Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

2014

Consultation on the Supervision of Non-Financial Counterparties under EMIR.

Consultation Paper 90

Contents

Purpose of the Consultation Paper

In the aftermath of the financial crisis, regulators all over the world re-evaluated how derivatives should be traded, handled and reported to authorities, with the over-riding objective of seeking to prevent another global financial crisis.

In Europe, this led to the introduction of a new regulatory framework, Regulation (EU) No 648/2012 on over the counter ("**OTC**") derivatives[1], central counterparties and trade repositories otherwise known as the European Markets Infrastructure Regulation ("**EMIR**").

On 8 October 2014[2] the Central Bank of Ireland (the "**Central Bank**") was appointed by the Minister for Finance as the sole National Competent Authority ("**NCA"**) in the State for EMIR.

The practical implication of our appointment is that we have a number of new responsibilities in terms of supervising compliance with EMIR, which we intend discharging in the most efficient and effective way, to both ensure the stability of the financial system and for the benefit of all market participants.

This consultation paper addresses one aspect of our new responsibilities, namely the supervision of EMIR compliance for Non-Financial Counterparties **("NFCs")**[3], which pose new and distinct challenges for the Central Bank and which can be summarised as follows:

> These NFCs are not pre-authorised (there are no proposals that NFCs would require an authorisation from the Central Bank to enter into derivatives) to carry out the derivative activity for which they are now supervised; which means that they are likely to be unknown to the Central Bank.

---

[1] 'OTC derivative' or 'OTC derivative contract' means a derivative contract the execution of which does not take place on a regulated market as within the meaning of Article 4(1)(14) of Directive 2004/39/EC or on a third- country market considered as equivalent to a regulated market in accordance with Article 19(6) of Directive 2004/39/EC.

[2] S.I. No. 443 of 2014.

[3] To clarify this Consultation Paper is seeking feedback regarding NFCs, which are by virtue of the Central Bank's appointment under the S.I. subject to the supervision of the Central Bank in respect of their derivative activity. This paper is not seeking any feedback in relation to any NFCs which are by virtue of an authorisation under any other piece of legislation currently under the supervision of the Central Bank.

The first challenge we face is to supervise NFCs for which we currently have limited or, in some cases, no information of.

The Central Bank's supervision does not encompass every aspect of a NFCs business activity, but is limited to its derivative activity. Simply put, we do not know what this group of NFCs do, or, the rationale for why they do it.

The second challenge we face is to be thorough without being excessively intrusive.

Our current view is that the estimated number of NFCs which will now fall under our supervision runs into thousands. Clearly this shall potentially be a material draw on the Central Bank's resources.

The third challenge we face is to develop a supervisory framework, which is both fit for purpose and cost effective.

This consultation paper describes the proposed supervisory framework, which the Central Bank has developed to meet each of these challenges.

We plan to achieve our supervisory goals by making the best use of the **EMIR Regulatory Return ("ERR")** (as set out in Annex One), which the Central Bank can seek from counterparties under the S.I.. The ERR is central to our proposed supervisory framework, it is discussed throughout this paper and we are seeking input and suggestions on it.

The objective of the consultation paper is primarily to gather information and feedback so that we may calibrate and fine-tune our proposed supervisory framework. This will hopefully ensure that it delivers maximum benefits in terms of ensuring high standards and rates of EMIR compliance in the State, in a cost efficient manner.

Who should read this Consultation Paper?

Non-Financial Counterparties[4] and service providers for example brokers, solicitors, managers, auditors or other service providers.

[4] NFC is defined in Article 2 (9) EMIR, as meaning an undertaking established in the Union other than a CCP or a Financial Counterparty.

EMIR compliance for Non-Financial Counterparties

EMIR is a complex regulation with a significant number of regulatory and implementing technical standards, drafted by the European Securities and Markets Authority ("**ESMA**") and the European Banking Authority ("**EBA**"), which provide further granularity, including, how NFCs should ensure that they are in compliance with EMIR. The implementation of the various obligations has been on a phased-in basis. For example some of the obligations regarding the risk mitigation techniques for non-centrally cleared OTC derivative contracts commenced in March 2013, others in September of that year, the reporting of all derivatives (including both exchange traded and OTC derivatives) to Trade Repositories commenced on 12 February 2014, with the reporting of collateral relating to derivatives commencing on 11 August 2014.

Some obligations raised in EMIR dealing with the clearing of OTC derivatives and bilateral margining of non- centrally cleared OTC derivatives, have not been fully finalised.

However, as far as NFCs which are the subject of this consultation paper are concerned there is finality and clarity on the vast majority of EMIR obligations.

EMIR conceptually divides NFCs into two categories:

- Those which use derivatives to reduce the overall risk that they are exposed to, i.e. use derivatives for hedging purposes against commercial activity or treasury financing activities; and
- Those which use derivatives as a source of revenue, either by intermediating or building speculative positions.

The majority of NFCs are by and large thought to fall into the first category and the assumption is that they use derivatives to offset risk onto the market for insurance-like purposes. However, EMIR does not assume that all NFCs are by definition in the first category.

There is a test which NFCs must pass to be categorised in the first group, which is based on OTC derivatives being objectively measurable as reducing risks directly relating to the commercial activity or the treasury financing activity of that NFC or of a group as described in Article 10 of Commission Delegated Regulation (EU) No. 149/2013.

To be considered as being objectively measurable as reducing risks as set out above, an OTC derivative contract, whether on its own or in a combination with other OTC derivative contracts directly or through closely correlated instruments, must meet one of the three criteria outlined below;

It covers risks arising from the potential change in the value of assets, services, inputs, products, commodities or liabilities that the NFC or its group owns, produces, manufactures, processes, provides, etc. in the normal course of business. [5]

It covers risks arising from the potential indirect impact on the value of assets, services, inputs, products, liabilities, or commodities, (as set out above) resulting from the fluctuation of interest rates, inflation rates, foreign exchange rates, or credit risk.

A NFC must be satisfied that an OTC derivative contract qualifies as a hedging contract under the International Financial Reporting Standards adopted in accordance with Article 3 of Regulation (EC) 1606/2002.

If however, a NFC holds significant positions which are not of a hedging nature, depending on the size of these positions it will be considered as engaging in on-going speculative activity.

For example NFCs which hold more than €3 billion in gross notional value in OTC interest rate derivatives for the purpose of speculation, or more than €1 billion gross notional value in OTC equity derivatives which do not have a hedging purpose are considered to be in the second category.

[5] Refer to Article 10 1 (a) of EUR 149/2013 for the full listing on this matter.

Being in the second category and having breached one of the clearing thresholds in EMIR has the effect of reclassifying a NFC to a NFC+ and subjecting it to the same clearing obligations and risk mitigation techniques as a supervised Financial Counterparty. We currently estimate that there will be very few NFC+s in this category in the State.

However, the Central Bank retains the responsibility of having to satisfy ourselves as supervisors that this is indeed the case; which means in practical terms that we have to be comfortable with the classification of derivatives as a hedge which NFCs have applied.

The set of obligations which apply to all NFCs, regardless of their size and type of activity, concern the reporting of derivatives, (exchange traded derivatives and OTC derivatives) to Trade Repositories (TRs) and related risk mitigation techniques.

In terms of reporting to TRs under EMIR there is no *de minimis* which means that the Central Bank has to satisfy itself that all NFCs are reporting, to ensure that we have oversight of any emerging issues (through accessing data at TRs).

