Preparing for the implementation of EMIR REFIT

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Abstract

The new obligations under EMIR REFIT (as defined below) require firms to adopt new reporting standards for derivatives transactions and upgrade outstanding derivatives transactions to the new reporting format. The implementation date is 29th April, 2024 in the EU and 30th September, 2024 in the UK. To navigate the complexities of EMIR REFIT, firms should start preparing for the implementation of the new requirements as soon as possible.

Keywords: reporting, EMIR, REFIT, derivatives, regulation, EMIR 3.0

BACKGROUND

Following the 2008 financial crisis, the G20[1] (including the EU) committed to reforms in the financial sector with the aim of creating greater transparency and oversight in the over-the-counter (OTC) derivatives markets. The European Market Infrastructure Regulation (EMIR)[2] is part of an international drive to increase the stability of the OTC derivatives markets and reduce systemic risk. EMIR intends to increase trade transparency by requiring all OTC and exchange-traded derivatives to be reported to a trade repository (TR), reduce counterparty credit risk through a mandatory

clearing requirement for standardised OTC derivative transactions and impose additional risk mitigation requirements on uncleared OTC derivatives transactions.

EMIR REFIT[3] is the culmination of a review of EMIR that began in 2015[4] alongside years of effort to globally align and improve the quality of reported derivatives transactions data. As part of EMIR REFIT, the European Securities and Markets Authority (ESMA) was mandated to develop new technical standards to improve the quality of the data reported. EMIR REFIT requires significant changes to derivatives transaction reporting by increasing the complexity of reports to TRs.

Additionally, EMIR REFIT is a response to the poor data quality currently being reported by counterparties under EMIR and the lack of international harmonisation. Under Level 1 Measures, ESMA was required to provide the requisite Implementing Technical Standards (ITS) and Regulatory Technical Standards (RTS). Notably, the ITS set the implementation timeline including start date and grace period for reporting outstanding derivatives, whereas the RTS set the technical reporting requirements for counterparties, central clearing counterparties (CCPs) and TRs, such as the additional new reporting fields, reconciliation and tolerance preferences, and how to report cleared OTC and exchange-traded derivatives.[5]

IMPORTANCE OF EMIR REFIT

Initially, EMIR was a starting point intended to contain systemic risk in the EU derivatives market. EMIR REFIT seeks to address disproportionate compliance costs, transparency issues and insufficient access to clearing for certain counterparties. EMIR REFIT's aim is to simplify certain EMIR rules and reduce regulatory and administrative burdens where possible, especially for non-financial counterparties (NFCs). Additionally, EMIR REFIT is intended to ensure high data quality necessary for the effective monitoring of the systemic risk.

EMIR REFIT was enacted due to the regulatory objectives behind EMIR reporting such as the G20 obligations (discussed above), and the objectives of the Financial Conduct Authority (FCA), the Bank of England (BoE) and the National Competent Authorities (NCAs) of the Member States. The regulators' objective is to ensure a more globally consistent dataset, where appropriate, to enable authorities to better monitor for systemic and financial stability risk. The regulators also recognised the need to improve data quality, provide clarity to firms on their obligations (where required) and streamline the registration process for TRs.

EU EMIR REVIEW

In December 2020, ESMA published draft technical standards under EMIR REFIT.[6] These standards covered data reporting to TRs, procedures to reconcile and validate the data, access by the relevant regulatory authorities to data, and registration of the TRs. The key proposals set out in the draft RTS and ITS included: (i) alignment with international standards; (ii) end-to-end reporting in ISO 20022 XML; (iii) harmonised data quality requirements across TRs; (iv) simplified rules for extension of registration from the Securities Financing Transactions Regulation (SFTR) to EMIR; and (v) standardised process for data access.

On 10th June, 2022, the European Commission adopted six implementing and delegated regulations setting out ITS and RTS supplementing EMIR in relation to reporting, data quality and data registration of TRs under EMIR REFIT that were published in the Official Journal on 7th October, 2022.[7] These changes will impact counterparties that are subject to the reporting obligations under the EMIR derivatives reporting regime, and will affect counterparties who delegate reporting to a third party as well as those who report directly themselves.

