

Issues of Legal uncertainty in implementing EMIR

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HSBC 

EMIR is a directly applicable regulation rather than a directive.
It is important that:

- Level 1 text is clear and unambiguous
- Article 290 TFEU delegated powers and Article 291 TFEU implementing powers are also clear.

Despite the length of the EMIR legislative process, the final text has many issues of legal uncertainty, for example, in terms of lack of definitions:

- a “non-financial counterparty” is defined as “an undertaking established in the Union
- What is an “undertaking”?
- What does “established” mean?

The EMIR text was published in the Official Journal on 27 July, 2012. It was not entirely clear which provisions would take effect on 16 August, 2012 and which would only come into effect after the implementation of regulatory technical standards. For example:

- Article 11(3) provides that “Financial Counterparties shall have risk management procedures that require the timely, accurate and appropriately segregated exchange of collateral with respect to OTC derivatives contracts that are entered into on or after 16 August 2012.”

Even though the Regulatory Technical Standards for Art 11(3) have yet to be published, the inclusion of the specific date in the final text raises two questions:

- Are Financial Counterparties obliged to exchange collateral with effect from 16 August, 2012?
- If the answer is no, does Art 11(3) apply retroactively to derivatives in existence on 16 August, 2012?

ISDA raised the issue with the EU Commission and the answer from Patrick Pearson was as follows:

“In this case the community legislator clearly decided in Article 11(3) that procedures requiring the timely, accurate and appropriate segregated exchange of collateral with respect to OTC contracts should be in place as of 16 August, 2012. To the extent that this provision is sufficiently clear and precise its requirements are directly applicable as from 16 August 2012.

The precise level and exact type of collateral to be exchanged will be specified by the Regulatory Technical Standards to be adopted by the Commission under Article 11(15). As long as those standards are not yet in place, counterparties have the freedom to apply their own rules.....I draw your attention to the fact that only the Court of Justice of the European Union can give an authoritative interpretation of Union legislation”.

Regulatory Technical Standards – some issues

Article 11(1) requires counterparties to put in place “appropriate procedures and arrangements including at least.....the timely confirmation, where available, by electronic means, of the terms of the relevant OTC derivative contract”.

Apart from issues such as a lack of definition of what a “confirmation” is, the RTS then went on to set hard deadlines, by asset class, for confirming trades.

This would seem to imply that ESMA could create more restrictive rules than the Level 1 text.

Following industry representations, the EU Commission published FAQs which confirmed that the RTS do not necessarily introduce hard deadlines. Instead “If a firm has appropriate procedures and arrangements in place, but nevertheless does not achieve the deadline for legitimate reasons, this should be reported to its competent authority.....[to] determine whether the firm has made sufficient efforts to achieve the deadlines”.

What can we do ?

- More active involvement in drafting suggested amendments both at the Level 1 stage and the Regulatory Technical Standards ?
- Should there be a mechanism in the legislative process to defer implementation, grant temporary relief etc. (similar to CFTC no action relief)?
- Respond to the ESA review ?