Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

2015

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

(Consultation Paper 90)

Contents

Introduction

1. On 4 December 2014, the Central Bank of Ireland ('the Central Bank') published Consultation Paper CP90 *Consultation on the Supervision of Non-Financial Counterparties under EMIR*. The closing date for comments was 30 January 2015 and 14 responses were received from trade bodies, associations and individual firms.

2. By way of background, on 8 October 2014 the Central Bank was appointed as the National Competent Authority ("NCA") for European Union (European Markets Infrastructure) Regulations 2014 (S.I. No 443/2014 – 'EMIR S.I.') on over the counter ("OTC") derivatives, central counterparties ("CCPs") and trade repositories ("TRs"). Under this appointment, the Central Bank has a number of responsibilities, including:
   a. Authorisation and supervision of Irish-domiciled CCPs;
   b. Supervision of EMIR compliance by Financial Counterparties ("FCs"), most of which are firms which are subject to regulation by the Central Bank under pre-existing legislation and include, for example, credit institutions, investment firms and UCITS management companies;
   c. Supervision of EMIR compliance by Non-Financial Counterparties ("NFCs") and Pension Schemes, most of which are not supervised by the Central Bank under any other piece of pre-existing legislation.

3. Supervision of EMIR compliance by NFCs proves particularly challenging for the Central Bank for a number of reasons including:
   a. Most NFCs are not pre-authorised to carry out the derivative activity for which they are now supervised. EMIR does not require counterparties to seek authorisation to engage in derivatives. Therefore, unlike FCs, NFCs become subject to the Central Bank's supervision by the act of entering into a derivative, ex-post. The result is a distinctive information asymmetry faced by the Central Bank when engaging with NFCs, and the limited applicability of our standard supervisory framework; and
   b. The Central Bank's supervision does not encompass every aspect of a NFC's business activity but is limited to its derivative activity only. Simply put, our mandate is to ensure that NFCs follow the rules in reporting their trades, clear or margin them when required and have appropriate risk mitigation techniques in place for uncleared trades, but there is no constraint as to which trades they decide to engage in or the business purpose for doing so. This is different to the standard supervisory approach for FCs.

4. CP90 raised 8 specific questions for respondents to address. The section headed "Feedback on CP90" briefly summarises the responses received to each question along with the Central Bank's comments and decisions.

5. CP90 sought the views of industry on the practical implications of the Central Bank's proposed approach to supervising compliance with the EMIR S.I., with particular reference to NFCs. Central to our proposed approach was the deployment of a new supervisory tool, the EMIR Regulatory Return ('ERR') which the Central Bank has the power under the EMIR S.I. to request from counterparties.

6. The Central Bank has modified the supervisory model proposed in CP90 for NFCs which are not above the clearing threshold (i.e. NFC-) to adopt a risk-based approach to the supervision of these counterparties. The approach has been modified to allow it to be used in a two tiered manner:

   (i) The originally proposed ERR ("original ERR"), assessed by a third party, will take the form of a supervisory tool the Central Bank will use on an exceptional basis, primarily in cases of non-compliance, and may be tailored for the particular entity and the particular circumstances.

   (ii) For the purpose of assessing compliance with EMIR a shorter, focussed ERR (the "Annual ERR"), without the third party assessor regime, will be required on an annual basis from a targeted selection of NFCs that have significant derivative positions but are not classified as NFC+.

   The Central Bank will notify counterparties that will be required to submit the Annual ERR in writing by end-September 2015. Relevant counterparties will be required to complete and submit an Annual ERR in relation to the period 1 January 2015 to 31 December 2015 by end-January 2016 and on an annual basis thereafter.

   The revised model takes into account the size and complexity of derivatives activity by NFC- counterparties. The revised model also facilitates the Central Bank in fulfilling its mandate and responsibilities as competent authority under EMIR and ensures that its model of supervision is effective and proportionate. The section headed "Revised Supervisory Approach" briefly summarises the key features of the initial implementation of the revised model.

7. The Central Bank will keep its supervisory requirements under review to ensure that they remain effective and this revised supervisory model may be subject to change without further public consultation. Information on the Central Bank's supervision under EMIR will be published on our website.

8. Nothing in this feedback statement should be read with, seen as a clarification of, or a supplement to the EMIR S.I. This feedback statement is published to promote understanding of the policy formation process within the Central Bank and is not relevant to assessing compliance with regulatory requirements. Additionally nothing in this feedback statement will preclude the Central Bank from taking action in respect of an individual counterparty or group of counterparties at its discretion.

Revised Model of EMIR Supervision

1. The main aim of EMIR is to increase transparency and improve risk management for derivative users and to provide competent authorities with information regarding the extent of derivative trading which enables them to fulfil their mandates and responsibilities. In order to achieve this, data available to competent authorities must be complete, accurate and reliable.