ESMA more recently published its 'Final Report on the Guidelines for Reporting under EMIR' (Final Report),[8] including final guidelines on the new rules referenced above. These guidelines clarified the legal provisions on reporting and data management under the amended EMIR rules, and provided practical guidance on their implementation. Alongside the Final Report, ESMA published new validation rules as well as outgoing and ingoing reporting instructions.[9] The validation rules set out detailed technical rules on how the TRs should verify the completeness and accuracy of the reported data as well as the conditions and thresholds to be applied to determine whether the values reported by both reporting counterparties to an OTC derivatives transaction match. The rules also include a template for notifications of reporting errors and omissions to the relevant NCA, together with populated examples.

The EU standards come into effect from 29th April, 2024 after an 18-month transition period. To assist in-scope firms transition to the new requirements:

- an additional transition period until 29th October, 2024 will be granted to upgrade existing outstanding contracts that have been submitted to TRs before 29th April, 2024;
- derivative contracts that mature before 29th October, 2024 do not need to be updated; and
- any modification or termination of a pre-29th April, 2024 derivative will prompt an earlier upgrade to the new standard.

UK EMIR REVIEW

Following the UK's withdrawal from the EU (Brexit) and the end of the Brexit transition period, EMIR formed part of UK domestic law by virtue of the European Union (Withdrawal) Act 2018 (EUWA) as amended (UK EMIR). While EMIR REFIT was not automatically onshored in the UK as part of EMIR,[10] the Government decided that it should be taken forward.[11]

On 24th February, 2023, the FCA and BoE published their joint policy statement on changes to reporting requirements, procedures for data quality and registration of TRs under UK EMIR (the Policy Statement).[12] Alongside the Policy Statement, the FCA and BoE published final UK EMIR validation rules and XML schemas to support implementation of the amended technical standards and new rules.[13] The vast majority of these proposals are aligned with the standards set out by ESMA in the new EMIR reporting technical standards and its Final Report. The FCA has also published a UK EMIR breach notification form so market participants can notify the FCA about any errors or omissions in their reports in accordance with Article 9 of UK EMIR.[14]

The requirements set out in the Policy Statement come into effect on 30th September, 2024, except for certain amendments relating to the format and details of TR registration applications, which entered into force immediately on 24th February, 2023. Consequently, the changes under UK EMIR will take effect some months after the equivalent EU rules.

DIFFERENCES BETWEEN THE UK AND EU EMIR REVIEW

The new UK and EU reporting fields are largely aligned, but the principal differences are the additional optional reporting field for the identification of an execution agent in the UK, the differing completion of 'TRUE' in the 'intragroup' field and only the UK rules including Tokyo Overnight Average Rate (TONAR) as an option for completing floating rates fields.

There is also some divergence between the UK and EU validation rules, which firms will need to consider when building their reporting systems. The FCA has

published a worksheet setting out these differences together with the rationale for diverging from the EU approach.[15]

Additionally, UK EMIR REFIT and EU EMIR REFIT have differing notification obligations for significant or material reporting errors, and different reporting start dates. The go-live dates are different meaning there will be added complexity for firms that have dual reporting obligations to both ESMA and the FCA. Therefore, in addition to the challenges discussed below, one of the major issues will be regulatory divergence between the EU and UK, given the different implementation dates in the two jurisdictions. This time-lag means that firms will simultaneously have to report the additional fields, validations, actions, event type sequences and the new schema related to the ESMA version, while the FCA continues to require the legacy format and rules. This will be a complex undertaking for firms to manage. Furthermore, the FCA has released a different version of the XML schema to ESMA and there is a possibility that there may be further divergence in the future.

KEY CHANGES UNDER EMIR REFIT

EMIR REFIT brings about extensive changes that will affect counterparties who are required to report under the EMIR reporting regimes, whether they delegate reporting to a third party or report directly themselves. The key changes and issues in relation to EMIR REFIT are summarised below.

