11 Jul 2014 Consultation Paper (n°1)	1 Oct 2014 Final Report (n°1)	6 Mar 2015 Opinion on the RTS on interest rate swaps ("**IRS**")	RTS published in the Official Journal	1 Dec 2015	✓
2.	**Interest Rate (2)**	FRA and fixed-to-float swaps in NOK, PLN and SEK	11 May 2015 Consultation Paper (n° 4)	10 November 2015 Final Report (n°3)		RTS endorsed by the European Commission	10 June 2016	✕
3.	**Equity**	Lookalike/flexible equity derivatives and contracts for difference	11 Jul 2014 Consultation Paper (n°1)	1 Oct 2014 Final Report (n°1)		No RTS proposed at this stage	1 Oct 2014	✕
4.	**Credit**	Index credit default swaps ("**CDS**")	11 Jul 2014 Consultation Paper (n°2)	1 Oct 2015 Final Report (n°2)	20 Nov 2014 Letter to the Commission on RTS on clearing obligation	RTS published in the Official Journal	19 April 2016	✓
5.	**Foreign Exchange**	Non-deliverable forward ("**NDF**")	1 Oct 2014 Consultation Paper (n°3)		4 Feb 2015 Feedback statement on NDF	No RTS proposed at this stage	4 Feb 2015	✕

TABLE 2:

EMIR Counterparty Category	Clearing Start Date		Frontloading Start Date	
	G4 rates products (1. above)	Index CDS (4. above)	G4 rates products (1. above)	Index CDS (4. above)
Category 1	21 June 2016	9 February 2017	21 February 2016	9 October 2016
Category 2	21 December 2016	9 August 2017	21 May 2016	9 October 2016
Category 3	21 June 2017	9 February 2018	N/A	N/A
Category 4	21 December 2018	9 May 2019	N/A	N/A

RECAP: Does the EMIR clearing obligation apply to me?

- ***The EMIR mandatory clearing obligation applies to all trades between FCs and NFC+s, all trades between FCs or NFC+s and certain Hypothetical Counterparties and on a limited basis to trades between two TCEs. The temporary relief granted to certain pension scheme arrangements[8] that would otherwise be subject to the clearing obligation remains available until 16 August 2017[9].***

- ***In the event that two entities of different clearing categories enter into an interest rate product caught by the EMIR clearing obligation, the parties must clear the trade by the later applicable effective date. For example, a derivative in scope for the first clearing RTS entered into between a Category 1 entity and a Category 2 entity must be cleared by 21 December 2016 rather than 21 June 2016.***

- ***The G4 IRS RTS are very much seen as the blue print for the EMIR clearing obligation and pending equivalence determinations include a temporary derogation for certain intragroup transactions entered into between one TCE and an EU entity, provided that certain conditions are satisfied (the same derogation is also included in the CDS RTS).***

So, what next?

Likely eclipsed by events later that week or by the fact that many of the large institutions to which the clearing obligation now applies have been clearing such liquid interest rate swaps for some time, the first clearing go-live date passed with little comment.

As the dates for the other categories approach we expect discussion regarding client and indirect client clearing[10] to increase. At the time of writing, ESMA had just published a new consultation paper proposing to postpone the application of the EMIR clearing obligation for the smallest (Category 3) entities[11]. ESMA have requested feedback by 5 September 2016 and responses are expected to be published shortly thereafter.

2. Reporting

With a go-live date of 12 February 2014, the Article 9 EMIR reporting requirement has now been in effect for over two years. Although the reporting obligation is now usual business for counterparties, ongoing issues do remain and primarily relate to (i) the scope of the reporting requirement and the uncertainty remaining around the definition of "derivative" and (ii) how the reporting obligation may be refined, not only within the EU but on a global basis, in an effort to achieve international harmonisation across reporting requirements, with a big focus on the production of standardised data.

The status of FX transactions and MiFID II

As detailed in both our 2013 EMIR Stay Current and 2015 EMIR Stay Current, due to the lack of a harmonised implementation across Europe of MiFID[12], from which the EMIR definition of "derivative" or "derivative contract" emanates, uncertainties remain relating to which foreign Member State exchange derivatives are subject to the EMIR reporting obligation and are most focused on different interpretations of FX forwards.

