

EMIR and MiFID2/MiFIR  
When is an entity a member of a “group”?  
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C L I F F O R D  
C H A N C E

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# When does being a member of a “group” matter under EMIR?

## NFC+ status

An NFC must aggregate the non-hedging transactions of non-financial entities in the same “group” when determining whether it is an NFC+ because it exceeds the clearing threshold (Article 10(3) EMIR).

## Intragroup transaction exemptions

Transactions between members of a “group” may benefit from the exemptions for “intragroup” transactions from clearing, margining and venue trading if certain conditions are met (Articles 3, 4(2) and 11(5)-(11) EMIR and Article 28(1) MiFIR).

## Reporting of intragroup transactions

Reports to a trade repository must identify when a transaction is an “intragroup” transaction (Commission delegated regulation No. 148/2013, Annex, Table 2, Field 32).

## Clearing: Category 2 status

ESMA's revised draft RTS imposing the clearing obligation for interest rate derivatives divides financial counterparties and NFC+ AIFs between Categories 2 and 3 for the purposes of phasing in the clearing obligation according to whether they are members of a “group” whose aggregate month-end average of outstanding gross notional amount of non-centrally cleared derivatives over a specified three month period is above EUR 8 bn.

## Margin rules

The ESAs' consultation draft of RTS relating to the margin obligations for uncleared OTC derivatives envisaged that:

- **EUR 8 bn threshold (initial margin):** a counterparty would be required to collect initial margin in respect of an uncleared OTC derivative contract when it is a member of “group” whose aggregate month-end average of outstanding gross notional amount of non-centrally cleared derivatives over a specified three month period is above EUR 8 bn and its counterparty is also a member of such a group (the EUR 8 bn threshold would be phased in over a period to 2019);
- **EUR 50m margin threshold:** counterparties required to collect initial or variation margin would be able to apply a EUR 50m threshold but this would be calculated at “group” level;
- **Wrong way risk and concentration limits:** counterparties would be restricted from accepting collateral in the form of securities issued by a person that is in the same “group” as the posting counterparty and would be subject to concentration limits on collateral issued by persons in the same “group” or, in either case, issued by entities having “close links” (with the same meaning as under MiFID2).

# When does being a member of a “group” matter under MiFID2/MiFIR?

## Authorisation

- There is an exemption from authorisation for persons providing investment services exclusively for members of their “group” (Article 2(1)(b) MiFID2).
- There is an exemption from authorisation for persons dealing in and providing investment services relating to commodity derivatives/emission allowances where, inter alia, this is an ancillary activity to their main business considered on a “group” basis (Article 2(1)(j) MiFID2).
- There are certain optional exemptions relating to intragroup services relating to electricity, gas and emission allowances (Article 3(1)(d) and (e) MiFID2).
- Membership of a “group” and “close links” are also relevant to initial authorisation and approvals of a qualifying holding (Articles 10, 11, 13 and 84 MiFID2).

## Position limits

- Position limits are set aggregating the positions held by a person and those held on its behalf on an aggregate “group” basis (Article 57 MiFID2 and draft RTS 30).
- Draft RTS 30 proposes that hedges for members of the “group” qualify for the exemption for hedges held by or for non-financial entities.

## Conduct of business

- ESMA technical advice proposes 20% limit on firms depositing client money with a member of its “group” (p. 76, Article 16 MiFID2).
- ESMA technical advice proposes specific conflicts measures where firms place their own or other “group” members’ financial instruments or where lending or credit repaid with issue proceeds (pp. 93-4, Articles 16 and 24).
- Firms must identify/manage conflicts of interest involving those to whom they and their officers, etc. are linked by “control” (Article 23 MiFID2).
- “Close links” and other relationships are also relevant to whether investment advice is independent (Article 24(4) MiFID2).
- Draft RTS 7 proposes that firms must disclose “close links” with execution venues when reporting data for best execution purposes (Article 27 MiFID2).

## OTFs

Operators of OTFs must not allow execution of orders against the proprietary capital of the operator or other members of its “group” and firms with which the operator has “close links” cannot act as independent market makers (Article 20 MiFID2).

## Trading and transparency

- Pre-trade transparency on venues does not apply to derivative transactions of an NFC hedging its risks or the risks of its “group” (Article 8(1) MiFIR).
- The obligation to trade OTC derivatives on venues does not apply to transactions that are intragroup transactions under EMIR (Article 28(1) MiFIR).



# Is an entity a member of a “group”?

EMIR and MiFID2/MiFIR define a “group” as a group of undertakings consisting of a parent undertaking and its subsidiaries.

- An entity will be a “subsidiary” of a parent undertaking if one of the seven tests set out below is met, including where the parent’s head office is outside the EU (an entity is also a subsidiary of an ultimate parent undertaking if it is a subsidiary of another subsidiary of that parent).