- *Reporting format.* EMIR REFIT mandates the use of ISO 20022 messaging, with a harmonised XML schema, for making reports to TRs. TRs will not accept reports from market participants in another format under EMIR REFIT. Therefore, firms must build and implement an operational capability to submit and consume responses in XML ISO 20022 format, and move away from the current comma-separated values (CSV) submissions. The implementation will likely be a challenge for market participants that currently work with CSV or other formats. Firms will have to decide whether to obtain these new skills in house, use a third party provider, or pay a TR to convert their CSV into the appropriate XML. This may, however, be seen as a positive change as currently every TR has its own set of technical specifications; switching to XML ISO20022 schema will standardise reporting and prevent TRs requiring custom fields. The SFTR and MiFIR[16] also require reports to be submitted in ISO 20022 XML format.
- *Granularity of reported data.* Under EMIR REFIT, the total number of reportable data fields has increased to 203 (from the previous 129 reportable fields), with 89 new reporting fields. Notably, new business reasons for reporting will be mandated (event types), effectively extending the scope of reportable derivative transactions. Additionally, the information to be provided will include whether the derivative has crypto-assets as the underlying. This increased depth of reporting means that it will be a significant undertaking for firms to obtain, enrich and validate data fields. The level of detail to be reported is significantly extended, and appears to be more extensive than other regulatory regimes. There is also an emphasis on firms to ensure the accuracy and reliability of information reported.
- *Deviations from international standards.* In some parts, the EU standards deviate from the Committee on Payments and Market Infrastructures and the Board of the International Organization of Securities Commissions (CPMI-IOSCO)'s technical guidance on harmonisation of other critical OTC derivatives data elements.[17] For example, the EU standards do not include certain reporting fields that are set out in the CPMI-IOSCO's guidance. This will

likely lead to difficulties and divergence when attempting to achieve globally aligned reporting standards.

- *Generation of a Unique Trade Identifier (UTI).* In accordance with the guidance published by CPMI-IOSCO for UTIs, there will be a change in how to determine which party to a derivative is responsible for generating the UTI. The reporting rules set out a detailed waterfall and other criteria for generation of the UTI, under which agreement between the parties is the final fall-back if none of the other stages is applicable. This may lead to significant changes to current approaches on UTI generation, where often the responsible party is agreed in the Schedule to the International Swaps and Derivatives Association (ISDA) Master Agreement or the confirmation for a transaction.
- *Delegated reporting.* Under EMIR REFIT, where an EU financial counterparty (FC) enters into an OTC derivative with an EU NFC below the clearing threshold (NFC-), the FC is legally liable and mandatorily responsible for reporting both sides of the derivative transaction unless the NFC-elects to report to a TR themselves. Previously under EMIR, NFC-s were legally liable and mandatorily responsible for such reporting, even when delegating the responsibility to a third party. The change to require FCs to report on behalf of NFC-s should be particularly beneficial for NFC-s, which have already set up the corresponding reporting sections for TRs, as there is no need for coordination and the delivery of the necessary data fields to an FC. EMIR REFIT prescribes who is responsible for trade reporting for certain information regarding the transactions. For example, in the scenario described herein, the FC should have arrangements in place with each relevant NFC- to obtain from them the information that the FC needs to make the reports, and for the NFC- to renew its Legal Entity Identifier (LEI) as necessary. This may require a review of current documentation as it relates to delegated reporting by FCs for NFC-s, offering NFC-s some reporting relief. Where there is such obligated delegated reporting, firms may want to consider employing a third party service provider to report on the firm's behalf.
- *Notifying errors and omissions.* EMIR REFIT requires firms responsible for reporting to notify its NCA (and, if different, the NCA of the reporting counterparty) of certain types of significant or material errors or omissions in its reporting, as soon as becoming aware of them. Such errors include reporting errors that would not cause TR rejection. This is an enormous undertaking for firms.
- *Re-reporting of outstanding transactions.* EMIR REFIT will also require outstanding derivative transactions to be re-reported in accordance with the new data reporting fields. This will either be done as and when a report of the relevant transaction is made because the terms of the transaction are modified or, if this is not the case, it must be completed by way of an update report, within six months of the new requirements taking effect (ie 29th October, 2024). However, it will not be necessary to re-generate a new UTI for the transaction.
- *Validation and reconciliation of data by TRs.* EMIR REFIT provides enhanced requirements for TRs to reject reports that do not comply with the standards. Where reports have been made by the counterparties to a transaction to different TRs, the TRs must seek to reconcile the data and identify any reconciliation breaks. TRs must provide timely feedback to reporting entities (within 60 minutes) on rejections and reconciliation breaks. The EU technical standards include specific provisions as to which of the reporting fields need to reconcile, and any tolerance levels allowed for those fields. However, these requirements

have resulted in concerns that some of the tolerance levels are too low and may lead to high numbers of reporting fails.

