DILLON EUSTACE

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December 2017

EMIR Update – Central Bank issues Statement on the Variation Margin requirements for physically-settled FX forwards

Central Bank Statement

The Central Bank issued a statement on 19 December 2017 in response to the European Supervisory Authorities ("**ESAs**") joint statement on 24 November 2017 in respect of the requirement under EMIR's regulatory technical standards (the "**Margin RTS**") to exchange variation margin for physically-settled FX forwards from 3 January 2018 (the "**ESAs Statement**"). This follows-on from similar statements recently issued by, inter alia, the Financial Conduct Authority (FCA) in the UK on 7 December and the Federal Financial Supervisory Authority (BaFin) in Germany on 12 December in support of the ESAs Statement and providing guidance to the market.

The Central Bank's statement provided the following:

- it welcomed the ESAs Statement;
- it noted that the ESAs are undertaking a review of the relevant requirements and will propose some targeted amendments which are likely to continue to require the exchange of variation margin for physically-settled FX forwards in a risk-based and proportionate manner but to limit the scope to transactions between institutions (credit institutions and investment firms);

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- it confirmed that, in accordance with the recommendation from the ESAs and pending the outcome from their review, it will apply its risk-based supervisory powers in the day-to-day enforcement of applicable legislation in a proportionate manner.

Pending entry into force of the amendments to the Margin RTS (as referred to below), which will not be formally adopted before the 3 January 2018 deadline in respect of the requirement to exchange variation margin for physically-settled FX forwards, the ESAs are of the view that "*for institution to non-institution transactions the competent authorities should apply the EU framework in a risk-based and proportionate manner until the amended RTS enter into force*." The ESAs draft amendments to the Margin RTS provide a derogation from exchanging variation margin where transactions involve counterparties that are not "institutions" within the meaning of the Capital Requirements Regulation (i.e. credit institutions or investment firms). Such counterparties (who will be in a position to avail of this derogation) would include investment funds. In the interim period (prior to formal adoption of the amendments to the Margin RTS), although not expressly stated, it may be inferred from the Central Bank's statement that investment funds do not need to comply with the relevant requirement to exchange variation margin for physically-settled FX forwards.

Recent EU regulatory background

On 4 May 2017, the European Commission published its proposal to amend the European Market Infrastructure Regulation ("**EMIR**"). Certain end-user counterparties of physically-settled FX forwards in Europe have faced challenges in seeking to implement procedures to comply with the variation margin requirement from 3 January 2018.

On 24 November 2017, in the ESAs Statement, the ESAs announced that they were reviewing the Margin RTS and developing draft amendments to "*align the treatment of variation margin for physically-settled FX forwards with the supervisory guidance applicable in other key jurisdictions*". The ESAs reiterated their commitment to apply the international standards and "*require the exchange of variation margin for physically-settled FX forwards in a risk based and proportionate manner*" and in particular, "*this would most likely imply that the scope should cover transactions between institutions (i.e. credit institutions and investment firms)*" but suggested that certain transactions with end-users (i.e. *institution to non-institution*, which would include investment funds) could be brought outside scope. In light of the difficulties certain end-users are facing, the ESAs referred to their expectation that EU national competent authorities should "*generally apply their risk based supervisory powers in their day to day enforcement of applicable legislation in a proportionate manner*."

On 18 December 2017, the ESAs followed up by issuing draft amendments to the Margin RTS which exempt certain counterparties, including investment funds, from the variation margin requirement in respect of physically-settled FX forwards. The amendments to the Margin RTS and their subsequent implementation would re-iterate the ESAs commitment to apply the international standards with a more comparable scope to that of other key jurisdictions, as referred to above.

For further information on EMIR, please refer to previous briefings issued by Dillon Eustace including the briefing entitled "Proposal for EMIR Reform – targeted changes with important consequences for AIFs, AIFMs and UCITS Management Companies''.

If you require any further information in relation to the above or EMIR generally, please refer to your usual contact within Dillon Eustace.

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