# Insight: Capital Markets

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# The European Market Infrastructure Regulation: European Union regulation of OTC derivatives, central counterparties and trade repositories

The Regulation on over-the-counter derivatives, central counterparties and trade repositories (commonly referred to as the European Market Infrastructure Regulation or "**EMIR**") was published in its final form on 27 July 2012[1] and entered into force, subject to transitional provisions, on 16 August 2012. On 27 September, the European Securities and Markets Authority ("**ESMA**") submitted its final advice on technical standards (the "**Final Report**")[2] to the European Commission. Many of the provisions in EMIR will not be effective until the technical standards have been adopted by the European Commission.

EMIR requires certain counterparties to clear all over-the-counter ("**OTC**") derivative contracts that meet certain eligibility criteria through an authorised central counterparty ("**CCP**"). EMIR sets out a complex dual process to be followed by ESMA for determining the classes of OTC derivative contracts subject to mandatory clearing. The classes of OTC derivative contracts, and hence the scope of the clearing obligation, depends on the outcome of this process and therefore remains uncertain.

EMIR also imposes an obligation on CCPs and counterparties to ensure that details of derivative contracts, whether they are traded on exchange or OTC and whether or not they are cleared, are reported to authorised trade repositories.

In addition, for non-cleared OTC derivative contracts, EMIR requires counterparties (including those otherwise exempted from the clearing obligations) to put in place appropriate procedures to measure, monitor and mitigate operational and counterparty credit risk.

Further, EMIR introduces an initial authorisation requirement and a framework of common requirements for CCPs to ensure that CCPs are regulated on a consistent basis. Some requirements also extend to clearing members of CCPs. As well, EMIR deals with the authorisation and regulation of authorised trade repositories.

There are some open questions about the timeline for EMIR compliance. It is not always obvious which requirements are self-standing and which can apply only once technical standards have come into effect. Further, some of the procedures envisaged by EMIR – such as the authorisation of CCPs and trade repositories and the determination of the classes of OTC derivatives contract subject to mandatory clearing – will take time to


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1 Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC Derivatives, Central Counterparties and Trade Repositories, http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:201:0001:0059:EN:PDF.

2 ESMA "Final Report: Draft Technical Standards under the Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC Derivatives, CCPs and Trade Repositories", 27 September 2012, http://www.esma.europa.eu/system/files/2012-600.pdf.

implement, making it difficult to predict when exactly the clearing and reporting obligations will be applied. Finally, the clearing and reporting obligations also apply retrospectively to certain transactions entered into before EMIR became effective. This so-called 'frontloading' adds to the regulatory burden faced by participants in OTC derivative markets. At the same time, the uncertainty about the timeline and about which transactions will be affected by mandatory clearing presents challenges when preparing for compliance with EMIR.

## Introduction

1. EMIR was informed by the experience of the financial crisis and, in particular, the near-collapse of Bear Sterns in March 2008, the bankruptcy of Lehman Brothers and the bail-out of AIG in September 2008, which had drawn attention to risks arising in the less regulated non-exchange-traded or OTC derivatives markets. Its aim is to enhance safety and transparency in the OTC derivatives market.

2. EMIR introduces a number of new requirements. In this client note, we focus specifically on:

    a. the obligation to clear certain OTC derivatives contracts through CCPs;

    b. the obligation to report a wider range of derivatives contracts through authorised trade repositories;

    c. risk-mitigation requirements in relation to contracts not cleared by a CCP;

    d. requirements on CCPs and their clearing members; and

    e. requirements on authorised trade repositories.

3. We also consider the timeline for achieving compliance with EMIR.

## Clearing obligation

4. Under EMIR, certain OTC derivative contracts must be cleared through CCPs. These OTC derivative contracts have to meet all of the following conditions.

### Condition 1: counterparties covered by the clearing obligation

5. The relevant OTC derivative contracts need to be concluded between (i) two financial counterparties, (ii) a financial counterparty (see paragraph 6 below) and a non-financial counterparty subject to the clearing obligation (see paragraphs 7 to 8 below), (iii) two non-financial counterparties subject to the clearing obligation, (iv) a financial counterparty or a non-financial counterparty subject to the clearing obligation and an entity established in a third country that would be subject to the clearing obligation if established in the European Union or (v) two entities established in one or more third countries that would be subject to the clearing obligation if they were established in the European Union, provided that the contract has a direct, substantial and foreseeable effect in the European Union or where such an obligation is necessary or appropriate to prevent the evasion of any provisions of EMIR. Technical standards will specify what contracts will be considered to have a direct, substantial and foreseeable effect in the European Union or cases where it is necessary or appropriate to prevent the evasion of any provision of EMIR. ESMA has yet to issue draft technical standards in this area.