We must also check that any NFC engaging in derivatives is acting in accordance with the various risk mitigation techniques i.e. that the NFC is taking the necessary precautions when utilising derivatives, by having dispute resolution procedures in place with other counterparties, through portfolio compression, portfolio reconciliation and timely confirmation. Additionally in relation to a NFC+, we need to further assess that it is clearing the mandated OTC derivative contracts; bilaterally margining non-centrally cleared OTC derivative contracts and that all non-centrally cleared OTC derivative contracts are valued on a daily basis.

To add to the complexity of an already challenging task EMIR requires NFCs to report to TRs, and not directly to the Central Bank and it gives full discretion to report to any of the registered or recognised TRs. The obligation is that trades must be reported, not that they are reported to the same TR.

A further complication is that the nature of reporting, which is based on the life cycle of a trade, is not a once-off obligation. As a result NFCs are obliged to report to a TR when a derivative is terminated, concluded or modified.

In summary, in order to fulfil our mandate as EMIR supervisor for NFCs, the Central Bank must:

1. Satisfy itself that all NFCs report to a TR in a timely fashion all derivatives that they entered into, as well as any changes made to contracts during their life, such as valuation, coupon payments, expiry, novation, etc.

2. Satisfy itself that NFCs holding speculative positions in excess of the maximum admissible thresholds[6] are promptly reporting their change of regulatory status and thereafter complying with all additional requirements, such as mandatory clearing of OTC derivatives and additional risk mitigation techniques (i.e. bilateral margining) for non-centrally cleared OTC derivatives.

3. Satisfy itself that NFCs engaging in OTC derivatives which are not centrally cleared are exercising the necessary risk mitigation techniques, including for example timely confirmation, portfolio compression, dispute resolution and portfolio reconciliation.

The Central Bank's proposed supervisory framework for Non-Financial Counterparties

What is the Central Bank's view of the NFCs that engage in derivatives?

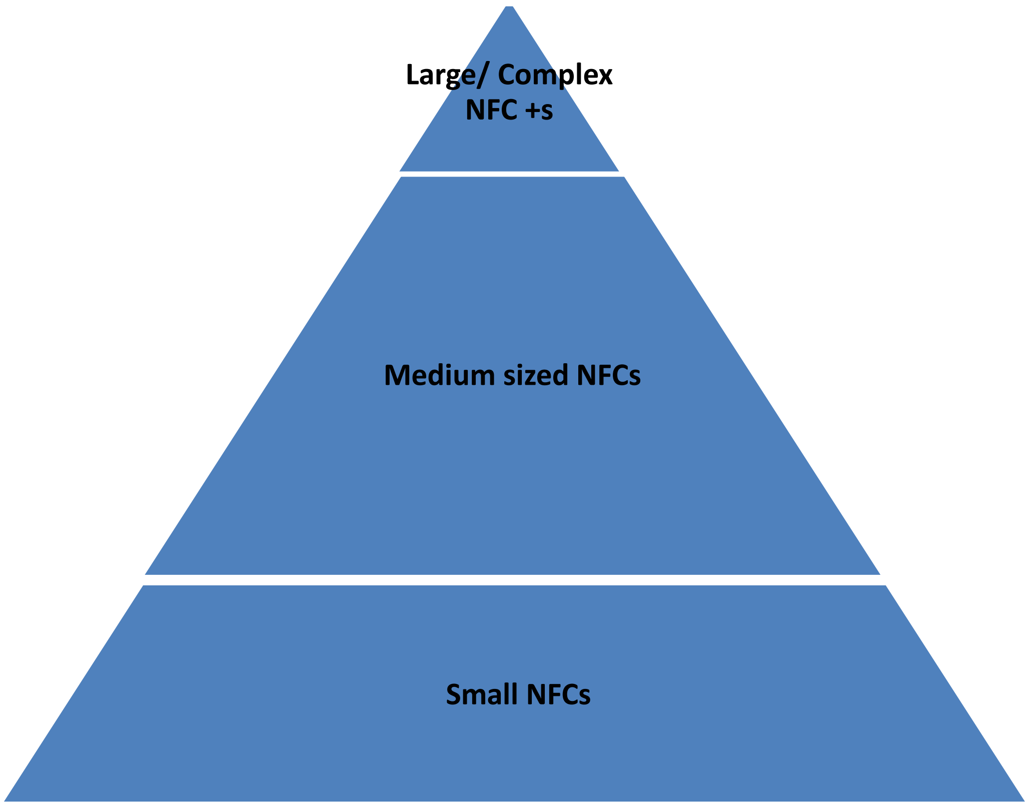
Our view is that the landscape of NFCs engaging in derivative activity in the State is divided into three main categories.

- Small NFCs: This group is non-complex and trades primarily in foreign exchange OTC derivatives. The S.I. sets out certain exemption provisions and a NFC which meets each of these is not required to submit to the Central Bank an independent assessment of the ERR.

[6] Article 11 of Commission Delegated Regulation (EU) No 149/2013.
(a) EUR 1 billion in gross notional value for OTC credit derivative contracts;
(b) EUR 1 billion in gross notional value for OTC equity derivative contracts;
(c) EUR 3 billion in gross notional value for OTC interest rate derivative contracts;
(d) EUR 3 billion in gross notional value for OTC foreign exchange derivative contracts;
(e) EUR 3 billion in gross notional value for OTC commodity derivative contracts and other OTC derivative contracts not provided for under points (a) to (d).

- Medium Sized NFCs: These are Counterparties with significant positions in derivatives, but not large enough individually to be of systemic concern or complex enough to require bespoke supervisory frameworks.
- Large/Complex NFCs: These are NFCs which have speculative positions above the clearing thresholds and are subject to the clearing obligations and risk mitigation techniques for non-centrally cleared OTC derivatives or that have portfolios of derivatives that are notionally above the clearing threshold but are exempt because they constitute hedges of commercial or treasury activities.

The Central Bank's initial view of the categorisation of NFCs (based on the number of potential NFCs in each category)



Question One: Do you think that this is the optimal categorisation which the Central Bank should use to underpin our supervisory framework? If not what other categorisation would you propose?

How does the Central Bank intend engaging with NFCs in the proposed supervisory framework?

As NCA, in order to monitor compliance with EMIR the Central Bank may ask any person, in respect of whom it may exercise its powers under the S.I., for any relevant records pertaining to a NFC's derivative activity. The Central Bank has access to granular TR data and can inspect NFCs to satisfy itself that a NFC is meeting any obligations which it is subject to under EMIR.

However, the Central Bank is mindful of resource constraints (both for the Central Bank and the NFCs) and aims to supervise compliance with EMIR in a proportionate way.

Large/Complex NFCs

It is our intention to engage directly with any NFC+ which happens to fall into the second category as described on page 4[7]. We anticipate these to be sophisticated investors with large portfolios and robust systems to manage the risks associated with derivatives. We think that the only way to discharge our obligations satisfactorily is to understand these NFCs, and to closely monitor their activity, as we would with any other comparable supervised Financial Counterparty <u>in respect of its derivative activity</u>.

There is an obligation under EMIR for a NFC+ to submit a notification to us and ESMA of its status, so we see no challenge in identifying members of this category.

