



January 2015

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

The European Market Infrastructure Regulation (“**EMIR**”) affects all entities “established” in the European Union<sup>1</sup> that enter into derivatives. Unlike other legislation covering financial services which only applies to regulated entities, EMIR has implications for all EU entities that enter derivatives;( i.e. to corporates, SPVs, pension funds unregulated funds etc).

By virtue of its appointment as the sole national competent authority in the State for EMIR<sup>2</sup>, the Central Bank of Ireland (the “**Central Bank**”) has been charged with a number of new responsibilities including supervising compliance with EMIR. In particular, the Central Bank has been tasked with supervising Non-Financial Counterparties<sup>3</sup> (“**NFCs**”), many of whom will not be known to the Central Bank simply because they are unregulated.

On 4 December 2014, the Central Bank published Consultation Paper 90 which contains proposals in relation to the supervision of NFCs under EMIR (the “**Consultation Paper**”). The Consultation Paper focuses on the supervision of EMIR compliance for NFCs, which present certain new challenges for the Central Bank. The Consultation Paper is relevant to any NFC and their service providers.

In addition, the Central Bank recently published an advertisement in

<sup>1</sup> EMIR may also affect non-EU entities in certain circumstances. Please see the publications section of our website for further information on how EMIR may affect non-EU entities.

<sup>2</sup> S.I. No. 443 of 2014

<sup>3</sup> A NFC is defined as any undertaking established in the EU that enters into derivatives and does not fall within the financial counterparty category. In other words, any non-regulated EU entity will be a NFC under EMIR.

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various publications addressed to users of derivatives in Ireland (the “**Notice**”). In the Notice, the Central Bank requests every NFC that has entered into a derivative transaction since 12 February 2014 to email its contact details to [emir@centralbank.ie](mailto:emir@centralbank.ie)

## The Central Bank’s Proposed Supervisory Framework for Non-Financial Counterparties

The Central Bank proposes to divide NFCs into three main categories;

- *Small NFCs*: This group is non-complex and trades primarily in foreign exchange OTC derivatives for hedging purposes
- *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; and
- *Large/Complex NFCs*: These are NFCs which have derivative positions that exceed the clearing thresholds which are set out in EMIR or have derivative positions that would exceed the clearing threshold but for the fact that certain positions are excluded from the relevant calculations because they constitute hedges of commercial or treasury activities.

In accordance with the Central Bank’s risk based supervisory approach, the categories referred to above will underpin the supervisory framework; i.e. Small NFC’s will be subjected to a lighter supervisory framework than Medium Sized NFCs and Large/Complex NFCs.

## The EMIR Regulatory Return (“ERR”)

Statutory Instrument No. 443 of 2014 European Union (European Markets Infrastructure) Regulations 2014 (the “**SI**”) introduces a new regulatory return; the EMIR Regulatory Return (“**ERR**”). An entity may not be required to submit an ERR more than once in a twelve month period.

The SI provides that certain NFCs meeting certain conditions shall be exempt from the requirement to submit a ERR where they satisfy the following conditions;

- The counterparty has had less than 100 outstanding OTC derivative contracts at any time during the reporting period to which an ERR relates;
- The counterparty has outstanding OTC derivative contracts which cumulatively have a gross notional value of less than €100 million; and
- The counterparty has delegated the reporting of the details of their OTC derivative contracts to a third party.

It is hoped that the ERR will provide the Central Bank with quantitative and qualitative data to map the population of NFCs engaging in derivatives, so that the Central Bank can learn and further fine tune its supervisory approach. It is also hoped that the ERR will provide the Central Bank with information relating to exceptions and cases/matters where the Central Bank should focus its supervisory attention.

The Consultation Paper contains a draft ERR at Annex One of the Consultation Paper, 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; asks questions on the number of contracts and outstanding portfolio positions;
- Section Three: Risk Mitigation Techniques. This section focuses on the data consistency and risk management requirements, like portfolio reconciliation and portfolio compression; and
- Section Four: Discretionary Information; this section seeks particulars to assist the Central Bank in understanding a NFC's business model etc.

The key aspect of the ERR is that it is signed by directors or partners of the reporting NFC and by an appointed Third Party Assessor; i.e. the S.I. introduces a requirement such that the ERR be independently assessed at the cost of the entity. In this regard the S.I. provides that the Central Bank may approve the appointment of such a Third Party Assessor where it is satisfied that the person has the requisite expertise to; (i) objectively assess whether the ERR has been prepared and completed in compliance with the S.I.; and (ii) perform the functions reasonably required of such a Third Party Assessor in respect of the ERR. The Central Bank has sought feedback on the form and content of the ERR.

## How does the Central Bank Intend Engaging with NFCs in the Proposed Supervisory Framework?

The Central Bank's proposed supervisory approach is outlined as follows:

- *Small NFCs*: will be subject to themed inspections and will also be required to submit a tailored ERR (provided that they are not exempt in the S.I.)
- *Medium Sized NFCs*: will be required to submit an annual ERR. The Central Bank also envisages that certain Medium Sized NFCs may subject to Central Bank consent, choose to opt-in to the supervisory regime proposed for large/complex NFCs.
- *Large/Complex NFC's*: would be subject to direct supervision by the Central Bank in a similar manner to the way Financial Counterparts are currently supervised by the Central Bank for the purposed of EMIR.

## Questions for Consideration

The questions for consideration which are set out in the Consultation Paper are as follows:

*Question One:*

Do you think that the Central Bank's categorisation of NFCs into (i) small NFCs (ii) medium sized NFCs and (iii) large/complex NFCs as outlined in the Consultation Paper is the optimal categorisation which the Central Bank should use to underpin its supervisory framework? If not what other categorisation would you propose?

*Question Two:*

Should the minimum threshold below which the Central Bank cannot seek an independent assessment of the ERR 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 the proposed supervisory approach which is outlined in the Consultation Paper?  
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 the Central Bank 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 in the Consultation Paper, are the Central Bank asking the right questions in the ERR? If there are questions which can be improved upon, please let the Central Bank have this feedback.

*Question Seven:*

If there is specific feedback regarding any professional disclosures to be included in the Report of Factual Findings which the Third Party Assessor would complete, please submit details to the Central Bank.

*Question Eight:*

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

## Conclusion

The consultation process runs from 4 December until 30 January 2015. The Central Bank welcomes comments and views from all interested parties by email to [emir@centralbank.ie](mailto: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

The closing date for submissions on the Consultation Paper is 30 January 2015. It is intended that submissions will be published on the Central Bank website [www.centralbank.ie](http://www.centralbank.ie).

A copy of the Consultation Paper can be accessed via the following link:

<http://www.centralbank.ie/regulation/processes/protected-disclosures/Documents/Industry%20Letter.pdf>

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