6. The EMIR definition of a 'financial counterparty' includes investment firms, credit institutions, insurance undertakings, assurance undertakings, reinsurance undertakings, UCITS and their management companies, institutions for occupational retirement provision and alternative investment funds managed by AIFMs, in each case authorised or registered in accordance with applicable European Union legislation.

7. A 'non-financial counterparty' is defined as an undertaking established in the European Union other than a financial counterparty or a CCP. Energy and other non-financial sector companies should check carefully whether they might be captured by the definition of an 'investment firm' under the Markets in Financial Instruments Directive ("**MiFID**")[3] (or, in future, the proposed new Markets in Financial Instruments Directive ("**MiFID 2**") and accompanying Regulation ("**MiFIR**"))[4] and hence, be classified as a financial rather than a non-financial counterparty.

8. If a non-financial counterparty exceeds a specified clearing threshold, it:

    - must immediately notify ESMA and the relevant competent authority;
    - becomes subject to the clearing obligation for future contracts provided the rolling average position over 30 working days exceeds the threshold; and
    - must clear all relevant future contracts within 4 months of becoming subject to the clearing obligation.

The clearing threshold will be set out in technical standards. In its Final Report, ESMA envisages different clearing thresholds for five classes of OTC derivatives, i.e. EUR 1 billion in gross notional value for credit derivative contracts, EUR 1 billion in gross notional value for equity derivative contracts, EUR 3 billion in gross notional value for interest rate derivative contracts, EUR 3 billion in gross notional value for foreign exchange derivative contracts and EUR 3 billion in gross notional value for OTC commodity

3 Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC, http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2004:145:0001:0044:EN:PDF.

4 See the European Commission's legislative proposals for MiFID 2 and MiFIR, http://ec.europa.eu/internal_market/securities/isd/mifid_en.htm.

derivative contracts and other OTC derivative contracts not within one of the previous categories. The use of gross notional values may facilitate monitoring but has been criticised for failing to accurately reflect risk. Controversially also, the breach by a non-financial counterparty of the clearing threshold in one class would mean that OTC derivatives in all classes might have to be cleared by the non-financial counterparty. The clearing thresholds will be reviewed on a regular basis.

When calculating whether it exceeds the clearing thresholds, a non-financial counterparty may disregard the OTC derivative contracts which are objectively measurable as reducing risks directly related to its commercial activity or treasury financing activity or that of its group. In its Final Report, ESMA proposed a relatively broad definition of OTC derivative contracts which can be disregarded on this basis. Roughly speaking, this definition includes, on the one hand, OTC derivative contracts hedging risks arising in the normal course of business and risks resulting from fluctuation of interest rates, inflation rates, foreign exchange rates or credit risk and, on the other, OTC derivative contracts which correspond to the definition of a 'hedging contract' pursuant to International Financial Reporting Standards ("**IFRS**"). ESMA also dropped its earlier proposal to exclude contracts entered into "*for a purpose that is in the nature of speculation, investing or trading*"[5] from this definition.

The consequences of exceeding the clearing threshold will be operationally burdensome for non-financial counterparties that have neither experience with clearing nor the necessary operational capabilities in addition to being costly due to the associated collateral requirements. For such entities, it will be imperative not only to closely monitor their hedging positions, but also to have contingency plans should they at some point become subject to the clearing obligation.

9. An OTC derivative contract between, on the one hand, a financial counterparty or a non-financial counterparty subject to the clearing obligation and, on the other, a non-financial counterparty that is not subject to the clearing obligation would not be covered by the clearing obligation. Therefore, market participants will be likely to need further guidance on how they are supposed to determine whether or not their counterparty is a non-financial counterparty subject to the clearing obligation.

### Condition 2: classes of OTC derivative contracts subject to the clearing obligation

10. EMIR sets out two complementary approaches for determining which classes of OTC derivative contracts are covered by the clearing obligation.

    The 'bottom-up' approach takes as its starting point either that ESMA has received a notification from a competent authority that it has authorised a CCP to clear a class of OTC derivatives (the "**Notification**") or that ESMA has completed a procedure for recognising a non-EU CCP for the provision of certain clearing services. ESMA will then, after public consultation and consultation with the European Systemic Risk Board ("**ESRB**") and, if appropriate, third country competent authorities, develop and submit to the European Commission for approval draft technical standards on whether the relevant class of OTC derivatives should, in general, be subject to the EMIR clearing obligation.