Small NFCs

We are mindful of the size and limited complexity of NFCs at the other end of the spectrum: especially those which satisfy each of the exemption provisions[8] in the S.I.. These NFCs are likely to engage in a limited number of derivatives, to use derivatives mainly for hedging of

[7] Pursuant to Article 10, EMIR
[8] Regulation 14 (5) (a)-(c) in the S.I.
(*a*) the counterparty has had less than 100 outstanding OTC derivative contracts at any time during the reporting period to which the EMIR regulatory return relates;
(*b*) the counterparty has outstanding OTC derivative contracts which cumulatively have a gross notional value of less than €100 million at the time the request was made;
(*c*) the counterparty has delegated the reporting of the details of their OTC derivative contracts to a third party or parties in accordance with Article 9(1) of Regulation 648/2012 during the entire period to which the EMIR return relates.

foreign exchange risk, typically with their own banks acting as the other counterparty to the trade and who will most likely report to TRs on their behalf.

Although collectively representing a large portion of NFCs, this category trades in low volumes in a relatively risk averse way, it is also characterised by individually small NFCs and as a group poses limited systemic risk.

Our proposed approach for this category of NFCs is to include them in both targeted and random thematic inspections on a sample basis so that we can monitor this category's compliance with EMIR in a proportionate way.

This approach is consistent with PRISM, our existing risk-based supervisory approach for low impact firms, and we are of the view that it strikes the right balance in terms of proportionality and the efficient use of resources on one side, and the credible threat of enforcement for non-compliance on the other.

Medium sized NFCs

The question that this consultation paper is seeking feedback on is how to optimally engage with medium sized NFCs: which are materially large, but which are not above any of the clearing thresholds and therefore are not by default to be treated as equivalent to supervised financial counterparties (in respect of their derivative activity) or comparable to our proposed supervisory approach for NFC+s.

Extending the direct supervision approach reserved to supervised financial counterparties or to NFC+s to a NFC-, would entail direct engagement, establishing information flows and monitoring frameworks, and periodic assessments, including inspections.

It seems to us that this may be disproportionate for this category and would absorb a significant amount of supervisory and operational resources in the Central Bank, the cost of which would somehow have to be funded by NFCs; not to mention the costs to industry in terms of the dedicated staff and time, required to maintain on-going engagement with the Central Bank.

The S.I. introduces a new supervisory tool, the EMIR Regulatory Return (ERR) which the Central Bank can use to address this challenge. In essence it is an annual self-assessment by the NFC dealing with its compliance with EMIR.

We intend to use the ERR for all NFCs which are below a clearing threshold, which is specified in EMIR [9] (and so referred to as NFC-) and above a minimum threshold.

The S.I. also empowers the Central Bank to impose a requirement that the ERR be independently assessed prior to submission.[10]

The S.I. sets the minimum exemption threshold: on the satisfaction of each of the three exemption provisions a NFC shall not have to submit an independent assessment of the ERR.[11] (Cross-refer to line C, in the diagram below).

While the S.I. provides the minimum threshold below which the Central Bank cannot seek an independent assessment of the ERR, the Central Bank is considering applying a higher threshold (i.e. to raise the threshold from C to B in the diagram below). The Central Bank is seeking views on any issues which may arise if such a higher minimum threshold is applied.

The purpose of the ERR is to allow self-assessment by the NFC (which is assessed by an independent third party) of its compliance with EMIR.

An alternative to the ERR model could be a direct engagement model where a medium sized NFC could, with the Central Bank's consent, elect not to submit an independently assessed annual ERR and instead to engage directly with the Central Bank on an on-going basis. (Cross-refer to the diagram below and move above line A). In this scenario it is very likely

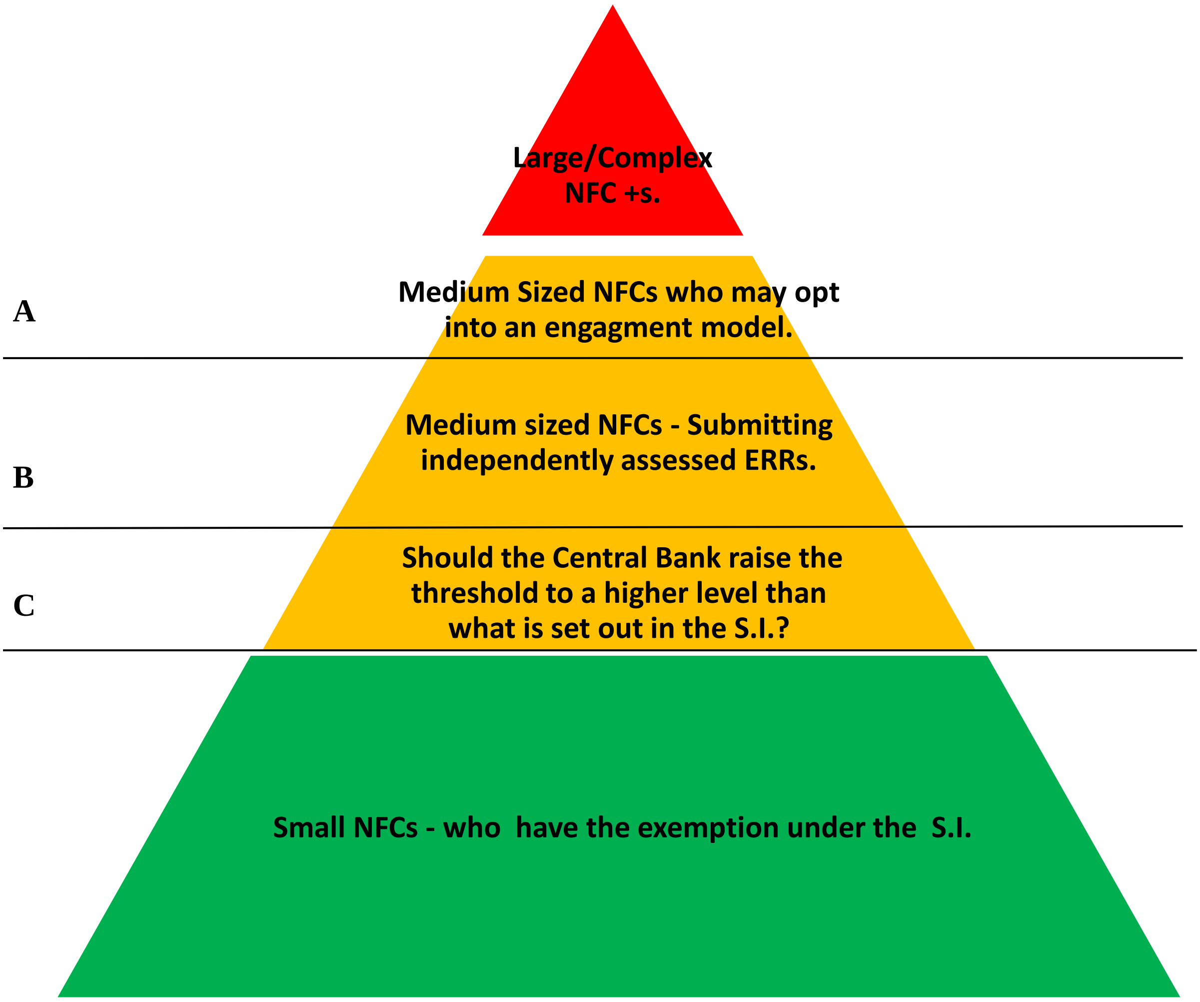
[9] The clearing thresholds are set out in Article 11 of Commission Delegated Regulation (EU) No 149/2013.
[10] The appointment of a Third Party Assessor shall be approved by the Central Bank under Regulation 12 (1) of the S.I. but appointed by the NFC. To be clear the costs of the Third Party Assessor will be met by the NFC.

