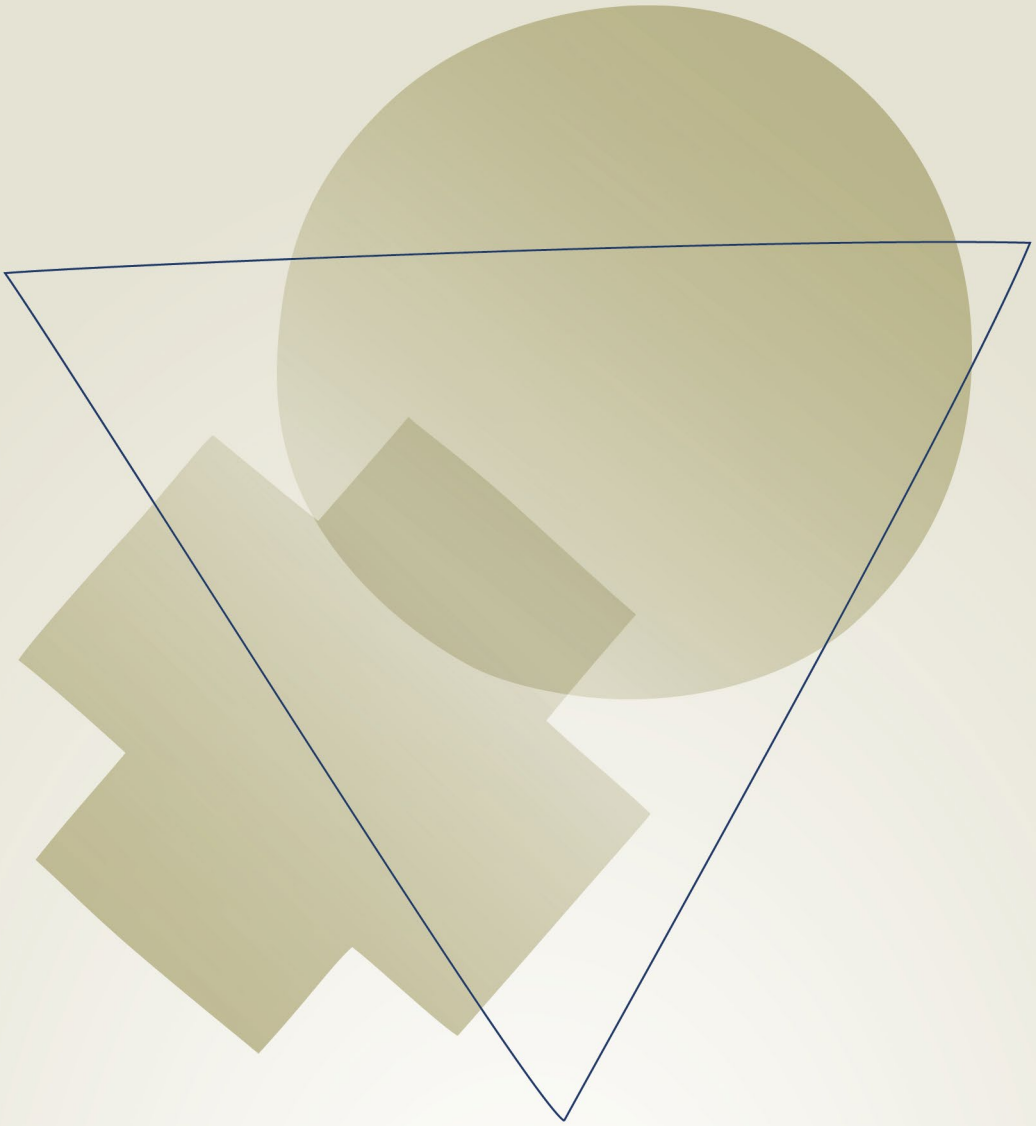
Derivatives trading · Valid from June 2024