HOW SHOULD FIRMS COMPLY WITH THE NEW REQUIREMENTS?

To minimise the technical and procedural challenges of EMIR REFIT, it is important that firms initiate early internal integration of the relevant requirements.

Firms that continue to report directly to TRs will be required to, among other things:

- implement substantial changes to their reporting systems;
- prepare to implement a switch in their reporting systems over the weekend prior to the reporting start date;
- where they have dual reporting obligations to both UK and EU TRs, implement new and legacy rules between 29th April, 2024 and 30th September, 2024 as a result of the different reporting EU and UK start dates;
- evaluate the new and modified reporting fields to understand how they should be populated, and discuss with operational and legal teams as well as industry working groups;
- identify the impacted transactions and adopt an implementation strategy to transition to the new rules; and
- develop a strategy for updating reports of outstanding derivatives.

Where firms report on behalf of others, they will need to consider whether they require any information from counterparties to update reports for outstanding derivatives and then implement the relevant reporting requirements. It may also be possible for certain firms that currently report directly to TRs to rely solely on delegated reporting arrangements.

Firms that rely on third parties to report on their behalf will need to:

- consider whether the terms of their delegated reporting agreement should be updated to account for the new rules;
- confirm whether the third party will update reports for outstanding derivatives; and
- discuss the new requirements with the third party to ensure it can comply with the new reporting requirements.

All firms subject to the rules will need to consider:

- how to comply with the relevant notification obligation for significant or material reporting issues;
- the impact of the new reporting and monitoring rules;
- conducting a gap analysis of their control framework and an assessment of their current data to determine where to source data points for each specific field; and
- whether they wish to report on a position level as this will need to be agreed with their counterparties.

As a result of firms' previous experience effecting similar regulatory change projects, firms will appreciate the vast amount of work, effort and time that goes into such projects. These efforts do not just fall to a single team, but require the engagement of efforts across the firm from the operations and technology teams to senior management. Such efforts should not be underestimated or understated. Firms should carefully consider the resources required to tackle the changes to derivatives reporting rules.

Firms should strategically prepare for their implementation of EMIR REFIT. Where firms approach the new requirement in a piecemeal fashion, this may lead to an unsustainable approach with increased costs and risk.

Given the complexities of EMIR REFIT and the regulatory challenges in financial services, firms may wish to engage external

support. Firms may decide to reconsider how they implement the new requirements using third party technology or service providers.

With the above in mind, firms may wish to consider employing third party solutions such as those that have been developed by RegTech to help overcome complexities and ongoing changes in financial services such as the requirements in EMIR REFIT. It is important that firms are able to adapt and scale to regulatory changes. Third party reporting solutions are almost inevitable as such technological solutions can increase the likelihood of harmonisation and the ability to adapt quickly to regulatory challenges. Despite such solutions, however, firms themselves will need to have a thorough understanding of the regulatory considerations of outsourcing and operational resilience.

EMIR REFIT will likely expose weaknesses in a firm's current reporting processes and existing regulatory infrastructure. EMIR REFIT, therefore, provides an opportunity for firms to build more robust, accurate and data-driven infrastructures to support current compliance needs as well as future compliance and regulatory developments, permitting firms to future-proof themselves as much as possible.

CONCLUSION

We recommend that firms start planning ahead of the implementation deadlines to have a clear understating of the impact of EMIR REFIT. As noted above, the new reporting requirements differ depending on the firm. However, all firms will need to consider their compliance with the new obligations and increased regulatory expectations regarding the monitoring and correction of reporting issues under EMIR REFIT. Firms will also need to determine whether they would like to report on a position level, and the notification requirements for significant or material reporting issues (if any). Additionally, it would be helpful for firms to prepare an implementation plan, including identifying any gaps in current systems and/or processes.

