

Circular

Brussels, 8 May 2017

Reference: NBB_2017_16

Contact person:

Rita Tam

Phone +32 2 221 45 16 – fax +32 2 221 31 04

rita.tam@nbb.be

Intragroup derivative transactions exemption procedure from the clearing and the collateral exchange obligations arising from Regulation (EU) No 648/2012 of 4 July 2012 on OTC derivatives central counterparties and trade repositories ('EMIR regulation')

Scope

This circular letter is applicable to the Belgian financial and non-financial counterparties subject to the supervision of the NBB, as defined in article 2 of the Regulation (EU) No 648/2012 of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (hereinafter referred to as the EMIR regulation) which have intragroup OTC derivative transactions.

This includes Belgian credit institutions, Belgian insurance and reinsurance undertakings, Belgian stockbroking firms (sociétés de bourse), Belgian payment institutions, settlement institutions and assimilated, hereinafter referred to as “the institutions”.

Summary/Purpose

Following the entry into force of the delegated regulation on the clearing obligation¹ and on the risk-mitigation techniques obligation for non-centrally cleared OTC derivatives² arising from the EMIR regulation and its supplementary Delegated Regulation of 19 December 2012, this circular letter clarifies the procedure that the institutions have to follow in order to notify or apply for the exemption of their intragroup derivative transactions from the clearing and collateral exchange obligation, in accordance with the article 4.2 and 11.6-11.10 of the EMIR regulation. This circular letter also specifies, in annex, the content of the file that institutions are required to submit in this respect to the NBB.

Structure

- 1. Main principles of the central clearing and the exchange of collateral obligations and the related exemptions for the intragroup derivatives transactions*
- 2. NBB’s guidelines regarding the notification/application procedure for:*
 - ✓ the exemption of the intragroup derivative transactions from the clearing obligation.*
 - ✓ the exemption of the intragroup derivative transactions from the collateral exchange obligation for non-centrally cleared derivatives.*

¹ Delegated Regulation (EU) 2015/2205, Delegated Regulation (EU) 2016/592 and Delegated Regulation (EU) 2016/1178.

² Delegated Regulation (EU) 2016/2251 of 4 October 2016.

Dear Madam,
Dear Sir,

This circular letter complements the joint NBB-FSMA communication NBB-2013-07 of 17 July 2013 which covered the obligations arising from the entry into force of the Delegated Regulation 149/2013 of 19 December 2012 supplementing the EMIR regulation (EU) No 648/2012 of 4 July 2012 on OTC derivatives, central counterparties and trade repositories.

This circular letter reconfirms the guidelines that the NBB sent earlier³ to the institutions which clarified the process that the institutions have to follow and the content of the notification/application file that they have to provide to the NBB. This circular letter also clarifies some specificities of the NBB's intragroup transactions' exemption procedure for national and international groups including financial as well as non-financial counterparties that are subject to the supervision of other European national competent authorities, including the FSMA in Belgium. It also describes the current procedure for significant credit institutions directly supervised by the European Central Bank (ECB).

Section 1: Main principles of the central clearing and the exchange of collateral obligations and related exemptions for the intragroup derivative transactions.

Clearing Obligation

Under EMIR, the central clearing obligation requires that some OTC derivative contracts between financial counterparties and/or non-financial counterparties exceeding the clearing threshold⁴ are cleared in CCPs that are authorised or recognised under EMIR.

The OTC derivative contracts that are subject to this obligation are specified in several delegated regulations (*hereinafter referred to as "RTS"*) by category of OTC derivatives. These RTSs implement the central clearing obligation according to a phase-in plan⁵. ESMA keeps on its website a regularly updated public register of the classes of OTC derivatives subject to the central clearing obligation, the CCPs authorised or recognised to clear these classes, and the dates from which the central clearing obligation takes effect⁶.

The EMIR regulation recognizes however that the submission of intragroup transactions to the central clearing obligation may limit the efficiency of the intragroup risk management processes. Accordingly, intragroup derivative transactions can be exempted from the central clearing obligation, provided that this exemption does not increase systemic risks and that the following conditions are fulfilled (article 4.2 of the EMIR regulation):

- The transactions comply with the definition of intragroup transactions specified in article 3 of EMIR: *"both counterparties are included in the same consolidation on a full basis and they are subject to an appropriate centralised risk evaluation, measurement and control procedures"*.
- *The pairs of counterparties have notified their respective competent authority in writing that they intend to make use of the exemption for the OTC derivative transactions concluded between each other.*
- *The notification is made not less than 30 calendar days before the use of the exemption*
- *None of the two competent authorities object to the notification within 30 calendar days following the notification.*

³ Respectively on 4 September 2015 (for credit institution and stockbroking firms) and 10 September 2015 (for insurance and reinsurance undertakings).