European Market Infrastructure Regulation **(EMIR)**



Background

In response to the economic and financial crisis, heads of state and government from the G20 countries reformed the derivatives market in 2008 and 2009 with the aim of improving foreign exchange market transparency, mitigating systemic risks and increasing protection against market abuse. In this context, the European Union (EU) adopted Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC[1] derivatives, central counterparties and trade repositories (known as the European Market Infrastructure Regulation, EMIR), which entered into force in the EU on 16 August 2012 and has since then been directly applicable in all EU Member States. Following the incorporation of the EMIR into the Agreement on the European Economic Area (EEA Agreement), these provisions have also been directly applicable in Iceland, Liechtenstein and Norway since 1 July 2017 (hereinafter referred to as EEA countries).[2] At the same time, the corresponding EMIR Implementation Act (EMIR-Durchführungsgesetz, EMIR-DG) came into force in Liechtenstein.[3] All key level II legal measures adopted by the European Commission on the basis of the EMIR were incorporated into the EEA Agreement by the decisions adopted on 31 May 2018. The Financial Market Authority Liechtenstein ("FMA") summarised the applicable legal situation under the EMIR in its FMA Guidelines 2022/2.[4] The EMIR and the EMIR Refit[5] are applicable in Liechtenstein, as amended from time to time.

This fact sheet is intended to provide you with information concerning the core content of the EMIR Regulation. Please note that the information contained in this fact sheet is non-binding and that we do not offer any warranty that it is complete and accurate. In particular, it cannot act as a substitute for legal or expert advice in any specific individual circumstances.

Which transactions are affected by the EMIR?

The EMIR aims to make stock exchange and over-the-counter derivatives trading more transparent and secure by requiring the settlement of standardised OTC derivatives via central counterparties and the reporting of all derivative contracts to trade repositories. The derivative contracts concerned are defined in Article 2(5), (6) and (7) EMIR. The definition of derivatives under the EMIR is extremely broad and covers both exchange-traded and OTC derivatives from the following classes:

- Credit derivatives (credit default swaps)
- Equity derivatives (e.g. OTC options on equities)
- Interest rate derivatives (e.g. interest rate swaps)
- Currency derivatives (e.g. forward forex transactions)
- Commodity derivatives and other derivatives not mentioned above

Who is affected by the EMIR?

All undertakings established in an EEA country that conclude derivative contracts are directly affected by the regulation, regardless of whether or not the undertaking in question provides financial services. The term "undertaking" is not defined conclusively in the EMIR Regulation. According to the settled case law of the Court of Justice of the European Union (CJEU), the concept of "**undertaking**" is determined with reference to the activities of a person and not on its legal status or the manner in which it is financed. Accordingly, an undertaking is an entity that carries out economic activity without being exclusively a consumer or employee. Economic activity is activity involving the offer of goods or services on a particular market. Thus, the term "undertaking" includes any market-related conduct relating to the supplying or sourcing of goods or services. The absence of the profit motive does not constitute grounds for exclusion. Undertakings in the real economy, such as industrial, commercial and service undertakings, members of the liberal professions (e.g. doctors, lawyers and architects) and sole traders are affected by the EMIR.

I. Financial counterparty (FC)

Pursuant to Article 2(8) EMIR, these include banks/credit institutions, investment firms, insurance and reinsurance undertakings, investment funds (UCITS and alternative investment funds [AIFs] that are either established in the EEA or managed by an authorised or registered investment fund manager) regulated by the respective European legal acts and certain institutions for occupational retirement provision.
Certain financial counterparties have such a low volume of activity on the OTC derivatives market that central clearing is not financially feasible. These counterparties, which are commonly referred to as small financial counterparties ("FC"), are as a general rule exempt from the clearing obligation. However, if the position of a small financial counterparty – calculated at group level – exceeds the clearing threshold referred to in point (b) of Article 10(4) EMIR for at least one category of OTC derivative, it becomes subject to the clearing obligation for all categories of OTC derivative (see Article 4a EMIR, Financial counterparties that

[1] OTC stands for "over-the-counter", i.e. traded directly between the parties and not on a stock exchange.
[2] Decision of the EEA Joint Committee No 206/2016 of 30 September 2016.
[3] EMIR Implementation Act of 2 March 2016, State Law Gazette (LGBL) No. 2016.156.
[4] FMA Guidelines 2022/02 ; the status of the EEA adoption procedure can be accessed via the EFTA website: https://www.efta.int/eea-lex.
[5] see Annex 1.

are subject to the clearing obligation). The concept of the clearing threshold is explained in greater detail below under "Central clearing – clearing obligation".