[11] Regulation 14 (5) (a) - (c) of the S.I.
(*a*) the counterparty has had less than 100 outstanding OTC derivative contracts at any time during the reporting period to which the EMIR regulatory return relates;
(*b*) the counterparty has outstanding OTC derivative contracts which cumulatively have a gross notional value of less than €100 million at the time the request was made;
(*c*) the counterparty has delegated the reporting of the details of their OTC derivative contracts to a third party or parties in accordance with Article 9(1) of Regulation 648/2012 during the entire period to which the EMIR return relates.

that a NFC would contribute to the Central Bank's associated costs of supervising such an entity.

Having considered both a direct engagement supervisory model and the ERR supervisory model, the Central Bank is of the view that on balance the ERR model is the more efficient and effective supervisory model for this group of NFCs.

The below diagram illustrates the various options, which we have presented in this section.



Question Two: Should the minimum threshold be set at a level above the criteria specified in the S.I. and if so, what would be the appropriate level?

The EMIR Regulatory Return

The ERR is an annual return which certain NFCs will have to submit to the Central Bank. As mentioned above, only NFCs below all of the clearing thresholds in EMIR and above a set minimum threshold will need to submit the ERR. The S.I. sets out specific parameters in terms of NFCs which would not have to submit an independently assessed ERR.

The ERR has two principal objectives:

1. To provide the Central Bank with a self-assessment as to whether the NFC is complying with EMIR in a format that facilitates independent third party assessment and validation of the data; and alternatively to identify to us exceptions and cases/matters where we should focus our supervisory attention;
2. To provide us with quantitative and qualitative data to map the population of NFCs engaging in derivatives, so that we can learn and further fine tune our supervisory approach.

To achieve these goals we have drafted an ERR (Annex One), which is divided into four sections:

- Section One: An information section which seeks general information about the NFC including the company name, identifiers, and other static data.
- Section Two: Trade reporting information. We have identified how we could translate compliance with EMIR requirements into quantitative data. The solution selected is to ask NFCs to report aggregate values from their TR statements and from their internal derivatives management systems, so that we can quickly compare them. In doing so we also seek data on type of activity (in terms of asset classes) and counterparties.
- Section Three: Risk mitigation techniques[12]. This focuses on the data consistency and data management requirements, like reconciliation and compression.
- Section Four: Discretionary Information: This seeks particulars to assist us in understanding a NFC's business model etc.

The key aspect of the ERR is that it is signed by directors/partners of the reporting NFC and by an appointed Third Party Assessor. A Third Party Assessor is approved by the Central

[12] Please note that any reference to risk mitigation techniques, is a reference to those raised in EMIR,

Bank under Regulation 12 of the S.I., which also sets out certain matters to be considered in this context. For example, does the Third Party Assessor have sufficient detachment? Is there any potential conflict of interest? Does the Third Party Assessor have the requisite expertise?

We see the role of the Third Party Assessor as being fundamental in providing an independent safeguard, the key function of which is to provide the Central Bank with a factual statement that sets out whether the reported data is a faithful transcription of two separate sources: the TR data and the NFC's records. This is a key requirement in enhancing the effectiveness of the TR supervisory architecture: data has to be accurate and consistent. Achieving accuracy and consistency of reported data is ensured by frequent reconciliation, data matching and dispute resolution. The Third Party Assessor is designed to cover the risks associated with inaccurate transcriptions of data into the TRs, and is complementary to the data quality exercise.

The objective of the Third Party Assessor is limited therefore to data quality: a faithful transcription of information – as is – between the internal derivative position keeping systems and the TR data available to supervisors. To fulfil its mandate, the Third Party Assessor will need to satisfy him or herself that the reporting entity (the NFC) keeps accurate internal records, knows what data is reported to TRs, and that these two data sets match; which is not a given in the case of unregulated entities or for multiple outsourced reporting arrangements.

The Central Bank envisages the role of the Third Party Assessor will be to:

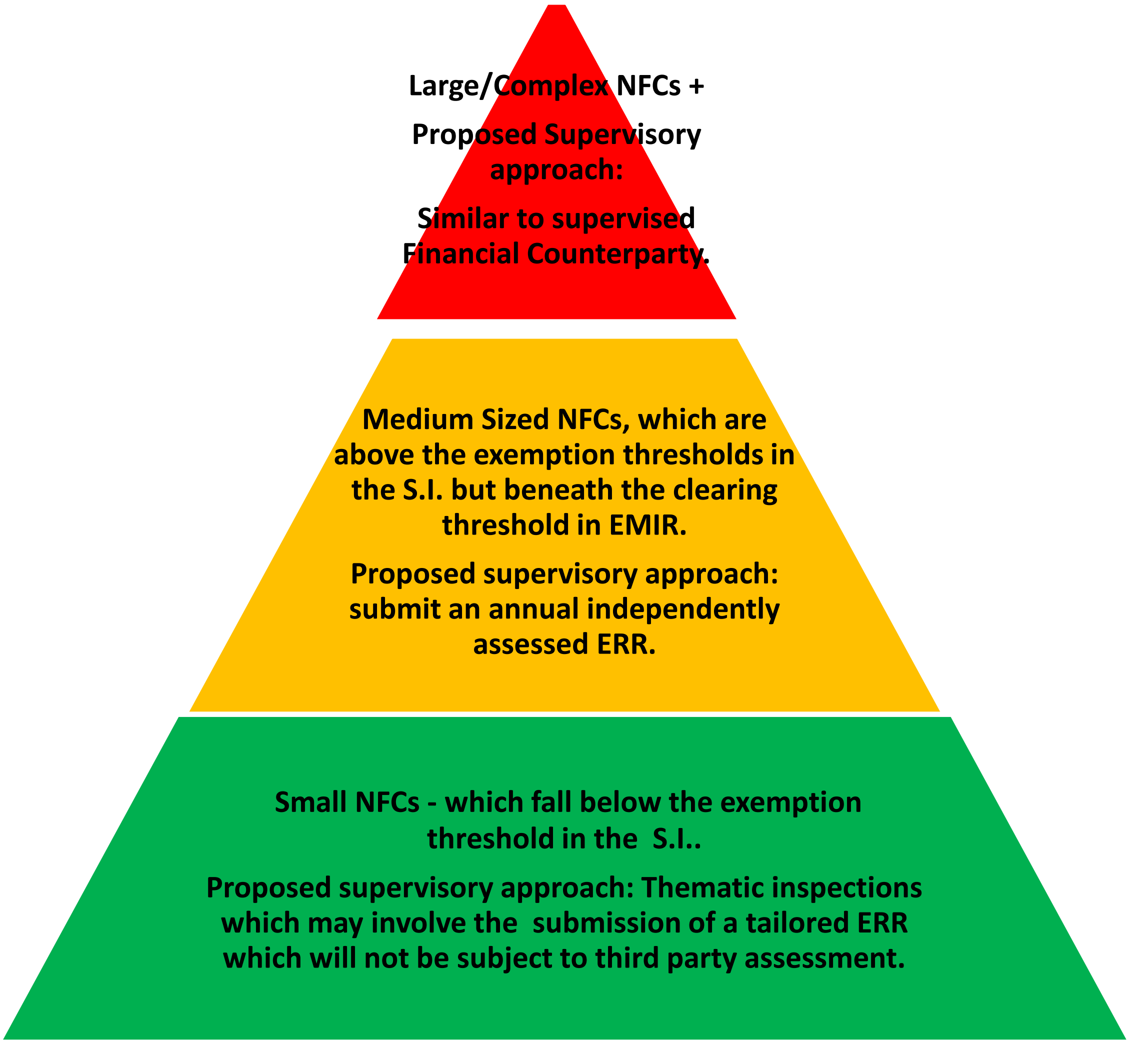
- Assess the accuracy of the submissions per the TR(s) statements or records, having compared the source of that data from the TR(s) in question, to the details captured by the NFC in the appropriate table on the ERR.
- Assess the accuracy of the balance(s) per the NFC's own records, however these are retained, to the balance(s) captured by the NFC in the appropriate table on the ERR.
- Where discrepancies in the above information are identified the Third Party Assessor will be required to document the NFC's discrepancies and the reasons for the discrepancies, which have been provided by the NFC.
- Provide the Central Bank with a factual statement documenting the data accuracy of the ERR.

