MAKING THINGS RUN

The EMIR-regulation

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and outlook

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The EMIR-regulation

The worldwide trading with derivative products – taking into account the notionals – is to abt. 90% based on OTC (over the counter) business. With EMIR (since 2012) and the EMIR-Refit regulations as a respective adjustment (since 06/2019), the correct and necessary process was kicked off to properly react to the financial crisis of 2008/2009. The main focus lies always on lowering visible risks and to increase the transparency concerning the currently processed transactions, specifically between financial institutions.

In the context of EMIR-Refit regulations, new client classifications were invented. This implies increased efforts, especially the settlement systems of derivative instruments and securities as well as systems to define client classifications (Static Data). Every 12 months the NFC (non-financial counterparty) is obliged to review its classification status and to communicate the result immediately.

Nevertheless, the fine tuning efforts in the regulation processes are not finalized. They are rather continuously enhanced by the ESMA (European Securities and Market Authority) to have technical regulation standards (RTS) as well as implementation standards (ITS) up-to-date. On a technical level, the IOSCO group introduced multiple technical adjustments, e.g. the invention of UPI reference data as well as the new ISO20022 standard. Financial institutions need to consider and implement these standards in the future. This document handles the adjustments brought on the way, considers the necessary implementation standards and the impacts caused on the various applications of the impacted institutes.

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The core items of the EMIR-regulation No. 648/2012[1]

The EMIR-regulation affects the financial institutions like banks, security companies or insurance companies (financial counterparties, FC), as well as other institutions and companies (non-financial counterparty, NFC).

Clearing Obligation (article 4 EMIR)

The Clearing Obligation regulates that over the counter traded derivative products no longer can be settled between buyer and seller, in case that they exceed a predefined threshold with the derivative products. FCs as well as certain non-FCs (NFC+) are affected. The clearing process in the future must be applied by Central Counterparties (CCP) to minimize failure risk. In the European markets these must authorized by the ESMA. Since the EMIR-Refit- regulations, FC and NFC are automatically obliged to clear as stated for any OTC-derivative if they do not calculate the thresholds at all.

Requirement to report (article 9 EMIR)

To increase the market transparency of the derivative trades, since 2013 all derivative contracts (stock exchanged or OTC) must be reported to a TR (transaction register), avoiding multiple reporting of the same product. These reporting registers need to be authorized and monitored by the ESMA. The report contains the most crucial functional data of the contract (like information to identify the trading parties, maturity date, notionals, etc.). The unique identification using the Legal Entity identification (LEI) guarantees the identification of the involved parties. This specific LEI code can be requested from the local operating units.

[1] VERORDNUNG (EU) 2019/834 DES EUROPÄISCHEN PARLAMENTS UND DES RATES vom 20. Mai 2019 zur Änderung der Verordnung (EU) Nr. 648/2012, verfügbar unter https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32012R0648&rid=1

[2] VERORDNUNG (EU) 2019/834 DES EUROPÄISCHEN PARLAMENTS UND DES RATES vom 20. Mai 2019 zur Änderung der Verordnung (EU) Nr. 648/2012, verfügbar unter https://eur-lex.europa.eu/legal-content/DE/TXT/PDF/?uri=CELEX:32019R0834&from=DE

[3] IOSCO: International Organization of Securities Commissions

[4] Die Clearingschwellen sind in Artikel 11 der Verordnung (EU) 149/2013 festgelegt, verfügbar unter https://eur-lex.europa.eu/legal-content/DE/TXT/PDF/?uri=CELEX:32013R0149&from=IT.

Risk management (article 11 EMIR)

The OTC trades that are excluded from the clearing process must follow a predefined way to minimize risk, operational as well as failure risk. Especially NFCs are deeply monitored, as they normally do not need to consider the clearing restrictions. Regulations in this case require a more strict equity capital.

The most crucial changes: The EMIR-Refit regulation No. 2019/834[2]

Discharge of smaller participants

The strict regulations from 2012 caused a disproportional work and demanded enormous responsibility from the market members. The most fundamental adjustments directly point to smaller parties and especially smaller non-financial parties (SFC). They receive the most noticeable changes. Their impact on the market is too low as that a strict regulation as in the old EMIR logic would be appropriate. The systematic risk is simply too low. One can see this especially in the reorganized threshold values.

