European Commission - Press release

Commission proposes simpler and more efficient derivatives rules

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The European Commission is today proposing some targeted reforms to improve the functioning of the derivatives market in the EU. The reforms provide simpler and more proportionate rules for over-the-counter derivatives to reduce costs and regulatory burdens for market participants without compromising financial stability. A good example of better regulation in practice, this is essential to the creation of a Capital Markets Union (CMU), a key part of the Investment Plan for Europe, and for investments, growth and jobs by improving the efficiency of the market while maintaining prudential objectives.

The EU adopted the European Market Infrastructure Regulation (EMIR) in 2012 following the financial crisis to better manage and monitor the risks arising from derivatives markets for financial stability. Today's reforms to EMIR build on the results of the Commission's Call for Evidence, a public consultation looking at the cumulative effect of the new financial sector rules put in place since the crisis. It is also part of the Commission's efforts to ensure that EU legislation delivers results for citizens and businesses effectively and at minimum cost (REFIT).

Valdis **Dombrovskis** Vice-President responsible for Financial Stability, Financial Services and Capital Markets Union said: "*The European Market Infrastructure Regulation is at the heart of the EU's financial reforms. Today's proposal ensures that EMIR achieves its objective of reducing systemic risk in the OTC derivatives market, while keeping costs to a minimum for the real economy. The proposal builds on the Commission's Call for Evidence and deepens our Capital Markets and our efforts to support investment, growth, and jobs*."

Jyrki **Katainen**, Vice-President for Jobs, Growth, Investment and Competitiveness said: *"Our aim is to simplify rules as well as to eliminate disproportionate costs and burdens to small companies in the financial sector, corporates and pension funds. The targeted changes will deliver real benefits for the industry, without endangering financial stability. Building on consultations with stakeholders, this is a prime example of better regulation."*

The proposal introduces more proportionate rules for corporates. It re-focusses the scope of the clearing obligation for financial counterparties to include some additional relevant market players while exempting the smallest financial counterparties. It also allows for more time to develop clearing solutions for pension funds. In addition, the Commission is streamlining the application of reporting requirements and making them more proportionate; it is also introducing improvements to ensure the quality of reported data. The changes include measures that could save market participants, and in particular corporates such as energy companies or manufacturers, up to €2.6 billion in operational costs and up to €6.9 billion in one-off costs.

Today, the Commission also adopted a Communication setting out its intentions to present further legislative proposals before the summer to address important and emerging challenges in derivatives clearing as its scale and importance grows. Further changes to EMIR will be necessary to ensure financial stability, as well as the safety and soundness of CCPs that are of systemic relevance for EU markets and to support the further development and deepening of the Capital Markets Union. In particular, the future proposal should seek to enhance the common EU supervisory arrangements for central counterparties (CCPs). In this context, specific arrangements based on objective criteria are necessary to ensure that that CCPs that play a key systemic role for EU financial markets are subject to the safeguards provided by the EU legal framework, including, where necessary, enhanced supervision at EU level and/or location requirements.

The main changes to EMIR

Reporting requirements:

- Under the proposal, **reporting requirements are being streamlined** for all counterparties. This will considerably **reduce the administrative burden**, while ensuring that the quality of data needed for monitoring derivatives markets and identifying financial stability risks is not lost. In particular, derivative transactions concluded on exchanges (so-called 'exchange-traded derivatives') will now only be reported by the CCP on behalf of both counterparties. To reduce the burden for all non-financial counterparties (corporates), transactions concluded between companies belonging to the same group (so-called 'intragroup transactions') will not have to be reported any longer, if one of the counterparties is a non-financial company. To reduce the burden for small non-financial counterparties, transactions between a financial counterparty and a small non-financial counterparty will be reported by the financial counterparty on behalf of both counterparties. Reporting on historic transactions will no longer be required. In addition, the proposal aims to improve the quality of reported data.

Non-financial counterparties (NFCs):

- Non-financial counterparties (corporates), use OTC derivatives to cover themselves against risks directly linked to their commercial or treasury financing activities ('hedging'). Also in the future, only non-hedging contracts are counted towards the thresholds triggering the clearing obligation. While under the current rules NFCs must clear all derivatives, if they exceed the clearing threshold for one class of derivatives, the Commission is now proposing that **NFCs clear only the asset classes for which they have breached the clearing threshold**, thereby reducing the burden for NFCs as they only have to centrally clear the asset classes in which they are most active.

Financial counterparties:

- Small financial counterparties are numerous but account only for very small volumes of OTC derivatives and of systemic risk. They currently have significant difficulties to find clearing services providers. **The proposal introduces a clearing threshold for small financial counterparties**, such as small banks or funds. This clearing threshold is based on the volume of OTC derivatives transactions. While all financial counterparties are required to report and collateralise OTC derivative transactions, only counterparties exceeding that threshold would be required to clear centrally.

Pension funds:

- Pension funds typically enter into OTC derivative transactions to protect their long-term liabilities to current and future pensioners against complex market risks. While central clearing of such transactions appears important, pension funds do not have normally access to the necessary cash collateral, and no specific solutions have been developed so far. Today's proposal introduces a new three–year temporary exemption for pension funds from central clearing. This will allow the various counterparties involved, including pension funds, central counterparties and the clearing members that provide clearing services, to develop a solution that enables pension funds to participate in central clearing without negatively impacting the revenues of future pensioners.

Background

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). Derivatives redistribute risk and can be used both to protect against legitimate risk and for speculative purposes. Most derivative contracts are not traded on an exchange but are instead privately negotiated between two counterparties (OTC). The global outstanding notional value of OTC derivatives amounted to USD 544 trillion, corresponding to 89% of the overall derivatives market as of end June 2016 (Source: Bank for international settlements).

EMIR implements the 2009 G20 commitment to increase the stability of the OTC derivatives market in the EU. The main objective of EMIR is to reduce systemic risk 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. It includes several measures: that all standardised OTC derivatives contracts be cleared through central counterparties (CCPs) and that OTC derivatives contracts be reported to trade repositories (TRs).

The need to eliminate disproportionate costs and burdens and to simplify rules without putting financial stability at risk were identified in an extensive assessment of EMIR by the Commission. It included a public consultation in 2015 and Call for Evidence on the EU Regulatory framework for financial services carried out between September 2015 and January 2016 that led, in November 2016, to the adoption by the Commission of a general report on EMIR and to the proposal adopted today.

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For more information: https://ec.europa.eu/info/law/derivatives-emir-regulation-eu-no-648-2012/upcoming_en

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