⁴ EMIR distinguishes between financial counterparties and non-financial counterparties. Non-financial counterparties will only become subject to the central clearing obligation if they exceed the clearing threshold set out in Art. 10 of the EMIR regulation and its delegated acts (art.11 of the delegated act (EU) No 149/2013 of 19 December 2012). Non-financial counterparties that may become subject to the central clearing obligation and that are subject to the supervision of the NBB comprise Belgian financial holdings, Belgian payment institutions, Belgian electronic money institutions, Belgian settlement institutions and institutions equivalent to settlement institutions.

⁵ The phase-in plans will depend on the category the institution belongs to. Four categories of institutions are defined in article 2 of the first RTS on central clearing obligation for interest rate derivatives (delegated regulation ((EU) 2015/2205, Delegated Regulation (EU) 2016/592 and Delegated Regulation (EU) 2016/1178.

⁶ Available via <https://www.esma.europa.eu/regulation/post-trading/otc-derivatives-and-clearing-obligation>.

- For a counterparty established in an equivalent third country⁷, the entity established in a Member State must send an application and receive the approval of its competent authority within 30 calendar days.

For the exemption from the central clearing obligation for intragroup derivative transactions that involves counterparties that are subject to the supervision of different competent authorities, a separate notification/application must be transmitted to each relevant supervisory authority. The file must be submitted to each authority no later than 30 calendar days before the starting date of the central clearing obligation for the relevant category of derivatives and the respective pair of counterparties.

Collateral exchange obligation:

The remaining bilateral, non-centrally cleared OTC derivatives are subject to bilateral risk mitigation techniques (including an exchange of collateral for initial margins and variation margins) between counterparties according to rules that are specified in delegated (EU) 2016/2251 of 4 October 2016, unless the counterparties submit an exemption request and receive the positive decision from their NCA(s) to be exempted from the collateral exchange obligation (EMIR Article 11.3) on intragroup non-cleared OTC derivatives.

To request an exemption from collateral exchange obligation for intragroup OTC derivatives transactions, the institutions must submit their application to the NBB. The NBB will communicate to financial counterparties its decision in writing within 3 months after the file is declared complete, according to article 32 of delegated regulation (EU) 2016/2251 of 4 October 2016.

Notwithstanding the above exemption possibility, EMIR stipulates that the exempted intragroup counterparties from collateral exchange (EMIR article 11.3) must still apply the risk-mitigation techniques applicable to non-centrally cleared OTC derivative contracts as referred to by articles 11.1, 11.2 and 11.4 of EMIR.

For significant credit institutions subject to direct supervision by the ECB, the respective national competent authorities (NCAs) are responsible for the treatment of the notifications/applications and decision making in this context until further notice. The NCAs involved will inform the ECB about their decisions regarding the exemption files. Consequently, significant credit institutions are required to comply with the respective exemption procedures and requirements determined by the NCA of the counterparties involved in the intragroup derivative transactions. All Belgian credit institutions, including those subject to direct supervision by the ECB, should therefore comply with the NBB requirements and guidelines specified in this circular.

Section 2: NBB guidelines regarding the notification/application procedure for the exemption of the intragroup derivative transactions from the central clearing obligation and the collateral exchange obligation.

Each institution notifying/applying for the intragroup derivative exemption should provide the NBB with a file including information mentioned in annexe 1 for the exemption of central clearing obligation; and in annexe 2 for the exemption of the collateral exchange obligation on non-centrally cleared OTC derivatives.

The NBB accepts a unique file established at the parent company level or at the Belgian sub-consolidated level⁸ covering exemption notifications/requests of all related entities included in the scope of consolidation, provided that it includes an exhaustive list of all the pairs of counterparties covered by the file, with a clear distinction of pairs including a Belgian counterparty. This unique file should comply with the NBB requirements as specified in this circular letter, possibly with additional documents addressing NBB's requirements.

⁷ The counterparty of the 'applicant entity' cannot be located in a non-equivalent third country.

⁸ A Belgian parent company which has subsidiaries in Belgium should preferably ensure that the information related to all their Belgian subsidiaries is included in this unique file. If that is not feasible, the missing Belgian subsidiaries should provide the NBB with their own files.

When a pair of counterparties within a group however includes an entity located in an equivalent third country⁹, a separate application file should be provided to the NBB.

The institutions may notify/apply for intragroup derivative exemption from the central clearing obligation/collateral exchange requirement at once for all their intragroup derivative activities, irrespective of whether the classes of derivatives for which they apply for are included or not in the currently enforceable RTS(s) on clearing obligations.