Reporting requirements of FCs concerning NFCs

Looking back at June 2020, the FCs, which trade derivative products with NFCs, are responsible for the EMIR process. The NFC on the other hand is reliable for the correct data transmission that the FC cannot identify itself. The necessary information needs to be transmitted with the timespan of 5 business days, and this alone is very optimistic, not considering the operational effort for the FC.

UTI and UPI

Based on the new regulations there exists a detailed, but nonetheless complicated algorithm which decides who must generate the UTI (used to identify the derivative transaction). This UTI has a key role, as it must be identical for both parties.

The unique mapping of a derivative product is an international task. This has led to an ISO standardized UPI (Unique Product Identifier). With the introduction of MiFIR, only regulated products have the proper permit to be traded on the market and therefore can use an ISIN. Other derivative products were kept out of this logic. To solve this, specific information like asset class, optiontype, amortizing structure etc. is added. The product is therefore described in a unique manner.

This leads to the significant reduction of reconciliation effort. This definition of a new process has also the outcome that the data is consistent over several regimes. The current planning sees the GoLive for this process in Q3 2022.

Changes in RTS and ITS

In March 2020, the ESMA published a consultation paper for technical standards. After an enhanced timeline, the final standards have been published in December 2020. Currently, the commission in Q4 2021 shall publish the final distribution and therefore the kick off for the 18-month implementation timeline.

New and adjusted values

The amount of transmitted fields raises considerably from 129 to 203. At the same time 67 of the currently used fields need to be adjusted. This includes 152 so called critical data fields (CDE), defined in the CDE guidance.

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[5] SMA Consultation Paper: Technical standards on reporting, data quality, data access and registration of Trade Repositories under EMIR REFIT, verfügbar unter: https://www.esma.europa.eu/sites/default/files/library/esma74-362-47_cp_on_the_ts_on_reporting_data_quality_data_access_and_registration_of_trs_under_emir_refit.pdf

[6] Technical standards on reporting, data quality, data access and registration of Trade Repositories under EMIR REFIT, verfügbar unter: https://www.esma.europa.eu/file/110916/download?token=C9MdQ0N4“ \t „_blank“ \o „https://www.esma.europa.eu/file/110916/download?token=c9mdq0n4

[7] https://www.bis.org/cpmi/publ/d186.pdf

As described in the RTS, the following data categories will be adjusted or enhanced.

Collateral	New fields to better describe the Collateralization category, Margining and Counterparty Rating.
Price Data	Einführung von acht neuen Feldern, u.a. Price schedule oder Spread Currency
Package Structures	sieben neue Felder werden eingebunden, welche z.B. den Package transaction price beschreiben
Payment Instructions	Anpassung von Meldefeldern für Zahlungseigenschaften (u.a. Other payment type, dazu zählt beispielsweise ein Upfront Payment, wie es bei Kreditderivaten häufig auftritt)

This leads to a fundamental adjustment of existing interfaces, including the processing systems as well as the connected databases that store the information basis for the reporting to the register.

Combination of Action-Type and Event-Type

ESMA suggests to use the combination of action types and (the newly introduced) event types to describe lifecycle events of products. This process allows sharpening the real life mapping of events with the already existing action types. Additionally, Life Cycle events can now be bundled.

Figure 2: Combination of Action-Type and Event-Types

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	EVENT TYPE											
ACTION TYPE	Tade	Step-In	PTRR	Early Termination	Clearing	Excercise	Allocation	Credit Event	Inclusion in Position	Corprate Event	Update	No Event Type Required
New	T	T P	T		T	T	T		P	T P		
Modify	T P	T P	T P	T P		T P	T	T P	P	T P	T P	P
Correct												T P
Terminate		T P	T P	T P	T	T P	T	T P	T P	T P		
Error												T P
Revive												T P
Valuation												T P
Margin Update												T P
Position Component												T

PTRR (Post-Trade-Risk-Reduction) is a special Event Type and is worth special mentioning. The sender of the information can apply a compression and other practical methods of risk reduction on a portfolio level.