    The 'top-down' approach involves ESMA acting on its own initiative, after public consultation and consultation with the ESRB and, if appropriate, third country competent authorities, to identify and notify to the European Commission the classes of derivatives that should be subject to the clearing obligation but for which no CCP has yet received authorisation.

    Under either approach, ESMA's overarching aim will be to reduce systemic risk. It will take into consideration objective criteria when selecting classes of OTC derivatives for compulsory clearing, including their degree of standardisation, their volume and liquidity and the availability of fair, reliable and generally accepted pricing information. Recital (19) of EMIR suggests that CCP clearing specifically addresses counterparty credit risk and may not be the optimal solution for dealing with settlement risk, which may distinguish certain classes of OTC derivative contracts such as "*foreign exchange*". Recital (16) of EMIR asks ESMA to take account of "*the specific nature of OTC derivative contracts which are concluded with covered bond issuers or with cover pools for covered bonds*". However, there remains uncertainty as to which classes of OTC derivatives contracts will be affected by the clearing obligation.

11. ESMA will establish and maintain a public register that identifies the classes of OTC derivatives subject to the clearing obligation.

### Condition 3: dates of entry of OTC derivative contracts subject to the clearing obligation

12. For the clearing obligation to apply, the OTC derivative contracts need to be entered into or novated either (i) on or after the date from which the clearing obligation takes effect (as determined in technical standards) or (ii) on or after the Notification but before the date from which the clearing obligation takes effect if the contracts have a remaining maturity above a specified minimum (as determined in technical standards).

5 ESMA "Consultation Paper: Draft Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories", 25 June 2012, paragraph 58, http://www.esma.europa.eu/system/files/2012-379.pdf.

Thus, as discussed in paragraph 43 below, the clearing obligation has, to some extent, retrospective effect.

### Exemptions

13. Certain exemptions may apply:

a. A total exemption from EMIR (the "**Total Exemption**") is available for members of the European System of Central Banks ("**ESCB**") and certain other European Union and national bodies as well as the Bank for International Settlements.

b. A partial exemption from EMIR (the "**Partial Exemption**"), except for the reporting obligation considered in paragraphs 14 to 17 below, applies to multilateral development banks, certain public sector entities owned by central governments with explicit guarantee arrangements provided by central governments as defined in point (18) of Article 4 of the Banking Consolidation Directive[6] and the European Financial Stability Facility and the European Stability Mechanism.

c. For three years after the entry into force of EMIR, there is a transitional exemption from the clearing obligation for OTC derivative contracts that are objectively measurable as reducing investment risks directly relating to the financial solvency of certain European pension scheme arrangements.

d. Exemptions from the clearing obligation may be available for intragroup transactions as defined in EMIR. Counterparties in the European Union must notify their competent authority before relying on this exemption. Where one of the counterparties is established in a third country, the competent authority must authorise application of the intragroup exemption and notify ESMA of its decision.

## Reporting obligation

14. The reporting obligation is much broader in scope than the clearing obligation. It covers both cleared and non-cleared derivative contracts (and any modification or termination thereof), whether traded on exchange or OTC. To be reportable, such contracts must either (i) be entered into before 16 August 2012 and remain outstanding on that date or (ii) be entered into only on or after 16 August 2012.

15. Where the reporting obligation applies, financial and non-financial counterparties and CCPs must ensure that the details of any derivatives contract they have concluded and of any modification or termination of the contract are reported to a trade repository (see paragraphs 37-39 below), or, if that is not possible, to ESMA, no later than the following working day following the conclusion, modification or termination of the contract. However, EMIR permits counterparties and CCPs which are subject to the reporting obligation to delegate the reporting to a third party service provider in order to reduce the administrative burden for the bulk of market participants.

16. Trade repositories have to publish aggregate positions by class of derivatives. They must also provide access to the information held in the repository to ESMA, the ESRB, competent authorities and certain other authorities.

17. Apart from the Total Exemption mentioned in paragraph 13 above, no exemptions from the reporting obligation are available.

## Risk mitigation obligation

18. Financial and non-financial counterparties entering into an OTC derivative contract that is not cleared by a CCP must ensure that appropriate procedures and arrangements are in place to measure, monitor and mitigate operational risk and counterparty credit risk. These risk mitigation obligations also apply to OTC derivative contracts entered into between third country entities that would be subject to those obligations if they were established in the European Union, provided that those contracts have a direct, substantial and foreseeable effect within the European Union or where such obligation is necessary or appropriate to prevent the evasion of any provision of EMIR.