Although remaining in draft form, the MiFID Commission Delegated Regulation of 25 April 2016[13] ("**Delegated Regulation**") addresses derivatives contracts and in particular Article 10 (*Characteristics of other derivatives contracts relating to currencies*) provides guidance on what will constitute (i) a spot contract and (ii) a "means of payment". If the relevant criteria are satisfied the derivative contract in question will not be a financial instrument and ultimately, therefore, not subject to the EMIR reporting requirement. Although currently very broadly drafted, (the Delegated Regulation may be supplemented by further legislation/technical standards) the Delegated Regulation should serve to provide much needed direction to the market; in particular, Article 10 1(b) relating to "a means of payment" sets out parameters (not including any reference to commercial purpose i.e. the current FCA test) for the consideration of financial instruments including forwards which are used to effect payments. As a consequence of NDFs neither facilitating payment nor being settled physically, NDFs would likely fail the new "means of payment" test and become reportable for the purposes of EMIR.

Single sided reporting and the EMIR review

Notwithstanding the various market initiatives to facilitate the reporting process, compliance with the reporting obligation remains a resource and preparation intense activity. Even where buy-side entities have delegated the reporting obligation, legal responsibility to comply with the reporting requirement remains and reports must therefore be checked and processes considered. Such factors combined with the continued lack of global harmonisation and consistency of data across international reporting requirements devalue the volume of data now being sent to trade repositories and related debate and discussion is on-going at the highest industry levels. A possible move to global entity based or single sided reporting and the related merits to abate such concerns was most recently highlighted by the April 2016 paper published by ISDA in conjunction with 12 other high profile trade associations including AIMA and GFMA[14].

The data to be reported

- In November 2015, ESMA published its Final Report[15] in relation to the new RTS and implementing technical standards ("**ITS**") relating to the EMIR reporting obligation. The aim remains to clarify the interpretation of the data fields required for reporting to trade repositories and the most appropriate way of populating them. ESMA itself acknowledged in the report that given the short period of time during which the initial reporting related RTS and ITS had to be produced *"…the practical implementation of EMIR reporting and the experience gained so far has shown several shortcomings and limitations that need to be addressed so that the EMIR reports can better fulfil their objectives*". The European Commission was expected to respond to the final report within three months but this three-month period expired on 13 February 2016 and at the time of writing no further action has currently been taken.

- In May 2016, ISDA published a paper relating to the Principles on the Development of Derivatives Product Identifiers[16] which ultimately supports the work of the International Organization of Securities Commission and the Committee on Payments and Market Infrastructures which are trying to establish a globally consistent derivatives product identifier. The creation of a global derivatives product identifier would be a major step for the global harmonisation of derivatives data reporting. Potential issues with the use of one mooted solution, the International Securities Identification Number (ISIN) as a standard identifier were highlighted in a recent International Financing Review article[17]. An analogy used in a recent article published in the IQ: ISDA Quarterly publication[18] neatly summarises the current problem, comparing the different reporting standards worldwide to car dealerships which are required to report facts globally about different cars sold — if some dealerships report size as weight, some as number of people a car holds and others as length it becomes easy to see how issues may arise and comparative analysis very difficult.

What next?

On the current timeline, MiFID II will become effective on 3 January 2018. It is only then that the formal amendments to the definition of "derivative" will take effect. Ahead of the MiFID II[19] go-live, later this year and following its publication of its first annual report to the G20 on the implementation and effects of the G20 financial regulatory reforms, the Financial Stability Board is expected to publish best practice standards for derivatives reporting.

Notwithstanding the publication of any such best practice standards, the reality is that any changes to EMIR or indeed other derivatives regulatory regimes including the Dodd-Frank Act[20] will necessarily take time. The continued consideration of this issue at the highest industry levels should provide some comfort, and we hope will serve in time to formulate a solution. In the meantime, where a party has to simultaneously comply with multiple reporting obligations, such party should always comply with the most onerous obligations. Furthermore, until such time as there is clarity on a party's compliance with the EMIR reporting obligation exempting it from compliance with the corresponding obligations of any other derivatives regulatory regime (or *vice versa*), it will be prudent for that party to always ensure compliance with *each* applicable jurisdiction's requirements.