2. Therefore, one of the Central Bank's main supervisory tasks will be to achieve improved data quality from NFCs and FCs. Mindful of the nature of the risks posed by derivative users the Central Bank will, where possible, apply a risk-based model by focusing on larger users of more complex derivative products first – notably Interest Rate Swaps and Credit Derivatives.

3. The Central Bank will follow-up with counterparties where trade repositories have identified a high level of reports that have failed to pass their validation checks on submission.

4. In the near future the Central Bank will undertake a campaign of data validation, in conjunction with the Europe-wide ESMA initiative, details of which will be published on our website. The program will entail checking data from both financial and non-financial counterparties. The campaign will be progressive in two ways:
   - In terms of fields, concentrating first on anomalies regarding identifiers (LEI, UTI, UPI), and progressively extending the scrutiny to other defining elements of the transaction (dates, timestamps, and valuations).
   - In terms of asset classes, prioritising on the basis of the systemic risk and oncoming regulatory deadlines. The proposed sequence is as follows:
     - Interest Rate derivatives
     - Credit derivatives
     - Equity derivatives
     - Commodity and other derivatives
     - Foreign exchange derivatives

5. In order to assess compliance with EMIR, NFCs that have been identified by the Central Bank through a review of trade repository data as having significant derivative positions will be required to complete and submit certain key sections of the ERR on an annual basis. Relevant NFCs will not be required to appoint a third party assessor to review this report in advance of submission to the Central Bank. The requirement to submit a return will be

advised to relevant NFCs on a bi-lateral basis by end-September of the relevant year and relevant counterparties will be required to complete the Annual ERR for that calendar year and on an annual basis thereafter. The Annual ERR will be due for submission by end-January of the following year.

6. The Central Bank will also undertake a series of bilateral meetings with a sub-set of significant users of derivatives within the State.

Feedback on CP90

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?

The majority of respondents were not in favour of the proposed categorisation and believed that it should be reconstructed and aligned with ESMA categorisation. It was noted that the EMIR Framework at an EU level does not distinguish between large and small NFC-s nor does it adopt a categorisation of complex/non-complex NFC-s. It was the general view of respondents that the current distinction between NFC-s and NFC+s is sufficient and well understood by the marketplace.

A number of respondents noted the challenges faced by the Central Bank in developing a national supervisory framework, and supported a risk-based supervisory approach to EMIR compliance.

A large number of respondents were opposed to the introduction of the ERR as described in CP90. The main arguments against the introduction of the ERR were costs, which are perceived as high and disproportionate to the regulatory objectives; and the range of application, with a broad support for not imposing it on counterparties that carry notional portfolios below the clearing threshold, and therefore make use of hedging techniques. Some concerns were expressed in relation to competing on a level playing field with other jurisdictions that have no comparable obligations, and the negative repercussions in terms of competitiveness for Irish derivatives users that this would imply.

Central Bank : A modified version of the ERR, the Annual ERR, that is not required to be assessed by a third party, will only be required from counterparties that are not classified as NFC+ and have been identified by the Central Bank as having significant derivative positions.

The original ERR will only be used in conjunction with a third party assessor on an exceptional basis, primarily in cases of non-compliance by any NFC above the EMIR S.I. threshold.

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

Most respondents were not in favour of a higher minimum threshold as described in CP90 and did not support the sub-categorisation of NFC-s. Some respondents questioned the validity of the three criteria used to categorise, noting that the number of contracts and gross notional value of the contracts should be sufficient to determine the systemic relevance of entities in the market. In their view there is no merit in distinguishing between small and medium NFCs, particularly taking the nature of their activities into account.

There was strong opposition against extending direct supervisory engagement to NFCs below the clearing threshold, either in a mandatory or a voluntary fashion.

Central Bank: The Annual ERR will be required from a targeted selection of NFCs that have significant derivative positions but are not classified as an NFC+. Relevant counterparties will be advised of the requirement to submit the Annual ERR directly by the Central Bank by end September 2015.

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

Many operational difficulties were presented in response to the proposal to apply an ERR to NFC-s. A number of respondents encouraged the Central Bank to re-evaluate the purpose of their monitoring of NFC-s and the consequences of imposing the administrative and cost burden of ERRs on certain types of NFC-s. Others commented that obliging NFC-s to have an ERR reviewed by Third Party Assessors will impose unknown additional costs on NFC-s and is disproportionate to any benefit which it may provide.

Central Bank: The ERR, assessed by a third party, will be used in a more limited manner as a supervisory tool, primarily in cases of non-compliance. The Annual ERR, that is not required to be assessed by a third party, will be used as a compliance monitoring tool for NFCs with significant derivative positions.

