MFSA

MALTA FINANCIAL SERVICES AUTHORITY

CIRCULAR ON THE EUROPEAN MARKETS INFRASTRUCTURE REGULATION N^{O} 648/2012 ('EMIR' OR THE 'REGULATION')

ONSITE COMPLIANCE VISITS FINDINGS

This Circular is being addressed to all market participants which enter into Derivative Contracts as defined under EMIR[1].

General Findings from Onsite Compliance Visits

Since 2014 the Malta Financial Services Authority ('MFSA') has been conducting a number of EMIR-related onsite compliance visits to financial and non-financial counterparties falling within the scope of EMIR. The purpose of the onsite compliance visits is for the MFSA to verify the extent of implementation of the Regulation by the industry, and to review the relevant controls and procedures for the proper conduct of business in terms of EMIR.

MFSA officials from the Securities and Markets Supervision Unit monitored the results and have identified a number of issues which were commonly raised during these visits.

Below is a brief description of the findings and the recommended action in each case.

1. Procedures

A number of undertakings were unable to provide a set of written procedures which establish the processes carried out by the respective undertaking in order to be compliant with EMIR. It is recommended that all counterparties entering or intending to enter into derivative contracts, should have a detailed set of written procedures in place to ensure their compliance with EMIR.

[1] *'derivative' or 'derivative contract' means a financial instrument as set out in points (4) to (10) of Section C of Annex I to Directive 2004/39/EC as implemented by Article 38 and 39 of Regulation (EC) N^{o} 1287/2006*

2. Delegation

Under EMIR it is possible to delegate certain duties to third-party entities, for example the reporting obligation as set out in Article 9 of EMIR. It is important to note that all the necessary documentation, such as an EMIR reporting delegation agreement, should be in place when delegating such duties. The Authority expects undertakings to have in place complete and finalised documentation of any such agreements, which would need to be made available during on-site inspections.

When delegating certain duties to third-party entities, market participants are reminded that compliance responsibility still remains with the delegating undertaking. Such undertakings should therefore conduct reasonable checks and request periodic confirmations to ensure that the delegated third-party is carrying out such duties in an accurate and timely manner, in accordance with the delegation agreement.

3. Risk Mitigation

Article 11 of EMIR specifies that counterparties should have appropriate arrangements in place to mitigate risks when entering into OTC derivative contracts which are not cleared by a CCP.

When conducting on-site visits the MFSA expects to be provided with the necessary documentation which cover all risk mitigation requirements under EMIR.

There are a number of ways in which entities have sought to comply with the risk mitigation requirements. Some entities have implemented tailor-made bilateral agreements with their counterparts whilst others entered into standard master agreements, such as ISDA agreements.

When making use of standard master agreements, undertakings should confirm whether the standard agreement covers all of the risk mitigation requirements under EMIR. For instance, certain counterparties have opted to become EMIR-compliant by becoming signatories to specific EMIR protocols. When signing such protocols, it is important to ensure that both counterparties are signatories to these protocols to ensure compliance. In the instance where a master agreement was in place prior to the coming into force of EMIR, some counterparties opted to become compliant by having their standard master agreement updated via an amendment agreement.

4. Clearing

The clearing obligation under Article 4 of EMIR requires that all OTC derivative contracts (that are entered into or novated on or after the relevant clearing obligation start date) be subject to mandatory clearing and must be cleared in an EMIR EU authorised, or non-EU

recognised, CCP. This obligation became effective from 21 June 2016 subject to phase-ins that are based on firms' categorisation and derivatives volumes.

The clearing obligation applies to contracts between any combination of financial counterparties and non-financial counterparties who exceed the clearing threshold (NFC+s). The clearing threshold for NFCs is measured on a group-wide basis that is not objectively measurable as reducing risks directly related to the commercial activity or treasury financing activity of the non-financial counterparty.

Currently, certain classes of interest-rate derivatives and credit derivatives are subject to the clearing obligation. Nevertheless, counterparties should, from time to time, look into all the classes of OTC derivative contracts which may become subject to the clearing obligation. An overview of the current status of the clearing obligation can be accessed through the following link - https://www.esma.europa.eu/regulation/post-trading/otc-derivatives-and-clearing-obligation.

5. Counterparty classification

The MFSA has noticed that certain undertakings, specifically collective investment schemes, have encountered difficulties in establishing their classification as financial or non-financial counterparty in terms of EMIR.

According to Article 2 of EMIR, UCITS authorised in accordance with the UCITS Directive and Alternative Investment Funds ('AIFs') within the scope of the Alternative Investment Fund Managers Directive ('AIFMD') are classified as financial counterparties and are subject to the full requirements of EMIR.

The MFSA would like to inform market participants that presently the EMIR Regulatory Fitness and Performance (REFIT) programme, which is *inter alia* addressing this issue, is at trialogue stage. The MFSA will be updating the industry in this respect.

Contacts

Should you have any queries on the above, please do not hesitate to contact Mr Nathan Fenech, Senior Manager, Securities and Markets Supervision Unit (NFenech@mfsa.com.mt), or Dr Anneliese Grixti, Senior Analyst, Securities and Markets Supervision Unit (AGrixti@mfsa.com.mt) for any further clarifications.

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