RECAP: Does the EMIR reporting obligation apply to me?

All counterparties within the scope of EMIR as well as CCPs must, no later than the working day following the occurrence of the relevant reporting trigger, report details of "any derivative contract" to an ESMA registered trade repository – the trigger being not only each new derivative transaction (including cleared or non-cleared, OTC and exchanged traded derivatives) but also any modification to, or termination of, an existing derivative contract.

3. <u>Risk mitigation techniques for non-cleared OTC derivatives – provision of margin</u>

More than three years following the go-live of the first risk mitigation technique for OTC derivatives which are not cleared, timely confirmation, the RTS relating to the final outstanding EMIR obligation from this category remain in draft form.

Progress has however been made and on 8 March 2016 the final draft RTS on risk mitigation techniques for OTC derivatives contracts not cleared by a CCP under Article 11(15) of EMIR[21] were submitted to the European Commission by the European Supervisory Authorities (the "**ESAs**"[22]). The three month period during which the European Commission had to decide if to endorse the RTS has now expired and on 9 June 2016[23], the European Commission communicated to the market that it was still reviewing the draft rules and would not be able to meet the original deadline, it being the Commission's expectation that the first i.e. biggest firms to be subject to the rules would now be so subject by the middle of 2017 rather than 1 September 2016.

Given "*Everybody's been moving toward September 1 [2016]. It's still a good date*"[24], this communication of further delay prompted an immediate reaction. The ESAs, in particular, responded very quickly, on 30 June 2016 sending a public letter[25] to the European Commission asking that it reconsider the delayed timetable, setting out three key reasons for its request.

The key concern is consistent international application and the issues that may arise with different timetables, assuming Japan and the U.S. remain on track to implement from 1 September 2016. The ESAs' position and potential concerns from an industry perspective were also highlighted by ISDA in its "derivatiViews"[26] publication, which, on 27 June 2016, three days before publication of the ESA letter, whilst acknowledging that it was positive that European regulators spend the necessary time to ensure their rules are appropriate also considered the global effect of the delay, urging regulators to consider the realignment of the global implementation deadline. A Bloomberg article[27] published at the time of writing indicates that the European Commission is considering ways to reduce the delay but there have been no formal related announcements.

The final draft RTS

The final draft RTS published in March largely reflect the proposals considered in our 2015 EMIR Stay Current. There are, however, some key changes including delayed implementation of margin for physically settled FX swaps whilst MiFID II is finalised and in relation to intragroup transactions. The profile of the draft final RTS can be summarised as follows:

Articles 1-11: ***Risk Management procedures (including scope of margin and exclusions)***

Articles 12-21: ***Calculation and Collection of Margins***

Articles 22-8: ***Eligibility and Treatment of Collateral***

Articles 29-30: ***Collateral Valuation***

Articles 31-34: ***Operational Procedures and Documentation***

Articles 35:38: ***Procedures and criteria relating to exemptions for Intragroup Derivative Contracts***

Article 39: ***Transitional Provisions***

- **Do the new initial and variation margin rules apply to me?**

  – It remains the intention that the new initial and variation margin rules will only apply to systemically important FCs and NFCs including transactions entered into by such counterparties with a Hypothetical Counterparty.

  – Two NFCs (or TCEs which would be NFCs, if they were established in the EU) transacting together can agree not to exchange initial and variation margin.

  – For any given pair of counterparties, the least onerous margin requirements apply to the transaction.

  – No initial margin at 1 September 2016 (now delayed) if one of the counterparties has an aggregate notional average quarterly value of OTC derivatives below EUR 3 trillion.

  – For those counterparties with derivatives activity of less than EUR 3 trillion, posting of initial margin will be staggered over the next four years, until September 2020, from which the only exemption to the posting of initial margin is where at least one of the counterparties has an aggregate average notional derivatives activity of less than EUR 8 billion (calculations include all intragroup transactions and all non-centrally cleared OTC derivatives contracts of the group).

- **Which transactions?**

  – Generally all new transactions are covered.

  – Pending expected resolution of current definitional uncertainty and to avoid an unlevel playing field, the final draft RTS proposed a delayed implementation for FX forwards to the earlier of entry into force of the related delegated act and 31 December 2018.

