Editorial

European Market Infrastructure Regulation – An Initiative for Greater Safety and Integrity in OTC Derivatives Markets

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Following several weeks of intensive discussions, the law-making bodies of the European Union, the European Parliament, the European Commission and the Council of the European Union, reached an agreement on the legislation on over-the-counter (OTC) derivatives, central counterparties and trade repositories, the so-called European Market Infrastructure Regulation (EMIR), in their negotiations on February 9th, 2012. After the final coordination meetings on the compromise, the regulation was adopted by the European Parliament on March 29th, 2012. Thereafter, the Council will adopt the legislation but there is no concrete date set yet. Thus, it is still not clear when exactly, in the second half of 2012, the regulation will enter into force.

In 2008, the financial sector all around the world, in the wake of the collapse of Lehman Brothers in the same year, was hit by an extraordinarily severe crisis. This crisis exposed weaknesses in the financial system, including problems related to the use of OTC derivatives, and was the starting point for comprehensive regulatory measures in the European Union.

The year after, in September 2009, G20 leaders called for improving OTC derivatives markets by stating that "all standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end-2012 at the latest".

Partly in response to this demand, on September 15th, 2010, the EU Commission published its EMIR proposal for legislation on OTC derivatives, central counterparties and trade repositories. The proposal complies with the requirements set out by the G20 leaders and defines a new framework for more efficient, safe and sound OTC derivatives markets.

For this purpose, the regulation introduces a clearing obligation for standardized OTC derivatives as well as reporting obligations for all derivatives. Moreover, EMIR covers supervision and authorization provisions for central counterparty clearinghouses (CCPs) and authorization, supervision and organizational requirements for trade repositories. Non-financials and intragroup transactions both are exempted from the scope of EMIR, if they are below a predefined threshold.

Some articles of EMIR will be applicable immediately, while others require the development of regulatory technical standards by the European Securities and Markets Authority with other relevant authorities, which are necessary to fulfill the obligations laid down in the legislative text, by September 30th, 2012.

Market participants and infrastructure providers are already laying the foundations to meet the requirements set out in EMIR in close cooperation with customers. The fundamental need to adjust the processes and structures in the OTC derivatives business to comply with EU law led to new initiatives by market infrastructures. Thus, already now, and even more so in the future, special clearing services for OTC derivatives will be provided, risk management models will have to be extended and new reporting services for a wide range of OTC financial instruments will be offered.

In addition to EMIR, other regulatory initiatives such as the review of the Markets in Financial Instruments Directive and the Capital Requirements Directive will have an immediate impact on OTC derivatives markets. All follow the same objective, namely to make financial markets more stable and secure. The challenge for the future will be to ensure that the different initiatives do not provide conflicting provisions, but harmonized rules in a truly unified European financial market.

In summary, it needs to be acknowledged that the initiative by the European Commission and the compromise reached recently by the European law-making bodies on EMIR can be considered as an important step towards greater safety and integrity of financial markets. With this new regulation, the EU makes a decisive contribution to fulfilling the G20 requirements within the given timeframe.