The Third Party Assessor is not responsible for the completion of the ERR nor does it hold any responsibility for the NFC's compliance or non-compliance with the requirements set out in the EMIR or the S.I.. However, the Third Party Assessor shall independently assess relevant specified parts of sections 1, 2 and 3 of the ERR and provide a factual statement on the accuracy of the submission in the relevant respects.

The Central Bank, shall, issue rules and standards which will provide greater clarity on the role of the Third Party Assessor and which shall specify our expectations in terms of responses to the questions raised in the ERR.

The effect of the ERR reporting process is that a Third Party Assessor reviews what has been submitted to a TR or what is contained in a contract with another counterparty (i.e. risk mitigation techniques, portfolio compression etc.) against the NFC's own records. The role of the Third Party Assessor is to review the data from both data sources, identifying any discrepancies which arise.

We have illustrated below our proposed supervisory approach.



Question Three: Do you envisage any operational or other difficulties with the Central Bank adopting this approach?

If so please provide commentary as to how these difficulties could be resolved?

In answering the above question, we understand that for many respondents it is likely that the key issue is first and foremost one of costs. We understand that the proposed self-assessment by the NFCs will be expensive, whereas the costs incurred by the Central Bank are not immediately apparent, or impacting, to NFCs.

To address the first problem, i.e. the cost for the reporting NFCs, the Central Bank is proposing to ask NFCs to submit the ERR annually, but in a flexible way by choosing the timing of the submission. We are of the view that NFCs may have a preference to compile the ERR in and around the same time as the drafting of the annual financial statements so as to reduce any associated costs, as most if not all the required data would already be involved in the preparation of the annual financial statements.

Question Four: Should the Central Bank accommodate tailored submission periods from NFCs, or should it determine a fixed date for the submission of all ERRs?

To address the issue of funding the costs incurred by the Central Bank in discharging its obligations, our guiding principle is that NFCs may prefer to retain control of the cost structure through their direct engagement with Third Party Assessors. NFCs are better placed, to optimise their own specific cost structures. Therefore, we think that by NFCs engaging Third Party Assessors to review the collection and aggregation of data in a way that highlights anomalies, this may reduce the overall costs for the system to perform this control and achieve maximum economies for the system as a whole.

This can be illustrated by outlining the workload and infrastructure required to bring the entire review process across all three categories in-house in the Central Bank.

The Central Bank would create a reporting system which would be similar to the one which is currently used for supervised entities. The Central Bank would interact with the NFCs and reconcile submissions on the basis of data which the Central Bank would collect from TRs. The level of interaction would be driven by the extent and the complexity of the derivative trading of a NFC. That is to say that for the smaller NFCs, who are only engaging in foreign exchange derivatives, we would not anticipate engaging as frequently with this group as we would for a large NFC.

However as the Central Bank would be verifying particulars, we anticipate that the level of interaction between the Central Bank and NFCs would be considerable, across all three categories. The Central Bank would also run thematic inspections across all three categories.

Question Five: If the ERR was not adopted, how should the Central Bank charge supervisory costs to all categories of NFCs? Should we for example have a sliding scale for NFCs, which is dependent on the level of derivative activity?

We have attached a draft template of the ERR (Annex One), which in the first instance does by necessity, seek certain particulars regarding a NFC, this is primarily driven by the fact that we in the Central Bank have no previous engagement with the parties. The ERR also tests if a NFC is reporting to TRs and if it has exercised the various risk mitigation techniques.

We have included a draft Report of Factual Findings which the Third Party Assessor would complete. We are mindful that Third Party Assessors may be drawn from differing professions. We welcome specific feedback regarding any professional disclosures, which respondents are of the view may be appropriate for the Central Bank to consider.

We have included a section (Section Four) which seeks additional information on the NFC. Responses to the matters raised in this section are voluntary. The rationale for including this section is to facilitate a greater understanding by the Central Bank of a NFC's business model and the rationale for its engagement with derivatives.

It is our intention that the ERR shall be submitted electronically, therefore it is likely that formatting etc. shall change to reflect any IT requirements.

Question Six: If you are of the view that the ERR should be adopted, as broadly outlined, are we asking the right questions in the ERR? If there are questions which can be improved upon, please let us have this feedback.

Question Seven: If there is specific feedback re any professional disclosures, please submit details to the Central Bank.

Question Eight: What is your view on the proposed role of a Third Party Assessor?

Questions for consideration

Question One: Do you think that this is the optimal categorisation which the Central Bank should use to underpin our supervisory framework? If not what other categorisation would you propose?

Question Two: Should the minimum threshold be set at a level above the criteria specified in the S.I. and if so, what would be the appropriate level?

Question Three: Do you envisage any operational or other difficulties with the Central Bank adopting this approach?
If so please provide commentary as to how these difficulties could be resolved?

Question Four: Should the Central Bank accommodate tailored submission periods from NFCs, or should it determine a fixed date for the submission of all ERRs?

Question Five: If the ERR was not adopted, how should the Central Bank charge supervisory costs to all categories of NFCs? Should we for example have a sliding scale for NFCs, which is dependent on the level of derivative activity?

Question Six: If you are of the view that the ERR should be adopted, as broadly outlined, are we asking the right questions in the ERR? If there are questions which can be improved upon, please let us have this feedback.

Question Seven: If there is specific feedback re any professional disclosures, please submit details to the Central Bank.

Question Eight: What is your view on the proposed role of a Third Party Assessor?

Consultation responses

Given the challenges which we have outlined in terms of the Central Bank understanding the scale and scope of NFCs, which are now subject to EMIR and to ensure that we that we are operationally prepared. We would be grateful if any NFC engaging in derivatives completes the EMIR survey which will be published on the Central Bank's website.

The Central Bank will be hosting a roundtable for stakeholders in January 2015. If you wish to attend, we would be grateful if you could please submit details of any delegates to emir@centralbank.ie by close of business 18 December 2014.

The Central Bank invites all stakeholders to provide comments on the proposed supervisory framework for NFCs which are subject to the EMIR which forms part of this Consultation Document and on the questions raised within this Consultation Paper.