  – No initial margin for certain foreign exchange contracts.

  – Phase-in of margin for single stock equity options and index options to seek to avoid any international regulatory arbitrage.

  – Potential exemptions for posting or collection of initial or variation margin for:

    1. Certain derivatives associated with covered bonds for hedging purposes; and

    2. Where the counterparty is based in a jurisdiction where netting/collateral protection is not ensured.

- **When and how much?**

  – Largest entities will be subject to the requirements first with small entities given more time.

  – Initial margin requirements phased in over 4 years; 1 September 2016 start date for posting of initial margin (now delayed).

  – Amounts of initial margin must be calculated pursuant to either the so called "standardised approach" or using a counterparty or third party agent developed model. ISDA's work on its industry proposed proprietary standard model for calculating initial margin, the so called "ISDA SIMM" (standard initial margin model) continues. Most recently, on 3 June 2016, ISDA published on its website initial work-in-progress drafts of certain ISDA SIMM documents.

  – For the biggest counterparties, posting of variation margin was also scheduled to start on 1 September 2016 and for all other counterparties 1 March 2017 (new timetable to be confirmed).

- **So if I need to comply, what collateral do I need to post?**

  – Parties can agree a *de minimis* level of initial and variation margin of up to EUR 500,000 (or currency equivalent).

  – Parties can agree bilaterally to include an initial margin threshold of up to EUR 50 million, below which no initial margin need be transferred.

  – Focus remains on most liquid collateral and the draft final RTS prescribe eligibility criteria for both initial and variation margin (Article 22).

  – Concentration limits for initial margin (Article 28).

  – Initial margin must be segregated (Article 33).

  – Daily calculation of variation margin.

- **Are intragroup transactions covered?**

  – Pursuant to Article 11 EMIR, intragroup transactions can be exempted (by way of approval or notification process) from posting collateral if certain requirements relating to risk management procedures are met and there is an absence of any practical/legal impediments to the transferability of own funds and the repayment of liabilities between the counterparties. So as to seek to ensure that the criteria for granting an exception are applied consistently across Member States, the final draft RTS provide further clarity and detail on these aspects. In May 2016, pending finalisation of the final draft RTS, the FCA communicated that it had produced a draft application form as a guide for the information that an entity seeking to avail itself of the exemption should be in a position to provide.

– For relevant intragroup transactions, the deadline for exchange of initial margin is 1 March 2017.

– In the absence of an equivalence determination, intragroup trades involving one or more group entities in non-EU jurisdictions are also waived from margin requirements for three years post effective date, allowing time for the necessary equivalence decisions to be adopted by the European Commission.

Market initiatives

Although the European plans are now delayed, the market continues to prepare for the changes that are afoot:

- **2016 ISDA Variation Margin initiatives.** On 14 April 2016, ISDA published what was the first in a series of various documents to facilitate compliance with the new margining techniques, the 2016 Credit Support Annex for Variation Margin (New York law). Corresponding English law and Japanese law versions have now followed and on 15 July 2016, ISDA published a consultation draft of its 2016 Variation Margin Protocol designed to facilitate the multiple changes required by the new margin rules across multiple jurisdictions and counterparties. ISDA have requested feedback by close of business on Friday 29 July 2016.

- **ISDA Regulatory margin self-disclosure letter.** On 30 June 2016, ISDA published its Regulatory Margin Self-Disclosure Letter which, in relation to the margin requirements relating to Canada, the EU, Japan, Switzerland and the U.S., seeks to help parties ascertain which margin rules apply and if so, how.

RECAP: Do the risk mitigation techniques apply to me?

All categories of EMIR counterparty as well as TCEs in specific cases must comply with at least certain of these EMIR obligations, the exact level of compliance being dependent on individual counterparty type.

C. Equivalence and extra-territoriality

As set out above, focus on EMIR's international reach emanates from two key aspects of EMIR — those EMIR provisions which directly impose mandatory clearing obligations and risk mitigation techniques on certain transactions between FCs and NFC+s and a Hypothetical Counterparty and two TCEs, and EMIR's "equivalence" concept. Although dependent on the exact terms of the U.K.'s exit from the EU, in a post Brexit world obtaining a determination of equivalence for the current arrangements is likely to be key for U.K. incorporated entities.