II. Non-financial counterparty (NFC)
Pursuant to Article 2(9) EMIR, these include all undertakings established in an EEA country that are not classed as FCs. Depending on particular clearing thresholds, NFCs are also divided into NFC+ (above the clearing threshold) and NFC- (below the clearing threshold).

III. Parties not affected by the EMIR
The provisions of the EMIR do not apply to natural or legal persons that do not carry out any business activity. Although these groups of people do not per se fall within the scope of the EMIR, they may nonetheless be indirectly subject to the EMIR if for instance they conclude derivatives contracts with their counterparty (e.g. their bank) and their counterparty is subject to a reporting obligation under the EMIR.

Companies that are engaged exclusively in asset management are excluded from the scope of EMIR, which is to be assessed based on the circumstances of the specific individual case.

IV. Counterparties from third countries
Counterparties established in an EEA country are obliged to comply with or to enforce certain requirements under the EMIR also in respect of counterparties from third countries that would qualify as FCs or NFCs if they were established in an EEA country. Accordingly, these third-country counterparties are affected by the EMIR if they conclude derivative contracts with counterparties established in an EEA country.

What obligations does the EMIR include?

1. Central clearing – clearing obligation
Certain OTC derivatives must be settled via a central counterparty (clearing house) if both counterparties are subject to the clearing obligation. This is defined in Article 4a EMIR for financial counterparties and Article 10 EMIR for non-financial counterparties and is specified in greater detail in Delegated Regulation (EU) No 149/2013. In principle, the clearing obligation only applies to FCs and NFCs if the total volume of their OTC derivatives exceeds certain clearing thresholds.
Under the EMIR Refit, financial counterparties and non-financial counterparties may choose to calculate whether they exceed individual clearing thresholds. If counterparties do not carry out this calculation promptly following the entry into force of the amendments to the EMIR, this must be reported immediately to the ESMA and the FMA ("scenario 1"). As a result, they automatically become subject to the clearing obligation for all asset classes.

If the values are calculated ("scenario 2"), the average, aggregate month-end position in OTC derivative contracts for the previous twelve months (gross notional value of existing derivative contracts) must be used as a basis. The calculation must be carried out at the level of the overall group of undertakings. Non-financial counterparties only have to include the positions of non-financial counterparties within the group and cannot include OTC derivative contracts that contribute objectively to the reduction of their risks ("hedging"). Financial counterparties must include the positions of financial and non-financial counterparties within the group. If the clearing threshold is exceeded, this must be reported immediately to the European Securities and Markets Authority ("ESMA") and the FMA. In such cases, financial counterparties automatically become subject to the clearing obligation for all categories of OTC derivative contract. If the clearing threshold is exceeded by non-financial counterparties, they only become subject to the clearing obligation in respect of the class of derivatives for which the clearing threshold was exceeded.
The clearing threshold is calculated on the basis of the gross nominal value of existing derivative contracts. There are different clearing thresholds depending on the category of derivative:

Category of derivative	Clearing threshold (EUR or countervalue)
Credit derivatives	1,000,000,000
Equity derivatives	1,000,000,000
Interest rate derivatives	3,000,000,000
Currency derivatives	3,000,000,000
Commodity derivatives and other derivatives	3,000,000,000

The ESMA operates and maintains a public register in which the categories of OTC derivatives that are subject to the clearing obligation are listed (www.esma.europa.eu/regulation/post-trading/otc-derivatives-and-clearing-obligation).