19. As a minimum, risk mitigation requires (i) the timely confirmation, where available, by electronic means, of the terms of the relevant OTC derivative contract and (ii) formalised processes which are robust, resilient and auditable in order to reconcile portfolios, to manage the associated risk and to identify disputes between parties early and resolve them, and to monitor the value of outstanding contracts.

20. In addition, financial counterparties (as defined in paragraph 6 above) and non-financial counterparties subject to the clearing obligation (as defined in paragraphs 7 to 8 above) must mark-to-market on a daily basis the value of outstanding contracts or, where market conditions prevent this, use reliable and prudent market-to-model. They must also have risk-management procedures that require the timely, accurate and appropriately segregated exchange of collateral with respect to OTC derivative contracts that are entered into on or after 16 August 2012, in the case of financial institutions, or on or after the clearing threshold is exceeded, in the case of non-financial institutions. This requires market participants to put in place collateral mechanisms also for OTC derivative contracts which are currently traded on an unsecured basis. Further, financial counterparties must hold an appropriate and proportionate amount of capital to manage the risk not covered by appropriate exchange of collateral.

6 Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions, http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2006:177:0001:0001:EN:PDF.

21. Implementing the risk mitigation measures poses challenges especially for small- and medium-sized financial counterparties and non-financial counterparties. The need for further technical standards in this area also creates some uncertainty about when exactly market participants need to comply with the different requirements, as considered further in paragraph 40 below.

22. Apart from the Total Exemption and Partial Exemption set out in paragraph 13 above, certain intragroup transactions may be exempted from the requirement for risk-management procedures that require the timely, accurate and appropriately segregated exchange of collateral with respect to OTC derivative contracts described in paragraph 20 above if certain conditions are met.

## CCPs

### Role of CCPs

23. A CCP is an entity that interposes itself between the counterparties to a contract traded in financial markets, becoming the buyer to every seller and the seller to every buyer. CCP clearing has the potential to reduce counterparty credit risk between the buyer and seller.

24. For clearing purposes, a counterparty to an OTC derivative contract may become a clearing member of a CCP or a client of such a clearing member. Alternatively, subject to certain conditions discussed further in paragraphs 33 to 36 below, it may establish indirect clearing arrangements with a clearing member (i.e. via a client of that client member).

### Authorisation of CCPs in the EU

25. Under EMIR, CCPs need to be authorised to provide clearing services within the European Union. EU CCPs must apply for authorisation to the competent authority in the Member State where they are established. Authorisation may be granted where the competent authority is satisfied that the applicant CCP complies with the requirements of EMIR and is notified as a system pursuant to the Settlement Finality Directive[7] and where a college of competent authorities, the ESCB, the central banks of issue of the most relevant European Union currencies of the financial instruments cleared and ESMA have provided a positive joint opinion.

### Recognition of third country CCPs

26. Third country CCPs need to apply to ESMA for recognition before they may provide clearing services to clearing members or trading venues established in the European Union.

27. This is subject to a number of conditions. First, the European Commission needs to have ascertained that the legal and supervisory framework for CCPs authorised in that third country is equivalent to the European Union's and that the legal framework of that third country provides for an effective equivalent system for the recognition of CCPs. Second, the CCP must actually be authorised in that third country and be subject to effective supervision and enforcement ensuring compliance with the prudential requirements applicable in that country. Third, ESMA must have established co-operation arrangements with the third country competent authorities. And fourth, the third country must have equivalent systems for anti-money-laundering and combating the financing of terrorism to those of the European Union. These requirements could restrict access of third country CCPs to the European Union market.

### Regulation of CCPs

28. EMIR sets out a number of continuing obligations for CCPs, including organisational requirements, conduct of business rules and prudential requirements. We outline only a few of these many requirements in this section, which aim to protect counterparties.

29. *Segregation:* CCPs will have to offer at least two forms of segregation:

    a. omnibus client segregation, whereby the CCP keeps separate records and accounts enabling each clearing member to distinguish in accounts with the CCP the assets and positions of the clearing member from those held for the accounts of its clients;

    b. individual client segregation, whereby the CCP keeps records and accounts enabling each clearing member to distinguish in accounts with the CCP the assets and positions held for the account of a client from those held for the account of other clients.

