DILLON EUSTACE

EMIR 3.0: Update for Irish investment funds and their management companies

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On 7 February 2024 the European Council issued a press release (see here) announcing that it had reached provisional agreement with the European Parliament on the legislative proposals amending EMIR seeking to make derivatives clearing in the EU more attractive ("**EMIR 3.0**"). This press release was modified on 14 February 2024 to add the final texts of the provisional agreement. The final compromise text of the EMIR regulation is available here. The final compromise text of the EMIR directive is available here.

We shall consider the key aspects of the revised EMIR 3.0 proposal which are likely to be of interest to Irish domiciled funds and their Irish management companies.

Active Account Requirement

Irish funds who: (1) are subject to the clearing obligation under EMIR; and (2) exceed the €3bn clearing threshold in respect of certain "in scope" derivatives (these are derivatives deemed to be of "**substantial systemic importance for the EU**" or "**SSI**") and which enter into these specific types of derivative trades, will be required to comply with the "active account requirement"[1].

If both tests are met, then the fund must within six months:

- establish at least one active account at an EU clearing central counterparty ("**CCP**");
- it must clear a certain "representative number of trades" through that EU CCP only if the fund exceeds a threshold of a notional clearing volume outstanding of €6 billion when all SSI contracts are aggregated; and
- carry out and report certain information to its competent authority[2].

1 Revised Article7(a) of EMIR
2 Revised Article 7a(3) of EMIR

The active account requirement aims to require in scope counterparties to move a significant proportion of their euro derivatives trading which are currently cleared by non-EU CCPs to EU CCPs so as to avoid excessive reliance on systemically important third country CCPs (such as those located in the UK).

The classes of derivatives which are proposed to fall within the scope of the active account requirement (on the basis that they are considered to be SSIs) initially include:

i. interest rate derivatives denominated in Euro or in Polish Zloty; and

ii. short-term interest rate derivatives denominated in Euro[3].

However, the list of in-scope derivatives which fall within the scope of the active account requirement can be increased by ESMA.

Certain operational requirements must be met for such accounts to be considered active. The account must be capable of being used at short notice and it must have in place the necessary IT connectivity, internal processes and legal documentation associated to the account being in place[4]. Compliance with the operational requirements must be stress-tested annually.

Certain additional reporting requirements will apply in respect of in scope funds on a six monthly basis to the Central Bank[5].

"In scope" funds that clear at least 85% of their in-scope derivative contracts are exempt from certain of these requirements.

Given that ESMA is mandated to draft regulatory technical standards giving further effect to EMIR 3.0, the details surrounding the active account requirements imposed on in-scope funds are not yet clear.

Changes to the Clearing Calculations

EMIR 3.0 reforms also include changes to the clearing threshold calculations used to determine whether a trade must be centrally cleared through a CCP[6].

This change will involve the provision of an additional method of calculation for determining whether or not the fund has exceeded the clearing thresholds. Hence EMIR 3.0 final text provides for two alternative measures, either one of which will trigger the clearing obligation.

- Firstly, the current clearing calculation methodology will continue to apply. This methodology requires the fund to calculate its aggregate month-end average positions in OTC derivative contracts (i.e. both cleared and uncleared) for the previous 12 months ('aggregate positions test')[7].

- Secondly, a further clearing calculation will be introduced that will enable the fund to base this calculation on the aggregate of its uncleared OTC derivatives only (i.e. those not cleared through an EU CPP / a CPP recognised as equivalent by ESMA)[8].

ESMA will be given a mandate under EMIR 3.0 to set separate clearing thresholds for each of these calculation methodologies, which presumably will be set at different levels.

3 Revised Article 7a(6) of EMIR
4 Revised Article 7a(3) of EMIR
5 Revised Article 7aa(1) of EMIR
6 Revised Article 4 of EMIR
7 Revised Article 4a(1)(b) of EMIR
8 Revised Article 4a(1)(a) of EMIR

Other EMIR 3.0 Reforms

Other changes expected to be introduced as part of the EMIR 3.0 reforms include:

- penalties for failure to comply in full with the trade reporting obligation imposed under Article 9 of EMIR. Under these reforms ESMA could impose periodic penalty payments where (i) data reported contains "manifest errors" or (ii) the fund or fund management company has not exercised due diligence when checking and reporting the data. A maximum penalty of 1% of average daily turnover for the proceeding business year per day of breach has been set under the amending legislation[9];

- an obligation to implement appropriate procedures and arrangements to ensure the quality of data reported[10];

- making the exemption from margin requirements for single-stock equity options and index options permanent[11]; and

- the disapplication of counterparty risk limits under UCITS framework[12] and under the Money Markets Fund Regulation ("**MMFR**")[13] where an OTC derivative is cleared at an authorised or recognised CCP under EU law[14][15].

Timings

The official publication of the final regulation is now expected for Q4 of 2024. The final legislative text will then enter into force 20 days thereafter. It is therefore expected that the active account requirement will commence during Q2 of 2025.

If you have any queries about the information contained in this article, please contact the authors or your usual Dillon Eustace contact.

9 Revised Article 12 of EMIR
10 Revised Article 9(1)(e) of EMIR
11 Revised Article 11 of EMIR
12 Directive 2009/65/EC as amended
13 Directive 2013/36/EU as amended
14 Changes to the MMFR introduced via the EMIR regulation proposal
15 Changes to the UCITS Directive introduced via the EMIR directive proposal

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