In order to settle OTC derivative transactions via central counterparties, the counterparties must join a clearing house or become a member of a clearing house in good time. If you are subject to the clearing obligation and wish to trade in derivatives that are subject to the clearing obligation, we recommend that you immediately enquire about joining a clearing house or becoming one of its members. VP Bank is not a member of a clearing house and is therefore unable to provide clearing services to its clients.

2. Reporting obligation
The EMIR imposes an obligation to report all derivative contracts (i.e. contracts for exchange-traded and OTC

derivatives) on FCs and NFCs established in an EEA country. The substance of the obligations under Article 9 EMIR has been revised and partially simplified within the EMIR Refit.

In future, derivative contracts between counterparties belonging to a group are exempt from the reporting obligation where at least one of the counterparties is a non-financial counterparty or would qualify as a non-financial counterparty if it were established in the EEA, provided that both counterparties are included within the same full consolidation, both counterparties are subject to appropriate centralised risk assessment, measurement and control procedures and the parent company is not a financial counterparty. Counterparties must notify the FMA if they wish to rely on this exemption. The exemption of intragroup derivative contracts from the reporting obligation is valid unless the FMA declares within three months of the date of notification that the requirements have not been met.

Transactions must be reported to an authorised or recognised trade repository (TR) at the latest on the next business day following the trade.[6]

In addition to key information concerning the derivative contract, such as the type, maturity, nominal value, price and settlement date of the contract, the TR report provided for must also state the identities of the parties. In addition, any amendments to or termination of derivative contracts must also be reported to the TR. The identification of the contracting parties involved in a derivative contract is now standardised worldwide. Legal entities are identified in the report using the Legal Entity Identifier (LEI). However, an anonymised client identification number (client code) is used to identify private individuals (those who do not carry out any business activity).

The LEI must be applied for with an approved local operating unit, e.g. WM Datenservice or the Federal Statistical Office in Switzerland. Further information and providers can be found at www.vpbank.com/LEI_de.

All derivative contracts concluded on or after 01 July 2017 or that are still outstanding on that date are subject to the reporting obligation. The content of the report is provided for in Delegated Regulation (EU) No 148/2013. The reporting format and frequency are also provided for in greater detail in Delegated Regulation (EU) No 1247/2012. In addition, details relating to the reporting obligation are set out in Articles 9(1a)–(1f) EMIR. Pursuant thereto, FCs are solely responsible and legally liable for reporting on behalf of both counterparties the details of OTC derivative contracts that they conclude with NFCs. However, the NFC is obliged to provide the FC with all information required by law in order for the report to be made that cannot be presumed to be available to the FC. If the NFC has already invested in a reporting system, it may take responsibility for the reporting obligation and submit the report itself, provided that it notifies the FC in advance. However, the NFC is obliged to report any ETDs concluded by an NFC with an FC.

The reporting obligation only ceases to apply to NFCs that conclude OTC derivative contracts with third-country FCs if the reporting system applicable to the third-country FC has been declared equivalent in accordance with Article 13 EMIR, the FC is obliged to report the information under the applicable third-country reporting regime and the data can be accessed by EEA supervisory authorities in accordance with Article 81(3) EMIR.

In situations involving undertakings for collective investment (funds), the management company or AIFM is responsible and legally liable for reporting the details of OTC derivative contracts involving the relevant UCITS or AIFs as counterparties and for ensuring the accuracy of the information reported. UCITS or AIFs are subject to the reporting obligation with respect to ETDs.

The change in the reporting obligation for derivative contracts concluded between an FC and certain NFCs starts to apply 12 months after the entry into force of the EEA adoption decision concerning the EMIR Refit.

Undertakings established outside the EU or EEA are not in principle subject to any separate reporting obligation under the EMIR. However, they are affected indirectly by the bank's reporting obligation, since the EMIR imposes an obligation on banks established in the EEA to report any derivative contracts (i.e. both exchange-traded and OTC derivatives) also with counterparties from third countries.

Our reportable clients can delegate responsibility for submitting the report to the bank. Should you require further information regarding the reporting obligation, please contact your client advisor. The ESMA provides further information concerning the reporting obligation on the following website: www.esma.europa.eu/trade-reporting.