    To be fully transparent, CCPs and clearing members will have to publicly disclose the levels of protection and the costs associated with these two models and offer those services on reasonable commercial terms. Details of the different levels of segregation must include a description of the main legal implications of the respective levels of segregation offered including information on the insolvency law applicable in the relevant jurisdictions. If a client opts for individual client segregation, any margin in excess of that client's requirement must be posted to the CCP and distinguished from the margin of other clients or clearing members.

30. *Default procedures and portability:* CCPs must have detailed procedures in place to be followed where clearing members default in their obligations arising from participation in the CCP. In particular, a CCP must be prepared to transfer the assets and positions held by a defaulting clearing member for the account of its clients (in the case of omnibus client segregation) / the client (in the case of individual client segregation) to another clearing member designated by all those clients / that client, on their / that client's

7 Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems, http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:1998:166:0045:0045:EN:PDF.

request and without the consent of the defaulting clearing member. The other clearing member is obliged to accept the assets and positions only where it previously contractually committed itself to do so. If a transfer to another clearing member does not take place within the transfer period specified in its operating rules, the CCP may take other steps, including liquidation of the assets and positions held by the defaulting clearing member for the account of its clients / the client. The implementation of these provisions on default procedures raises many practical questions, for example, about how a transfer of assets and positions to another clearing member might be facilitated where client positions are 'netted' and only net margin is posted to the CCP by the defaulting clearing member whilst it retains the difference between the gross and the net margin.

31. *Margin requirements:* CCPs must impose, call and collect margins to limit their credit exposures from their clearing members and, where relevant, from CCPs with which they have interoperability arrangements, i.e. arrangements that involve a cross-system execution of transactions. Margins must be sufficient to cover potential exposures until the liquidation of the relevant positions. They must also be sufficient to cover losses that result from at least 99% of the exposures movements over an appropriate time horizon and must ensure that a CCP fully collateralises its exposures with all its clearing members, and, where relevant, with CCPs with which it has interoperability arrangements, at least on a daily basis. The details of the calculations to be carried out for determining margin requirements will be set out in technical standards.

32. *Default fund:* CCPs must maintain a default fund to cover losses arising from the default of one or more clearing members which exceed margin requirements. In fact, a default fund must at least allow a CCP to withstand, under extreme but plausible market conditions, the default of the clearing member to which it has the largest exposures or the default of the second and third largest clearing members, if the sum of their exposures is larger. The CCP must establish the contributions to the default fund to be paid by clearing members.

## Clearing members and indirect clearing

33. As mentioned, EMIR allows a counterparty to establish indirect clearing arrangements with a clearing member via a client of a clearing member. However, under EMIR, these arrangements must not increase counterparty risk and must ensure that the assets and positions of the counterparty benefit from protection with equivalent effect to that set out in EMIR provisions on segregation and portability and default procedures. The types of indirect clearing arrangements that meet these conditions will be specified in technical standards.

34. In the Final Report, ESMA does not seek to impose a mandatory obligation to facilitate indirect clearing arrangements. However, ESMA recommends that if clearing members offer to facilitate indirect clearing arrangements, they should have to do so on reasonable commercial terms. Without prejudice to the confidentiality of contractual arrangements with individual clients, they must also publicly disclose the general terms on which they are prepared to facilitate indirect clearing arrangements. Conversely, ESMA proposes that the contractual arrangements for indirect clearing should require clients to honour the obligations of indirect clients towards the clearing member concerned. When agreeing the contractual arrangements, the clearing member also needs to be consulted on aspects that can impact its operations.

35. The Final Report also calls for segregation arrangements to be provided by clearing member to their direct clients in an indirect clearing context which mirror those which CCPs are required to offer to their clearing members. Further, the draft technical standards assign responsibility to the clearing member for establishing procedures for managing the default of a client that provides indirect clearing services. These procedures should also allow for the transfer of such assets and positions to an alternative client or clearing member. However, ESMA has dropped its earlier proposal to require clearing members to manage directly the assets and positions of indirect clients for at least 30 days following the default of a client if a transfer is not possible.

36. These are only some of the obligations that might be imposed on clearing members in an indirect clearing context. These obligations raise further practical questions about implementation in national law, including changes to national insolvency laws in order to facilitate indirect clearing. Indirect clearing also raises a number of follow up questions relating to netting, capital requirements and reporting both with regard to clearing members and clearing members' clients which are dealt with outside EMIR in the Capital Requirements Directives[8], which are currently also under review[9].