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?

Responses to this question were mixed. Many noted the benefit of incorporating EMIR compliance within the auditing of financial statements. Some respondents, however, supported flexible submission times for the ERR, particularly at the outset, to enable NFC-s to familiarise themselves with the requirements and compile the necessary data.

Central Bank: The Annual ERR will be required on an annual basis from NFC-s that have significant derivative positions. The Central Bank will notify relevant NFC-s on a bilateral basis when they are required to report and the relevant dates applicable for the return.

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

In terms of funding, there is no consistency in the responses received. Some objected to any type of levy, others arguing for a flat fee, and others supporting a volume based model. Some responses challenged the assumption that the cost of outsourcing data-consistency compliance to NFC counterparties is less than the cost for the Bank of carrying it out in house.

Central Bank: Unlike regulated entities, which are subject to the statutory levies, there is no dedicated funding mechanism in place to cover supervisory costs for the vast majority of the NFC population. This matter remains under consideration by the Central Bank and any proposal to levy entities falling within the scope of EMIR, not already subject to supervisory levies, will be the subject of separate industry engagement.

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

Those that are not opposed to the framework suggest a number of qualifications to the use of the ERR, mainly through higher thresholds, carve out of certain types of trades, or application only to counterparties using non IFRS models or where directors do not disclose hedging policies. One respondent supported a flexible model capable of change to address practical issues as they arise.

Central Bank: Comments made in terms of format and content of the ERR will be taken on board in relation to subsequent versions of the ERR.

A copy of the Annual ERR is set out in Appendix 1

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

Most respondents are opposed to the requirement for a Third Party Assessor for reasons of costs and practicality as mentioned above. Some respondents who express support for the Third Party Assessor model do so under a number of qualifications. They question the effectiveness, or added value of the Third Party Assessor, where many argued in favour of self-assessment statements possibly in the context of the Directors' annual compliance statement under the Companies Act 2014 or the annual return (Form B1) submitted to the CRO. Concerns were also expressed regarding competing on a level playing field with other jurisdictions that have no comparable obligations, and the negative repercussions in terms of competitiveness for Irish derivatives users that this would imply.

Central Bank: The submission of an ERR reviewed by a third party assessor will only be required on a specific case-by-case basis, primarily where there are instances of non-compliance. The Central Bank considers that this focussed use of the ERR and the burden of paying for a third party assessor is a credible deterrent to breaches of EMIR reporting requirements.

The submission of an Annual ERR from NFCs with significant derivative positions will not require the objective assessment of a third party assessor.

Appendix I – The Annual ERR

Section One: Static 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.*
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(s), 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 body/ pension scheme arrangement.*
1.7 Reference start date of the Annual ERR:	*dd mm yyyy.*
1.8 Submission date of the Annual ERR:	*dd mm yyyy*
1.9 Date of the latest signed financial statements of the NFC:	*dd mm yyyy*
1.10 The EMIR contact in NFC:	*Individual's name, position held in the NFC.*
1.11 The EMIR contact e-mail:	
1.14 The EMIR contact telephone number:	
1.15 The EMIR contact normal business address:	
1.16 The Directors/ Partners who are signing this Annual ERR:	*Directors/ Partners names + Titles (if appropriate).*

Section Two: Reporting Obligations

Table 2.1: Number of contracts/Contracts reported to Trade Repository

Derivative Class	*No. of contracts which have been concluded, modified or terminated, during the NFC 's reference period for the Annual ERR*	*No. of contracts which have been concluded, modified or terminated, and reported to a Trade Repository (TR), during the NFC's reference period of Annual 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			
Total			
Number of late reports			

Table 2.2: Details of outstanding contracts and trading volume

Derivative Class	*No. of live contracts as at the reference date of Annual ERR*	*Gross notional (in euros) of derivative contracts entered into during the reference period of the Annual ERR (flow)*	*Gross stock (in euros) of derivative contracts outstanding as at the reference date of Annual ERR (stock)*
Commodities	e.g. 5		
Credit			
Foreign Exchange			
Equity			
Interest Rate			
Other			
Total			

Table 2.3: Hedging method

Are OTC derivative contracts used to reduce risks directly relating to the commercial activity or treasury financing activity of the NFC?	*Yes/No*
If applicable, please specify the method used to objectively measure how risks are reduced.	*e.g. Internal model or IFRS*

Section Three-Supplementary Information

a)	**Please specify the legal structure of the NFC:**	
b)	**The NFC/Group Website:**	*If applicable, if not please mark as n/a.*
c)	**The NFC's CRO 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 sector does the NFC fall into?**	*Please indicate the NACE[1] code.*
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)	**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.*

[1] http://www.cso.ie/px/u/NACECoder/Index.asp

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