NOTES AND REFERENCES

(1) The Group of Twenty (G20) is the Premier Intergovernmental Forum for International Economic Cooperation.

(2) Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC Derivative Transactions, Central Counterparties and Trade Repositories, available at https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A02012R0648-20220812 (accessed 20th July, 2023).

(3) Regulation (EU) No 2019/834 of the European Parliament and of the Council (EMIR REFIT), available at https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2019.141.01.0042.01.ENG&toc=OJ:L:2019:141:TOC (accessed 20th July, 2023).

(4) Article 85(1) of EMIR required the European Commission to review EMIR and to submit a report of its findings to the European Parliament and the Council of the EU, available at https://eur-lex.europa.eu/legal-content/en/txt/?uri=celex%3a02012r0648-20220812 (accessed 20th July, 2023).

(5) The EU reporting RTS, available at https://eur-lex.europa.eu/eli/reg_del/2022/1855/oj (accessed 20th July, 2023), and the EU reporting ITS, available at https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv%3AOJ.L_.2022.262.01.0001.01.ENG&toc=OJ%3AL%3A2022%3A262%3ATOC (accessed 20th July, 2023).

(6) European Securities and Markets Authority (ESMA) (17th December, 2020) 'ESMA Publishes Draft Technical Standards Under EMIR REFIT', available at https://www.esma.europa.eu/press-news/esma-news/esma-publishes-draft-technical-standards-under-emir-refit (accessed 20th July, 2023).

(7) Official Journal of the European Union (7th October, 2022) 'Legislation, L262', Vol. 65, available at https://eur-lex.europa.eu/legal-content/en/txt/pdf/?uri=oj:l:2022:262:full&from=en (accessed 20th July, 2023).

(8) European Securities and Markets Authority (ESMA) (14th December, 2022) 'Final Report: Guidelines for Reporting under EMIR', available at https://www.esma.europa.eu/document/final-report-guidelines-reporting-under-emir (accessed 20th July, 2023).

(9) European Securities and Markets Authority (ESMA), available at https://www.esma.europa.eu/sites/default/files/library/esma74-362-2683_emir_refit_validation_rules_reconciliation_tolerances_and_template_for_notifications_of_dq_issues.xlsx.

(10) As a result of the EUWA, amendments to EMIR brought about by EMIR REFIT formed part of UK law at exit, and the OTC, CCP and TRs EU Exit Regulations (No 2) 2019 make the deficiency fixes to ensure that EMIR continues to operate effectively

in the UK after exit day. However, some provisions of EMIR REFIT did not become applicable until after exit day so these provisions did not form part of retained EU law, and therefore do not form part of UK law on exit day or today.

(11) To the extent that new regulatory powers were needed to develop new requirements for TRs as regards validation and reconciliation of data, these were included in Section 40 of the Financial Services Act 2021, available at https://www.legislation.gov.uk/ukpga/2021/22/enacted (accessed 20th July, 2023).

(12) See Policy Statement PS23/2. Bank of England and Financial | Conduct Authority (February 2023) 'Changes to Reporting Requirements, Procedures for Data Quality and Registration of Trade Repositories under UK EMIR – Feedback on CP21/31 and Our Final Rules and Guidance', available at https://www.fca.org.uk/publication/policy/ps23-2.pdf (accessed 20th July, 2023).

(13) Financial Conduct Authority (Last updated 27th April, 2023) 'Reporting Obligation', available at https://www.fca.org.uk/markets/uk-emir/reporting-obligation (accessed 20th July, 2023).

(14) *Ibid*.

(15) Available at https://www.fca.org.uk/publication/fca/uk-emir-validation-rules-2023.xlsx (accessed 20th July, 2023).

(16) Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15th May, 2014 on Markets in Financial Instruments and Amending Regulation (EU) No 648/2012 (MiFIR).

(17) Committee on Payments and Market Infrastructures, Board of the International Organization of Securities Commissions (CPMI-IOSCO) (April 2018) 'Technical Guidance: Harmonisation of Critical OTC Derivatives Data Elements (Other Than UTI and UPI)', available at https://www.bis.org/cpmi/publ/d175.pdf (accessed 20th July, 2023).