8 Directive 2006/48/EC of the European Parliament and of the European Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions and Directive 2006/49/EC of the European Parliament and of the European Council of 14 June 2006 on the capital adequacy of investment firms and credit institutions, both available at http://ec.europa.eu/internal_market/bank/legislation/index_en.htm.

9 See the European Commission's legislative proposals for a CRD IV package consisting of a new Capital Requirements Directive and an accompanying Regulation (http://ec.europa.eu/internal_market/bank/regcapital/new_proposals_en.htm) and a new Directive on the recovery and resolution of credit institutions and investment firms (http://ec.europa.eu/internal_market/bank/crisis_management/index_en.htm).

## Trade repositories

### Role of trade repositories

37. The role of trade repositories is to centrally collect and maintain the records of derivatives contracts. These records are created pursuant to the reporting obligation described in paragraphs 14 to 17 above.

### Authorisation, recognition and regulation of trade repositories

38. European Union trade repositories need to be registered by ESMA. Trade repositories established in third countries may apply to ESMA for recognition if they meet certain conditions, including the equivalence of the regulatory and supervisory framework in their country to that in the European Union.

39. Trade repositories are subject to a number of ongoing obligations. These include certain general requirements and other requirements relating to operational reliability, safeguarding and recording and transparency and data availability.

## Timeline

40. EMIR entered into force on 16 August 2012, but needs to be completed by technical standards drafted by ESMA and adopted by the European Commission. ESMA published its Final Report on draft technical standards on 27 September 2012. The European Commission must decide on their adoption within 3 months of submission (and after notice to the European Parliament and Council, which may object). In theory, according to recital (93) of EMIR, "*[a]ny obligation imposed by this Regulation which is to be further developed by means of delegated or implementing acts adopted under Article 290 or 291 TFEU should be understood as applying only from the date on which those acts take effect*". However, in practice, it is not always clear whether or not certain parts of EMIR are sufficiently self-standing to be capable of application prior to the technical standards. Efforts to seek greater clarity in this area, including in respect of risk-mitigation requirements for non-cleared contracts, continue.

41. EMIR also requires further processes to be concluded before certain obligations can apply. First, within 6 months of adoption of the technical standards, EU CCPs authorised under national law must apply for authorisation to their competent authority and third country CCPs for recognition by ESMA. Authorisation must be granted or refused within 6 months from submission of a complete application and registration within 180 working days of the submission of a complete application. Only notification of authorisation or completion of the procedure for registration will trigger ESMA's 'bottom-up' process for determining (i) the class of OTC derivatives that should be subject to the clearing obligation, (ii) the dates from which the clearing obligation takes effect, including any phase in period, and (iii) the minimum remaining maturity of OTC derivatives entered into on or after Notification but before the clearing obligation takes effect which are still captured. It is not clear from EMIR when the 'top-down' process will start. As a result, the class of OTC derivatives to which the clearing obligation will apply is unlikely to be defined before summer 2013. Market participants are likely to be given additional time before clearing of those classes of OTC derivatives becomes mandatory.

42. ESMA's Final Report recommends a gradual phase-in of the reporting obligation. Interest rate and credit derivative contracts must be reported by 1 July 2013 if a trade repository for the relevant derivative class has been registered before 1 April 2013 or, if not, 90 days after the registration of such a trade repository. Other derivative contracts need to be reported only by 1 January 2014 if a trade repository for the relevant derivative class has been registered before 1 October 2013 or else 90 days after the registration of such a trade repository. The reporting date is extended by 180 days for the reporting of certain data on collateral. Derivative contracts entered into before, on or after EMIR came into force but which are not outstanding on or after the reporting start date need to be reported to a trade repository only within three years of the reporting start date for a particular derivatives class. Derivative contracts which were outstanding on 16 August 2012 and are still outstanding on the reporting start date must be reported to a trade repository within 90 days of the reporting start date for a particular derivatives class.

43. The clearing and the reporting obligations are to some extent retrospective, i.e., as set out in paragraphs 12 and 14 above, they apply to certain derivative contracts entered into before the clearing and reporting obligations come into force. Thus, market participants need to be advised of the details of the new requirements with sufficient notice to prepare for compliance. In the Final Report, ESMA has indicated that it will publish information related to Notifications on its website as part of the public register to keep market participants informed about classes of derivatives that may become subject to the clearing obligation under the 'bottom-up' process. And, as mentioned, EMIR has discretion in specifying the dates from which the clearing obligation takes effect and has proposed a gradual phase-in of the reporting obligation.

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