Where a respondent disagrees with a proposal, he/she should set out reasoned arguments as to why the proposal is unnecessary or inappropriate and/or should suggest viable alternatives

Please make your submissions electronically by email to emir@centralbank.ie or in writing, to:

Markets Infrastructure Team
Markets Policy Division
Central Bank of Ireland
Block D
Iveagh Court
Harcourt Road
Dublin 2

Responses should be submitted no later than close of business 30 January 2015.

It is the policy of the Central Bank to publish all responses to its consultations. All responses will be made available on our website. Commercially confidential information should not be included in consultation responses. We will send an email acknowledgement to all responses sent by email. If you do not get an acknowledgement of an emailed response please contact us on 2246000 to correct the situation.

Markets Policy Division

Central Bank of Ireland

4 December 2014

Annex One – EMIR Regulatory Return Draft Template

Section One: Is intended to gather **general data** about the NFCs which will help to build and maintain a database of supervised NFCs.

Section Two: Specifically tests the **reporting obligations**, by asking questions on the numbers of contracts and outstanding portfolio positions, and asking to compare these with Trade Repository data in terms of timeliness, completeness, and accuracy of content.

Section Three: Assesses the various **risk mitigation techniques for non-centrally cleared OTC derivatives** specifically the obligation to perform periodic reconciliations with different counterparties, the procedures for monitoring portfolios and dispute resolution.

Each section contains the reporting templates, followed by notes explaining which Articles or Regulations (as appropriate) are being tested.

The assumption is that if all questions could be answered satisfactorily and truthfully, these questions represent a reliable test to reassure the Central Bank that by and large the NFC is capable of managing its derivative risk and is broadly in compliance with the rest of the EMIR.

Section Four: This section seeks specific data points, which are not necessarily required under any provision of the EMIR or the S.I..

The rationale in us seeking this data is that, we believe that it will greatly assist the Central Bank in understanding a NFC's business model, the rationale which underpins its engagement with derivatives and it shall also provide the Central Bank with greater clarity on a NFCs' status regarding clearing/bilateral margining etc.

Some questions are seeking information only and detailed responses are not strictly required. Further, the Central Bank will take no action if partial responses are provided.

Section One: General Data

1.1 Non-Financial Counterparty (“**NFC**”) legal name:	
1.2 NFC identification code:	
1.3 Type of identifier:	*Specify the identifier used when reporting to TRs: LEI or client code.* *[drop down text box]*
1.4 Issuer of the client code:	*If applicable, if not please mark as n/a.*
1.5 (a) NFC’s registered address:	
1.5(b) NFC’s address(es), at which derivative activity is carried out:	*If the response is the same as 1.5 (a) please mark as n/a.*
1.6 NFC’s EMIR classification:	*NFC/public sector entity/pension scheme arrangement.*
1.6 (a) If a pension scheme arrangement[13], which EMIR classification does the NFC fall under in Article 2 of EMIR:	
1.7 Reference start date of the annual EMIR Regulatory Return (“**ERR**”):	*dd mm yyyy.*
1.8 Reference dates of the previous ERR:	*dd mm yyyy -dd mm yyyy.* *If applicable, if not please mark as n/a.*

[13] As defined in Article 2 (10) EMIR.

1.9 Late submission:	*Yes/No, shows if the submission is beyond deadlines.*
1.10 Submission date of the ERR:	*dd mm yyyy.*
1.11 Date of the latest signed financial statements of the NFC:	*dd mm yyyy.*
1.12 The EMIR contact in the NFC:	*Individual's name, position held in the NFC.*
1.13 The EMIR contact's e-mail:	
1.14 The EMIR contact's telephone number:	
1.15 The EMIR contact's normal business address:	
1.16 The Directors/ Partners who are signing this ERR:	*Directors/ Partners names + Titles (if appropriate).*
1.17 The Third Party Assessor's name:	
1.18 The Third Party Assessor's company:	
1.19 The Third Party Assessor's e-mail address:	
1.20 The Third Party Assessor's telephone number:	
1.21 The Third Party Assessor's address:	

Comments of the Directors/Partners/Sole Trader [14]:

SECTION ONE-Notes

The questions seek data that is required under specific provisions of Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories ("**EMIR**") or Statutory Instrument No. 443 of 2014 European Union (European Markets Infrastructure) Regulations 2014 (the "**S.I**.").

1.1 EMIR Required: Detail the legal name of the NFC to derivative contracts. Article 9 (1) of EMIR, specifies that the counterparties to any derivative contract must ensure that the details of it and any modification or termination to it, are reported to a TR.

1.2 EMIR Required: Article 3 (1) of Commission Implementing Regulation (EU) No 1247/2012, requires that a legal entity identifier be used to identify (a) a beneficiary which is a legal person or (e) a counterparty which is a legal entity.

1.3 EMIR Required: Article 3 (1) of Commission Implementing Regulation (EU) No 1247/2012, requires that a LEI is used. As specified in the ESMA Questions and Answers on the implementation of EMIR for individuals who cannot access LEIs, they can use client codes[15].

1.4 EMIR Required: For individuals who have reported using client codes only please specify which entity provided it.

1.5 (a) & (b) EMIR Required: To assist with building the Central Bank's data on NFCs affected by EMIR.

1.6 & 1.6 (a) EMIR Required: Articles 1 & 2 of EMIR deal with the concept of entities which may become subject to the reporting obligations. For example, a NFC is defined in Article 2 (9), the definition of what constitutes a pension scheme arrangement is explored in Article 2 (10) and the definition of a public sector entity is set out in Article 1 5. (b).

1.7 S.I. Regulation 14 (1) (b) (iii): The Central Bank can specify in a notice the period for which an ERR should be submitted to the Central Bank and the deadline for doing so. The Central Bank is further empowered to issue Rules and Standards under the S.I. (Regulation 13).

[14] Listed in 1.16 or 1.1.
[15] Cross-refer to TR Q 10 (a) & (b) (24 October 2014. ESMA/2014/1300)

1. 8 S.I. Regulation 14 (3): The Central Bank may only ask a NFC to submit an ERR once in any twelve month period.

1.9 S.I. Regulation 14 (3): The Central Bank will require this information, as it will highlight if there is any period of time which is un-accounted for by an ERR. This should detail if the submission of an ERR has fallen outside of the deadline specified in a notice referred to in 1.7 above.

1.10 The ERR shall be submitted within three months of the date specified in 1.7 above; please cross-refer to Question 4 in the Consultation Paper.

1.11 Information Request: To assist with building the Central Bank's data on NFCs, affected by EMIR. Please cross-refer to Question 4 in the Consultation Paper and the commentary dealing with this matter.

1.12-1.15 The Central Bank shall require this detail in the event that there is a need to contact the NFC regarding its submission.

1.16 S.I. Regulation 14 (4) (a): The Central Bank will require the names of the directors/partners who are the signatories to the ERR.

1.17-1.21 S.I. Regulation 14 (4) (b): The Central Bank will require that the individual, who is signing on behalf of the Third Party Assessor, provides us with various details, so that we may contact him/her directly in the event that we have any queries regarding the submitted ERR.

