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## EMIR AND BREXIT UPDATE

### Amendments to EMIR herald a new tiered system for third-country CCP authorizations in Europe

Following their publication by the European Parliament and Council of Regulation on 23 October 2019, a number of amendments to Regulation (EU) No 648/2012 (“EMIR”) took effect on 12 December concerning the regulation of central counterparties (“CCPs”). The following provides a brief summary of the reforms pursuant to (EU) 2019/2099 (the “Regulation”) that, in the context of the impending departure of the United Kingdom from the European Union (“EU”), risk presenting significant challenges for EU counterparties. Certain changes concern only third-country (non-EU) CCPs and are presented first, while the remaining changes pertain to EU CCPs.

#### Enhanced regulation of third country CCPs

##### Third-country CCPs to be categorized as Tier 1 or Tier 2

Perhaps the most significant innovation in the new Regulation is the creation of two new categories of CCPs. The Regulation introduces a tiered system for the authorization of third-country CCPs, pursuant to which all third-country CCPs must be designated as either Tier 1 (and therefore not systemically important) or Tier 2 (systemically important). Tier 1 CCPs are those deemed non-systemic based on a number of criteria, including the nature, size and complexity of the CCP’s business in the EU, as well as its risk profile and interconnectedness to other financial market infrastructures and institutions.

Under a new Article 25(2b), Tier 2 CCPs now must satisfy additional conditions in order to receive authorization by the European Securities and Markets Authority (“ESMA”), and such authorization may be limited to certain services or activities. As amended by the Regulation, EMIR now requires Tier 2 (systemically important) third-country CCPs to comply with the capital requirements of EMIR (Article 16) as well as the full scale of requirements and interoperability arrangements for EU CCPs under Titles IV and V.

Finally, under a new Article 25(2c), ESMA may now conclude that a third-country CCP is of such substantial systemic importance that it should not be recognized unless it receives authorization by the competent authority of an EU member state. Consequently, such CCP must seek establishment in the EU (subject to and following an adaptation period).

The Regulation requires adoption of technical standards by 2 January 2021, following which ESMA shall classify, and make public their classification of, third-country CCPs seeking recognition to provide services in the EU as either Tier 1 or Tier 2.

## Review of recognition status for third-country CCPs

Under Article 25 as amended by the Regulation, ESMA shall now review the recognition of a third-country CCP every five years, and where appropriate, reclassify a Tier 1 CCP as a Tier 2 CCP, subject to an adaptation period of up to two years. With respect to Tier 2 CCPs, ESMA shall require annual confirmation of their compliance with certain of the new requirements under Article 25(2b) (which include an independent legal opinion confirming the CCP's consent to providing documents, records and onsite access).

Additionally, withdrawal of ESMA's recognition of a third-country CCP is now mandatory under certain circumstances, including in the event the CCP has not made use of its recognition decision within six months.

## Penalties for infringements and remedies available to ESMA

Finally, the Regulation introduces a number of remedies available to ESMA to enforce the obligations of third-country CCPs under EMIR. Third-country CCPs shall now be subject to fines relating to a number of infringements (the majority of which shall apply only to Tier 2 CCPs), in an amount of up to 10% of the CCP's annual turnover. ESMA may also impose penalties on Tier 2 CCPs (including any third parties to whom they have outsourced their operations or services) for their failure to supply information requested or their refusal to submit to investigations or on-site inspections.

## Changes relevant to EU CCPs

### Reinforced role of central banks

An emerging theme of the reforms is the enhanced profile given to central banks; central banks are now to be specifically solicited in determining the systemic importance of a CCP (and may impose certain requirements the central bank views as necessary to address systemic liquidity risks), and monetary policy is highlighted as underpinning the decision-making process by competent authorities, particularly in emergency situations (as per Article 24). Further enshrining its oversight role, the European Central Bank is now given two votes in decisions concerning CCP authorization by the supervisory college under Article 19 of EMIR.

### Competent authorities' independence diminished?

While the Regulation serves to strengthen the role of central banks, competent authorities risk seeing their role circumscribed at the expense of implementing uniform standards of review in their evaluation of CCPs. Whereas "strengthening consistency in supervisory outcomes" was previously a stated goal but not obligatory, ESMA shall now, pursuant to Article 21, prescribe the procedures and methodologies for supervisory review to apply across all member states. In addition, competent authorities must now submit draft decisions to ESMA prior to their adoption in respect of a host of issues, and where a member state opts to depart from ESMA's opinion, its decision to do so must be accounted for and justified.

### New procedures for CCPs to follow

While CCPs were previously required to obtain independent validation of their models determining margin requirements, default contributions and other risk control mechanisms, the Regulation now requires that any "significant" change to such models be authorized by the relevant competent authority and ESMA following consultation with the supervisory college.

## Introduction of CCP supervisory committee

Finally, the Regulation introduces a new Article 24a providing for the creation of CCP supervisory committees, which are tasked with drafting decisions and opinions relating to CCP authorizations as well as playing a key oversight role.

## UK CCPs given a year-long reprieve following Brexit

### **Adoption by the European Commission of an amendment to implementing Decision EU 2018/2031 according equivalence to the regulatory framework of central counterparties (“CCPs”)**

In anticipation of the United Kingdom (“UK”) leaving the European Union (“EU”) (hereinafter “Brexit”) (now scheduled to take place on 31 January 2020), on 19 December the European Commission (the “Commission”) adopted an amendment to Implementing Decision (EU) 2018/2031 (such decision as amended, the “Decision”) according equivalence to the regulatory framework of central counterparties (“CCPs”) in the UK.

The Commission had previously adopted a temporary equivalence determination based on a planned exit day of 30 March 2019 (which would have provided for a one-year transition period); however, following two subsequent extensions to Brexit the Commission has opted to extend the original transition period to provide for a full one-year transition period, to be effective as of the official Brexit date. Citing both the risk to financial markets (based on, inter alia, the global outstanding notional amount of cleared derivatives) as well as the need for certainty and visibility for CCPs, clearing members and their clients, the Commission has determined that a period of one year was necessary to ensure a transition with minimal disruption to counterparties as well as to global financial markets more broadly.

In addition to extending its equivalence decision, and taking into account the recently adopted EMIR reforms, the Commission noted that it will continue monitoring developments to determine whether to limit EU counterparties’ access to certain products, services or activities provided by UK entities. With respect to the foregoing, any such decisions will be communicated by the Commission at least six months prior to the expiry date of its Decision.

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