3. Risk mitigation techniques

Pursuant to Article 11 EMIR, market participants are obliged to apply certain risk-mitigation techniques for OTC derivative contracts not cleared by a central counterparty. The respective obligations and measures are described briefly below:

3.1 Obligation to confirm derivative contracts within specified deadlines

OTC derivatives that are not cleared centrally must be reconfirmed within specified deadlines. If so agreed between the parties, such reconfirmation may also be tacit. OTC derivative contracts with FCs or NFC+s must be confirmed by both counterparties on the next business day following the execution date.[6] OTC derivative contracts concluded with an NFC must be confirmed by both counterparties within two business days of the execution date.[7]

3.2 Obligation to agree upon suitable procedures for resolving disagreements (dispute resolution procedures)

Counterparties to a derivative contract must put in place suitable procedures to resolve disputes concerning individual transactions as quickly as possible. The duration of the dispute and the amount in dispute must be recorded. Disputes that cannot be resolved within five working days must be reported each month to the competent supervisory authority.

3.3 Obligation to carry out portfolio reconciliation and portfolio compression

In order to identify any discrepancies that may arise between counterparties with regard to material terms and conditions of an OTC derivative contract, portfolio reconciliation[8] must be carried out by the counterparties to an OTC derivative contract.

Portfolio reconciliation covers contract valuation by both counterparties as well as central transaction terms, such as the counterparty reference number, the product name, the maturity date, the planned payment or settlement dates, the nominal value or quantity, the currency, the underlying asset, the business day convention, any relevant fixed or variable interest rates and counterparty positions. The frequency of portfolio reconciliation depends on the number of outstanding transactions as well as classification by the counterparty.

Number of outstanding OTC contracts	FC/NFC+	NFC–
≥500	Daily	Quarterly
101 to 499	Weekly	Quarterly
51 to 100	Weekly	Annually
≤50	Quarterly	Annually

EEA counterparties to OTC derivative contracts are generally required to examine at regular intervals, and otherwise at least twice each year, for each individual counterparty whether portfolio compression can be carried out.

However, this provision only applies if they have at least 500 outstanding OTC contract positions with the bank.

3.4 Obligation to value transactions on a daily basis

An FC or NFC+ established in an EEA country is required to determine the value of outstanding derivative contracts on daily basis at current prices.[9]

3.5 Obligation to exchange collateral for derivative contracts not cleared centrally

Counterparties are required to protect themselves against credit risks associated with other counterparties to derivative contracts that are not cleared centrally. FCs and NFC+s are also required to establish risk management procedures for the timely and appropriate exchange of collateral.[10] In addition, FCs must have an appropriate, proportionate capital base for hedging those risks that are not covered by an appropriate exchange of collateral. In any case, the obligation to exchange collateral only applies if both counterparties are FCs or NFC+s. If an NFC- or a private individual is involved, there is no obligation to exchange collateral.

The corresponding obligations are laid down in Delegated Regulation (EU) 2016/2251 ("Margin RTS"). Physically settled FX forwards and swaps are permanently excluded from the obligation to make additional contributions if a counterparty (whether in the EEA or in a third country) is not an institution within the meaning of the CRR. The amount of collateral to be provided and the type of eligible collateral are defined in the margin RTS. The variation margin (VM) and the initial margin (IM) are intended as collateral instruments. The VM is used to regularly offset fluctuations in the value of derivative contracts. The IM, on the other hand, is intended to cover current and future expected fluctuations in value that may arise between the last exchange of collateral and risk re-coverage or the disposal of the position if one of the counterparties is unable to comply with its contractual obligations.

The obligation to provide an IM was introduced in phases by reducing threshold values. The obligation to exchange IM only applies if both counterparties belong to a group of undertakings, whose gross nominal value of open OTC derivative contracts not cleared centrally exceeds the applicable threshold. The IM must be exchanged when the contract is concluded, whereas the market value adjustment must be carried out on daily basis using the VM and operates in a manner akin to advance, daily contractual performance.