Section Two: Reporting Obligations

Table 2.1

2.1 (a) Has the NFC reported **directly** to Trade Repositories (TRs)?	*No/Yes. If yes, name(s) of TR(s) the NFC reports directly to.*
2.1 (b) Has the NFC delegated reporting to TRs?	*No/Yes. If yes, name of the party/parties to whom reporting is delegated.* *Please specify the nature of the relationship i.e. is a group entity reporting on behalf of the NFC.* *Please also specify the TR(s) which the delegated party/parties reported to.*

Table 2.2

Derivative Class	No. of contracts which have been concluded, modified or terminated, during the NFC 's reference period for the ERR	No. of contracts which have been concluded, modified or terminated, and reported to a TR, during the NFC's reference period for the ERR (confirm name of TR and numbers reported to TR.)	Difference
commodities	*e.g. 15*	*e.g. 10 DTCC* *1 Regis TR* *4 UnaVista*	*0*
credit			
foreign exchange			
equity			
interest rate			
other			

2.2(a)	No. of late reports	

Table 2.3

Derivative Class	No. of live contracts as at the reference date of the ERR	No. of live contracts, reported to a TR, as at reference date of the ERR (confirm name of TR and numbers reported to TR).	Difference
commodities	*e.g. 5*	*e.g. 5 DTCC*	*0*
credit			
foreign exchange			
equity			
interest rate			
other			

Table 2.4

2.4 (a) No. of derivative contracts for which the last reported valuation is pre-dating the last reconciliation.	
2.4 (b) No. of reported valuations which have not been provided by an independent third party or market quote.	
2.4 (c) No. of trades which have been confirmed late (in relation to timely	

confirmation obligations).	

Table 2.5

Derivative Class	Gross volume (in Euros) of derivative contracts entered into during the reference period of the ERR	Gross stock (in Euros) of derivative contracts as at the reference date of the ERR
commodities		
credit		
foreign exchange		
equity		
interest rate		
other		
Total		

Table 2.6

2.6(a) Has a hedging model been used?	*Yes/No*
2.6(b) If applicable, please specify hedging model	*Internal or IFRS*
2.6(c) Is a reporting log maintained, which identifies the person(s) which requested the modifications of the data registered with the TR/TRs, the reason for such modifications, a date and time stamp and a clear description of the changes?	*Yes/No*

Comments of the Directors/Partners/Sole Trader:

If applicable, please provide an explanation for late reports – Section 2.2(a)

SECTION TWO-NOTES

Table 2.1

2.1 (a) & 2.1 (b) EMIR Requirement, Article 9 (1): Counterparties engaging in derivatives shall ensure that, if the contract is concluded, terminated or modified the details are reported to a TR. Counterparties may delegate reporting.

Table 2.2

EMIR Requirement, Article 9 (1): Counterparties engaging in derivatives shall ensure that, if the contract is concluded, terminated or modified the details are reported to a TR. For counterparties who have traded in foreign exchange, please note the Central Bank's advice as detailed on our webpage.[16]

[16] **-**All FX transactions with settlement before or on the relevant spot date are not to be reported;
- All FX transactions with settlement beyond seven days are to be reported;
- All FX transactions with settlement between the spot date and seven days (inclusive) are to be reported only if, in a jurisdiction where one counterparty to the trade is located, local laws, rules or guidance would deem the transaction reportable; and where one counterparty is located in another jurisdiction the Irish counterparty should rely on documentation from that counterparty to inform it that there is a requirement in their jurisdiction.

2.2 (a) EMIR Requirement: It has been acknowledged that there were issues with NFCs accessing TRs directly after the commencement of the reporting obligation. Please provide detail of any reports which were submitted outside of the parameters for reporting as specified in Article 5 of Commission Implementing Regulation (EU) No 1247/2012.

Table 2.3

EMIR Requirement: So that the Central Bank can assess reporting compliance under Article 9 EMIR.

Table 2.4

2.4 (a) & 2.4 (b) EMIR Requirement: When reconciling a NFC must include a value for a contract, i.e. reconciliation implies a synchronised valuation.

2.4 (c) EMIR Requirement, Article 12 of Commission Delegated Regulation (EU) No 149/2013: Sets out the requirement for timely confirmation in respect of the various asset classes.

Table 2.5

EMIR Requirement: So that the Central Bank can check reporting compliance under Article 9 EMIR.

Table 2.6

2.6 (a) & 2.6 (b) EMIR Requirement, Article 10 of Commission Delegated Regulation (EU) No 149/2013: Is a NFC engaging in hedging i.e. where an OTC derivative contract is objectively measurable as reducing risks relating to the NFC's or its group's commercial activity or treasury financing activity? If so please detail whether an IFRS or an internal model was used.

2.6 (c) EMIR Requirement Article 4 of Commission Delegated Regulation (EU) No 148/2013: This is a direct requirement.

Section Three: Risk mitigation techniques[17] for non-centrally cleared OTC derivatives

Table 3.1

3.1 (a)	Is there a log maintained of any disputes?	*Yes/No*
3.1 (b)	What number of disputes were there during period to which the ERR relates?	*Number*
3.1(c)	What is the current number of outstanding disputes? What is the number of disputes, which were not resolved within 5 business days?	*Number* *Number*
3.1 (d)	Please clarify that the NFC has formalised detailed processes and procedures in relation to dispute resolution, with any counterparty, which it has entered into an OTC derivative contract with?	*Yes/No*

Table 3.2

Counterparty Name	LEI	No. of contracts	Date of last reconciliation	Procedure - has a portfolio reconciliation process been agreed?	Date of last compression?
				Yes/No	
				Yes/No	
				Yes/No	
				Yes/No	
				Yes/No	
				Yes/No	
				Yes/No	

[17] Any reference to risk mitigation techniques is a reference to risk mitigation techniques as outlined in EMIR.

SECTION THREE–NOTES

Table 3.1

3.1 (a)-(d) EMIR Requirement, Article 15 Commission Delegated Regulation (EU) No 149/2013: Requires that counterparties to OTC derivative contracts have dispute resolution procedures in place, regarding the valuation of OTC derivative contracts and the exchange of collateral between counterparties. These procedures must at least record the length of time the dispute remains outstanding, the amount and the specific counterparty. There should be a specific procedure in place for disputes which are not resolved within five business days.

Table 3.2

Reconciliation

EMIR Requirement, Article 13 of Commission Delegated Regulation (EU) No 149/2013: Sets out that prior to entering into a contract for an OTC derivative, the counterparties (including NFC -)[18] must agree in writing, or equivalent electronic means, the manner in which the portfolios shall be reconciled.

This process can be performed by the counterparties to the contract or alternatively by a third party, who has been mandated by one of the counterparties. The Article sets out the issues that shall need to be covered in this process making specific reference to valuation which has been attributed to each OTC derivative contract in accordance with Article 11(2) of EMIR.

A NFC - must reconcile on a quarterly basis where they have more than 100 OTC derivative contracts outstanding with another counterparty at any time during the quarter or once per year where counterparties have one hundred or less OTC derivative contracts outstanding with each other.

Compression

EMIR Requirement, Article 14 in the Commission Delegated Regulation (EU) No 149/2013: specifies that when a NFC enters into 500 or more OTC derivative contracts with a counterparty and such contracts are not centrally cleared. The counterparty must have in place procedures to regularly and, at the very least twice a year, analyse the possibility of carrying out a portfolio compression exercise.

Article 14 goes further and sets out that an entity shall have a reasonable and valid explanation for the competent authority setting out why they have concluded that such a portfolio compression exercise is not required.