For groups composed of institutions subject to the supervision of different European supervisory authorities and which intend to apply for exemptions, the NBB asks the Belgian institutions, the Belgian parent companies or the Belgian entity at the highest level of consolidation, to report the notifications/applications submitted to other relevant supervisory authorities whenever they include a Belgian institution subject to NBB supervision. This will enable the NBB to facilitate the coordination with the other relevant European supervisory authorities.

The file must be submitted by a person of appropriate seniority within the applying counterparty. The person should confirm having verified that all the information in the application is accurate.

In order to assess the respect of the conditions for the applications for exemption of intragroup collateral exchange, the counterparties are requested to identify any possible practical impediments to the prompt transfer of own funds or repayment of liabilities between the counterparties, including any of the following: (a) insufficient availability of unencumbered or liquid assets to the relevant counterparty when due and (b) impediments of an operational nature which effectively delay or prevent such transfers or repayments when due. In addition, a legal opinion is requested from the counterparties to identify any legal impediment to such transfers (cf. annex 2 for more information about the content of application files).

Whereas the application for exemption of the central clearing obligation can be motivated to address issues of efficiency of the organisation within a group, an exemption for collateral exchange granted to a subsidiary can have significant impact on its financial situation, in particular its ALM position and liquidity flows, and can – in conjunction with other waivers or exemptions in respect of capital and/or liquidity – materially affect its overall capacity to manage risk in a comprehensive way. As a consequence, applications for exemptions by subsidiaries, in particular where they are systemically relevant in Belgium, must demonstrate that the governance and the independent control functions remain in full control of their perimeter. The NBB will also assess whether the exemption does not increase the systemic risk in Belgium.

Notwithstanding the exemption possibility, to avoid the build-up of excessive risk, the counterparties shall manage/monitor their concentration risk towards their intragroup counterparties. In line with NBB requirements, credit institutions shall respect the intragroup large exposures concentration limit (100% of own funds) and take the necessary actions to resolve structurally the breaches to such limit.

As a matter of fact, all supervised institutions are expected to hold sufficient level of capital to compensate the absence of collateral. The level of counterparty risk and concentration risk must be taken into account in the process of the determination of internal capital requirements, which has to enclose stressed tests situations (as part of Pillar II forward looking risk assessment).

Institutions might decide to maintain the exchange of variation margins and limit their exemption request to initial margins. In those cases, the institutions are not required to estimate the impact of absence of collateral on prudential limits/ratios. Also, an internal legal opinion will be sufficient to verify and confirm the absence of legal impediments for the transfer of liabilities and own funds.

In accordance with EMIR Article 11.5, if both counterparties to intragroup transactions are established in the same member state, no formal application is necessary. However, counterparties should be able to demonstrate that there are no current or foreseen practical or legal impediment to the prompt transfer of own funds or repayment of liabilities between them. The NBB might request the Belgian institutions to report similar information as they provide for their cross-border intragroup collateral exchange exemption requests, in order to be informed about the activities and on any potential practical and legal impediment and on whether collateral is exchanged between Belgian intragroup counterparties. Such risk analysis on OTC derivatives exposures could be performed as part of the recurrent supervisory reviews. The absence of adequate risk mitigation should be properly taken into account in the capital requirements.

⁹ Equivalent third countries are listed in the implementing acts under article 13.2 of EMIR; see also <http://www.esma.europa.eu/page/Third-non-EU-countries>. As long as no implementing act has been adopted pursuant article 13.2 of EMIR Regulation, intragroup transactions on non-centrally cleared OTC derivative contracts for counterparties established in those third-countries enjoy of deferred application of initial margins and variation margins (articles 36.2 and 37.3-37.4)

The NBB may withdraw its positive decision following any change in the circumstances/situations that form the basis of its decision. Whenever any change occurs compared to the situation described in the file which could affect the fulfilment of the conditions set out in paragraphs 11.6-11.10 of EMIR Regulation, the counterparties will immediately notify the NBB.

If you have questions the contact persons are Vincent.Dupon@nbb.be (for credit institutions), Alain.Degroide@nbb.be (for insurance undertakings), Laurent.Ohn@nbb.be (for financial market infrastructures) and Rita.Tam@nbb.be (for general inquiries).

If the FSMA is the competent authority for your institution, your queries and application should be sent to the FSMA (EMIR-Intragroup@fsma.be).

A copy of this circular letter will be forwarded to the certified auditor(s) of your institution.

Yours faithfully

Jan Smets
Governor

Enclosures: 2