Having a look at figure 2, the two levels Position (P) and Trade (T) allow several ways of reporting. With the introduction alone the will be 57 new combinations of reporting. This comes with the price of complexity of the reporting. Only the transmission of single trades will cause 31 new possibilities.

The event type ‚Inclusion in Position', which can be used as ‚New', ‚Modify' or ‚Terminate', allows to combine single contracts to a structural position, which will need an additional UTI (Subsequent Position UTI). This process allows the reporting parties to transfer the portfolio information with a 1:n relation.

The new Action type 'Revive' allows undoing a falsely or purposely closed contract and putting it back in a live status. Margin Update on the other hand increases the flexibility in the handling of the margining, all in line with the SFTR requirements.

The advantage that is provided with the improved representation of the business cases, the life cycle oft he products in particular, paired with the enhanced number of fields comes with the price of adjusting the systems and interfaces, as pointed out already above.
Die Transparenz hinsichtlich der Vielzahl an Geschäftsvorfällen wird deutlich erhöht, jedoch ist alleine schon durch die Einführung der Event-Types ein beachtlicher Implementierungsaufwand in den Handels-/Derivatesystemen vorhersehbar.

Enhancement in Collateral Management

Until now, the consideration of securities was only applied pre-haircut. However, the transaction data never reflected the applied correction of the numbers. The new logic considers the enhancement of margin values considering post-haircut events. This increases the transparency in the development and changes of margins. Additionally it delivers a deeper look into the data quality of the securities.

Tolerance limit and reconciliation

After the validation of the data by the parties, the reconciliation process starts. A review of the allowed deviations was one major aspect in the EMIR Refit process. The allowed tolerances are lower for sure. For example date fields and numeric values are touched.

To make this possible, in the new RTS the following values are introduced:

- ‚Reconciliation Tolerance' (definition of a metric to reconcile numeric values in a more realistic manner)
- ‚Reconciliation Start Date' (define the date from that on the reconciliation is to be applied at all, commonly the reporting date)

There exist two levels of reconciliation concerning the transaction register. The Intra-TR Reconciliation is used to identify the transaction itself. When no opposing deal can be identified, the Inter-TR Reconciliation is used.

The main goal is always to communicate any kind of reconciliation error directly to the involved parties, as fast as possible, using the ISO 20022 format.

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The following table shows the details:

Quelle: Eigene Darstellung

Category	Valid values
Reporting Type	Single-side/dual-sided
Reporting requirement for both counterparties	Yes/No
Pairing status	Paired/unpaired
Reconciliation status	Reconciled/not reconciled

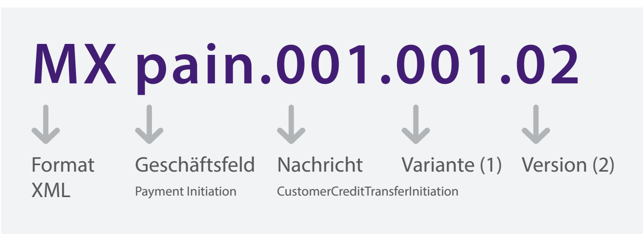
To avoid errors in the reconciliation process, the parties should always agree on processes between each other, often agreed on with a contract. The communication of any violation is a major concern. Additionally, involved parties shall keep any activity in a protocol.

ISO 20022 Standard and UPI

The ESMA defines that transmission of data must be applied in the ISO 20022 format. Main purpose of this requirement is the harmonization of the IT-based communication across the different regimes. This standard is not new, as SFTR and MiFIR already us it.
The harmonization is the basis for a more efficient data aggregation and value comparison of contracts. The establishment of this standard requires the adjustment of the Market members to use XML-based messages for both incoming and outgoing data. The effort for this is huge. Free your system landscape from static CSV-Files and move toward a granular XML files is not an easy task.

The challenge herby lies in the processing of information within the data, a loss of information must be avoided at any cost.

Figure 3: XML Struktur



Quelle: Eigene Darstellung

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The complexity of the regulatory requirements demands a timely preparation. Future changes need to prepared with care. The expertise of the targens company can be what you need to achieve these goals:

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