[18] A NFC- is a NFC, which has not become subject to the clearing obligation under Article 10 EMIR.

Comments of the Directors/Partners/Sole Trader:

I declare that the information which has been detailed in section 1, section 2 and section 3 is complete and accurate to the best of my knowledge.

Signed by:

Director/ Partner/Sole Trader of the NFC: ______________________________

Director/ Partner/Sole Trader of the NFC: ______________________________

DRAFT Report of Factual Findings of the Third Party Assessor

DRAFT Illustration of a Report of Factual Findings in connection with the NFC's EMIR Obligations

REPORT OF FACTUAL FINDINGS

To the Central Bank of Ireland

We have performed the procedures in accordance with the Central Bank's rules and standards with respect to [insert name of NFC] as at (the date of the ERR).

It is the Central Bank's intention that the Third Party Assessors engagement is undertaken in a manner equivalent to or in accordance with the International Standard on Related Services 4400 applicable to agreed-upon procedures engagements. Please note that we welcome feedback from representative professional bodies on this matter.

This report has been prepared for and on behalf of [insert name of NFC] and for the purpose of submission to the Central Bank of Ireland in accordance with Regulation 14 (1) (b) (ii) of Statutory Instrument No. 443 of 2014 European Union (European Markets Infrastructure) Regulations 2014.

This report is provided for the purposes of assessing the validity of [insert name of NFC's] compliance with EMIR and S.I. 443 of 2014 as evidenced by [insert name of NFC] responses in Sections One, Two and Three of the EMIR Regulatory Return.

This report has been prepared on the basis of information and/or documentation provided to us by [insert name of NFC] as follows:

1. [Example procedure required]

The Central Bank intends to include a formal checklist which we shall require a Third Party Assessor to complete. The questions will seek a binary response, for example.

Does the NFC's records specifying the number and asset classes of derivative contracts which have been concluded, modified or terminated during the reference period of the ERR match its TR or TRs records?

Third Party Assessor Response: Yes/No.

We report our findings below, detailing any exceptions:
1.
2.
3.

We recognise that there may be some specific professional disclosures required to indicate a limitation of the scope of the assessment of a Third Party Assessor.

The exact format of this report shall be developed further following engagement with the various professional representative bodies.

Our procedures did not constitute either an audit or a review made in accordance with generally accepted auditing standards, the objective of which would be the expression of assurance on the information provided by the NFC. We do not express such assurance. Had we performed additional procedures or had we performed an audit or review of the information provided by the NFC in accordance with generally accepted auditing standards, other matters might have come to our attention that would have been reported to you.

The nature, form and content of the responses has been determined by the NFC, it is not appropriate for us to assess whether the nature of the information being reported upon is suitable or appropriate for the Central Bank of Ireland's purposes. Accordingly we make no such assessment.

Our report is solely for the purpose set forth in the second paragraph of this report and for your information and is not to be used for any other purpose or to be distributed to any other parties. This report relates only to the items specified above and does not extend to any financial statements of the NFC, taken as a whole.

In relation to matters which fall under Section Four-Voluntary Disclosure we have not verified, assessed or reviewed any aspect of [insert name of NFC] responses.

Signature of Third Party Assessor:

Date:

Section Four-VOLUNTARY DISCLOSURE

<u>This does not form part of the mandatory ERR</u>

a) Please specify the legal structure of the NFC:	*[drop down text box]*
b) The NFC/Group Website:	*If applicable, if not please mark as n/a.*
c) The NFC's Companies Registration Office number:	*If applicable, if not please mark as n/a.*
d) Description of business activity of the NFC:	
e) The No. of employees in the NFC:	
f) The level of turnover as per the last set of signed financial statements:	
g) Which NACE code does the NFC fall into?	
h) Description of the NFC's use of derivative strategies:	
i) The Group parent:	*Please provide the name of the parent or if not applicable please mark as N/a.*
j) Does the NFC currently clear derivatives?	*No/Yes. If yes please provide the name of the CCP, type of contracts cleared, clearing brokers.*
k) Does the NFC margin derivatives bilaterally with counterparties?	*No/Yes. If yes, please provide the name of counterparties, the types of contract cleared, type of margin arrangement.*

l) If the Board of Directors approval of the dispute resolution procedures was required, please specify which minutes of a meeting of the Board of Directors record the granting of this approval.	*[insert date]*
m) Alternatively please specify who approved the dispute resolution procedures.	
n) Has the NFC entered into an ISDA agreement, with any of its counterparties?	*If applicable, please provide details, of the counterparties. If not please mark as n/a.*

SECTION FOUR–NOTES

a) Information Request: To assist with building the Central Bank's data on NFCs, affected by EMIR.

b) Information Request: To assist with building the Central Bank's data on NFCs, affected by EMIR.

c) Information Request: To assist with building the Central Bank's data on NFCs affected by EMIR.

d) Information Request: A brief description of the business activity of the NFC.

e) Information Request: How many employees are directly employed by the NFC?

f) Information Request: What is the gross amount of turnover as specified in the most recent set of signed financial statements.

g) Information Request: Please refer to www.cso.ie for information on NACE codes.

h) Information Request: Outline the rationale for the NFC engaging in derivatives. What is the underlying purpose? What is the strategy?

i) Information Request: Is there a group structure? If so, provide details of same.

j) Information Request: The Central Bank acknowledges that it is unlikely that many NFCs will be clearing OTC derivative contracts. Notwithstanding this, we would be obliged if in the event that a NFC is clearing, you might provide us with details.

k) Information Request: Again the Central Bank acknowledges that it is unlikely that any of the NFCs will be bilaterally margining at this stage. However, in the event that a NFC is doing so we would be obliged if the relevant information could be provided to us.

l) Information Request: EMIR is silent on the approval of such processes however we would ask that you provide details of the approval of any such procedures.

m) Information Request: EMIR is silent on the approval of such processes however we would ask that you provide details of the approval of any such procedures.

n) Information request: This is not a direct requirement under EMIR however, if an ISDA agreement has been entered into, please comment or mark as not applicable.

ANNEX TWO –ACRONYMS

CCP: Central Counterparty.

FC: Financial Counterparty.

EMIR: Regulation (EU) 648/2012 of the European Parliament and of the Council of 4 July 2012, on OTC derivatives, central counterparties and trade repositories.

ERR: EMIR Regulatory Return.

ESMA: European Securities and Markets Authority.

EBA: European Banking Authority.

NCA: National Competent Authority.

NFC: Non-Financial Counterparty.

S.I.: Statutory Instrument No. 443 of 2014 European Union (European Markets Infrastructure) Regulations 2014.

TR: Trade Repository.

ANNEX THREE – NFC EMIR OBLIGATIONS

	Reporting of all derivatives to a TR	Independently assessed ERR to be submitted to the Bank.	Mandatory[19] clearing of certain OTC derivatives through a CCP	Mark to market valuations reported to a Trade Repository	Bilateral margining re non-centrally cleared OTC derivatives	Risk Mitigation techniques for non-centrally cleared OTC derivatives
NFC+	√		√	√	√	√
NFC- above the exemption in the S.I.	√	√				√
NFC- below the exemptions in the S.I.	√					√

[19] Clarity on the commencement of the clearing and bilateral margining obligations for NFC+s is likely to follow in due course.

Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

Bosca PO 559, Sráid an Dáma, Baile Átha Cliath 2, Éire