Recent developments

Brexit has diverted attention away from what has been the most significant equivalence development of 2016, the resolution of the longstanding issue between the U.S. and the EU relating to the mutual recognition of CCPs.

Agreement was signalled on 10 February 2016 when the European Commission and the U.S. Commodity Futures Trading Commission ("**CFTC**") published a joint statement announcing that they had a common approach regarding requirements for CCPs in the EU and U.S.[28]

The related joint statement issued by the European Commission and CFTC[29] details the relevant legal processes. In Europe this required an equivalence determination and cooperation arrangements, both of which have now been fulfilled: the equivalence decision effected by the European Commission adopting the Commission Implementing Decision (EU) 2016/377 of 15 March 2016, which includes detail of the requirements which must be satisfied and more recently, the cooperation arrangements, following the publication of a Memorandum of Understanding between ESMA and the CFTC[30], which as well as satisfying the statutory requirement also seeks to ensure that ESMA has the adequate tools to assess compliance and monitor ongoing compliance of CCPs subject to the cooperation arrangement. In the U.S., on 16 March 2016, by way of its own follow-up to February's mutual agreement, the CFTC approved its own substituted compliance framework[31] in relation to dually registered CCPs located in the EU.

Although less politically prolific, progress has also been made in relation to other jurisdictions too and November 2015 marked further progress when the European Commission adopted five CCP equivalence decisions for Canada (limited to the provinces of Alberta, British Columbia, Manitoba, Ontario and Quebec), Mexico, the Republic of Korea, South Africa and Switzerland. Equivalence decisions in relation to other jurisdictions and for the jurisdictions already benefiting from CCP equivalence determinations but in relation to the other key EMIR obligations remain outstanding.

III. Closing Remarks

Whilst Brexit does create uncertainty, until details of the U.K.'s exit are finalised, counterparties must follow the FCA message and continue with business as usual, closely monitoring any new EMIR developments. Current expectations indicate that each of the EMIR obligations will be live at least in part prior to any U.K. withdrawal taking effect and, on the current timetable, MiFID II will also be effective prior to any withdrawal too. In the near term, we expect the most significant EMIR related change to be the margin rules and all affected parties should ensure that documents are in place or updated to provide for the new rules. Not to be forgotten also that the results of the EMIR Review are expected later this year and therefore further changes may be proposed to the existing framework, all potentially before the fly in the regulatory ointment that is Brexit crystallises.

Glossary:

EMIR RELATED TERM	DESCRIPTION
"AIF"	**Alternative investment fund.**
"Category 1"	**FCs and NFC+s who are current clearing members of at least one of the CCPs authorised or recognised before publication of the relevant RTS to clear at least one of the relevant classes of derivatives.**
"Category 2"	**Essentially other systemically important FCs and NFC+s, being those counterparties which are not Category 1 entities but which belong to a group whose derivatives activities exceed certain thresholds.**
"Category 3"	**FCs, which are not otherwise captured by Categories 1 and 2, and AIFs comprising NFC+s.**
"Category 4"	**NFC+s not captured by any other Category definition.**
"CCP"	**Central counterparties.**
"Financial Counterparties" or "FCs	**EU banks and other regulated entities including AIFs.**
"Non-Financial Counterparties" or "NFCS"	**Catch all category – all other undertakings established in the EU other than CCPs or FCs.**
"NFC+s"	**"Active" NFCs i.e. those NFCs that exceed certain thresholds for derivatives trades.**
"TCEs" or Third Country Entities"[32]	**Any entity established in a country outside of the EU.**
"Hypothetical Counterparty"	**An entity that would be subject to EMIR if it were incorporated in the EU.**

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[1] Commission Delegated Regulations (EU) No 148/2013 of 19 December 2012, supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories with regard to regulatory technical standards on the minimum details of the data to be reported to trade repositories.

[2] Extract from the FCA Statement published on 24 June 2016, "*Statement on European Union referendum result*" https://www.fca.org.uk/news/european-union-referendum-result-statement.

[3] International Financing Review, 25 June 2016, Issue 2139, "*Brexit casts doubt on derivatives rules*", Helen Bartholomew.