[6] See Article 12 of Delegated Regulation (EU) No 149/2013.
[7] See Article 12 of Delegated Regulation (EU) No 149/2013.
[8] See Article 13 of Delegated Regulation (EU) No 149/2013.
[9] See Article 11(2) EMIR.
[10] See Article 11(3) EMIR d.

By way of exception, Article 31a EMIR provides that physically settled FX forwards and swaps are permanently excluded from the obligation to make additional contributions if a counterparty (whether in the EEA or in a third country) is not an institution within the meaning of the CRR.

Details can be found in FMA Guidelines 2022/2. The ESMA provides further detailed information concerning the risk-mitigation techniques that must be complied with on www.esma.europa.eu/regulation/post-trading/otc-derivatives-and-clearing-obligation.

Summary of obligations:

	Central clearing (1)	Reporting obligation (2)	Risk-mitigation techniques (3)				
			Confirmation (3.1)	Dispute resolution (3.2)	Portfolio reconciliation (3.3)	Valuation (3.4)	Exchange of collateral (3.5)
FC	✓	✓	✓	✓	✓	✓	✓
FC-	x	✓	✓	✓	✓	✓	✓
NFC+	✓	✓	✓	✓	✓	✓	✓
NFC–	x	✓	✓	✓	✓	x	x
Private individual	x	x*	x	x	x	x	x

* Private individuals may, however, be indirectly affected by the EMIR if they conclude derivative contracts with their counterparty (e.g. their bank), which is subject to the reporting obligation under the EMIR.

We recommend that you familiarise yourself with the EMIR requirements and, where appropriate, also consult with an adviser in order to assess your personal situation. Further information concerning the EMIR can be found on the websites of the ESMA: www.esma.europa.eu and the FMA (https://www.fma-li.li/files/list/fma-wegleitung-2022-02-ausfuehrende-bestimmungen-zu-emir.pdf).

Do you have any questions concerning the contents of this fact sheet or the EMIR? Your client advisor will be happy to help.

Annex 1 – Specific comments concerning the EMIR Refit
The EMIR Refit includes the following relief for small financial counterparties and non-financial counterparties as well as intra-group transactions involving at least one non-financial counterparty:

- Introduction of the small financial counterparty that is exempt from the clearing obligation.
- Option to choose whether or not to calculate the clearing threshold for financial and non-financial counterparties.
- Removal of the reporting obligation for historical derivative contracts (contracts that were outstanding when the EMIR came into force but not when the reporting obligation started to apply).
- Exemption from the reporting obligation for derivative contracts concluded within the group if at least one counterparty is a non-financial counterparty, provided that certain requirements are met.
- Reporting obligation exclusively for the financial counterparty with respect to OTC derivative contracts that it concludes with a small non-financial counterparty. By contrast, small non-financial counterparties are still subject to the reporting obligation for exchange-traded derivative contracts ("ETDs") that they conclude with a financial counterparty.
- Reporting obligation for the management company and the AIFM with respect to OTC derivative contracts for which the relevant UCITS or AIF acts as a counterparty.

As the EMIR Refit does not in principle provide for any transition periods, the revised clearing obligations apply for EEA/EFTA countries in accordance with the FMA Guidelines 2022/2.

Counterparties must comply with the clearing obligation four months after this notification has been submitted to the ESMA and the competent supervisory authorities (applies to scenarios 1 and 2), where they become subject to the clearing obligation for the first time. Counterparties that are already subject to the clearing obligation at the time the EMIR Refit requirements enter into force in the EEA remain subject to the clearing obligation.

Any notification concerning the non-calculation of clearing thresholds (scenario 1) applies until further notice and does not have to be repeated annually. If a calculation is carried out (scenario 2), the result of the calculation must be transmitted if there has been any change in the group's status with respect to the clearing obligation. If the counterparty falls below the clearing threshold again at a later stage, this may be reported during the year. Evidence must be enclosed.