[4] Article 50 of the Treaty of European Union (the Lisbon Treaty) provides that a Member State may decide to withdraw from the EU in accordance with its own constitutional requirements and must notify the European Council of its intention to withdraw (http://www.lisbon-treaty.org/wcm/the-lisbon-treaty/treaty-on-European-union-and-comments/title-6-final-provisions/137-article-50.html).

[5] Chapter 2, Article 75, EMIR.

[6] https://www.esma.europa.eu/sites/default/files/library/2016-898_qa_xviii_emir.pdf.

[7] https://www.esma.europa.eu/regulation/post-trading/otc-derivatives-and-clearing-obligation.

[8] The ESMA maintained (last updated 7 July 2016) list of pension scheme arrangements exempted from the clearing obligation is available at https://www.esma.europa.eu/sites/default/files/library/list_of_exempted_pension_schemes.pdf.

[9] http://ec.europa.eu/finance/financial-markets/docs/derivatives/20150605-delegated-act_en.pdf. There may be a further one year extension but following any such extension no further extensions are permitted.

[10] See most recently ESMA "*Final Report: Draft regulatory technical standards on indirect clearing arrangements under EMIR and MiFIR*", see: https://www.esma.europa.eu/press-news/esma-news/esma-issues-technical-standards-indirect-clients (26 May 2016).

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

[12] Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC.

[13] https://ec.europa.eu/transparency/regdoc/rep/3/2016/EN/3-2016-2398-EN-F1-1.PDF.

[14] "*Improving Derivatives Transparency: The Merits of an Entity-based Reporting Framework*", April 2016 (https://www.treasurers.org/ACTmedia/ISDA_Entity_%20based_reporting_April2016.pdf).

[15] https://www.esma.europa.eu/sites/default/files/library/2015/11/2015-esma-1645_-_final_report_emir_article_9_rts_its.pdf.

[16] May 2016, "*Principles on the Development of Derivatives Product Identifiers*".

[17] International Financing Review, July 2 2016 Issue 2140, "*Swap identifier solution faces final hurdles*", David Wigan.

[18] IQ: ISDA Quarterly, volume 2, issue 2, April 2016, "*Pushing for Harmonisation*".

[19] 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.

[20] The Dodd-Frank Wall Street Reform and Consumer Protection Act, 2010.

[21] https://www.eba.europa.eu/documents/10180/1398349/RTS+on+Risk+Mitigation+Techniques+for+OTC+contracts+(JC-2016-+18).pdf/fb0b3387-3366-4c56-9e25-74b2a4997e1d.

[22] Together EIOPA (the European Insurance and Occupational Pensions Authority), the EBA (the European Banking Authority) and ESMA.

[23] Bloomberg, 9 June 2016, "*EU Collateral Rules Lag U.S. in $493 Trillion Swap Market*", Silla Brush, http://www.bloomberg.com/news/articles/2016-06-09/banks-gain-more-time-to-meet-eu-swap-collateral-regulations.

[24] Quote from Timothy Massad, U.S. CFTC Chairman referenced in Bloomberg article at Endnote 23.

[25] https://eiopa.europa.eu/Publications/Joint%20Committee/ESAs%202016%2050%20(ESAs_joint_letter%20to%20the%20Commission%20on%20delayed%20adoption.pdf.

[26] https://isda.derivativiews.org/.

[27] Bloomberg, 15 July 2016, "*EU Plays Catch-Up on Swaps Collateral Under U.S. Pressure*", Silla Brush, http://www.bloomberg.com/news/articles/2016-07-15/eu-plays-catch-up-on-swaps-collateral-rules-under-u-s-pressure.

[28] http://europa.eu/rapid/press-release_IP-16-281_en.htm.

[29] http://ec.europa.eu/finance/financial-markets/docs/derivatives/20160210-eu-cftc-joint-statement_en.pdf.

[30] https://www.esma.europa.eu/sites/default/files/library/mou_for_usa.pdf.

[31] "*Comparability Determination for the European Union: Dually-Registered Derivatives clearing organizations and central counterparties,*" 81 Fed. Reg. 15260 (March 22, 2016), https://www.federalregister.gov/articles/2016/03/22/2016-06261/comparability-determination-for-the-european-union-dually-registered-derivatives-clearing.

[32] Not specifically defined in EMIR.