The EMIR definition of “group” also includes certain groups specified in the EU Capital Requirements Regulation (CRR):

- Credit institutions situated in the same member state and permanently affiliated to a central body in that state which supervises them that are eligible for a waiver of certain capital requirements under CRR, e.g. Groupe Crédit Agricole, where Crédit Agricole S.A. is the central body of the Caisses Régionales.
- Members of a group eligible for 0% risk weighting on intragroup claims under CRR, such as:
  - Certain companies linked by a majority of common directors or managed on a unified basis in accordance with a contract or provisions in their memorandum and articles of association; and
  - Certain institutions that are members of an institutional protection scheme (i.e. a statutory or contractual liability arrangement protecting those institutions and in particular ensuring their liquidity and solvency to avoid bankruptcy where necessary), e.g. the joint liability scheme of the German Savings Bank Finance Group.

MiFID2 also includes broader concepts of “control” and “close links”.

- “Control” covers parent and subsidiary relationships and similar relationships between an individual and an undertaking. “Close links” include cases of control or common control as well as cases where a person has a direct or indirect participation representing 20% or more of the voting rights or capital of an undertaking.

## Notes:

- See Articles 2(16), (21) and (22) and 3(3)(a) EMIR; Article 4(1)(32) to (35) MiFID2; Article 2(1)(21) MiFIR.
- Subsequent legislation has updated Article 2 EMIR so that the relevant provisions now refer to the tests in Article 22(1) to (5) of the EU Accounting Directive (Directive 2013/34/EU) and Articles 10 and 113(6) and (7) of CRR (Regulation (EU) No. 675/2013). The relevant provisions of the CRR impose additional conditions that must be met by eligible institutions.

# The seven tests for when an entity is a “subsidiary”

## Seven tests

1	Majority voting rights?	Does the parent hold a majority of the shareholders' or members' voting rights in the entity?
2	Right to appoint majority of board?	Does the parent have the right to appoint or remove a majority of the members of the administrative, management or supervisory body of the entity?*
3	Contractual right to dominant influence?	Does the parent have the right to exercise a dominant influence over the entity, pursuant to a contract entered into with the entity or to a provision in its memorandum or articles of association, where the law governing the entity permits its being subject to such contracts or provisions?*
4	De facto control of majority of board?	Were a majority of the members of the administrative, management or supervisory bodies of the entity who have held office during the financial year, during the preceding financial year and up to the time when the consolidated accounts are drawn up, appointed solely as a result of the exercise of by the parent of its voting rights?*
5	Control by shareholders agreement?	Does the parent control alone, pursuant to an agreement with other shareholders in or members of the entity, a majority of shareholders' or members' voting rights in the entity?*
6	Unified management?	Are the parent and the entity managed on a unified basis by the parent?
7	Dominant influence or control?	Does the parent have the power to exercise, or actually exercise, dominant influence or control over the entity?

\* Parent must also be a shareholder or member of the entity. Source: Article 22(1) and (2) Accounting Directive.

**For the purposes of Tests 1, 2, 4 and 5, the parent must aggregate rights held by:**

- another subsidiary of the parent or
- a person acting in his own name but on behalf of the parent or another subsidiary of the parent.

**For the purposes of Tests 1, 2, 4 and 5, the parent's rights shall be reduced by rights:**

- Held on behalf of a third party;
- Held by way of security (if exercised in accordance with instructions received);
- Held in connection with the granting of loans as part of a normal business activity (if voting rights exercised in interests of person granting security).

**For the purposes of Tests 1 and 5, total voting rights in the entity are reduced by any rights attaching to shares held by or on behalf of the entity itself or its subsidiaries or a person acting in its own name but on their behalf (e.g. treasury shares).**

**Test 4 does not apply where the entity is a subsidiary of a third party under Test 1, 2 or 3.**



## Notes:

- See Article 22(1) to (5) of the Accounting Directive.
- The Accounting Directive provides for certain national options in the application of these tests. It is unclear how those options are reflected (if at all) in applying the Accounting Directive tests for the purposes of EMIR and MiFID2/MiFIR.
- The Accounting Directive is the basis for Member State GAAP accounting standards and the definition of parent and subsidiary undertaking are the basis of, for example, the definitions of parent and subsidiary undertaking in the UK Companies Act 2006.

# The “group” may differ from the IFRS or regulatory consolidated group

## A “group” may differ from the group included within a company's IFRS consolidated accounts for a number of reasons, including:

- The “group” may include additional entities not included in an IFRS consolidation e.g.:
  - IFRS may allow a parent company to exclude certain entities from the accounting consolidation on the grounds that they are immaterial or because of other circumstances. However, those entities may still be subsidiary undertakings of the parent under EMIR.
  - The definition of subsidiary for the purposes of IFRS is based on the concept of “control”. Control is only one test under the Accounting Directive. Therefore, an entity may still be a subsidiary undertaking of a parent under EMIR (e.g. the right to appoint a majority of the board) even if the parent does not “control” the subsidiary for the purposes of IFRS.
- It is unclear whether there can be cases where entities (such as SPVs) consolidated under IFRS can be treated as outside the “group” on the basis of an argument that “control” under IFRS is broader than “dominant influence or control” under the Accounting Directive.
- There may be additional differences between the “group” and an entity's accounting group where an entity prepares consolidated accounts under other accounting standards (e.g. US GAAP).

## A “group” may differ from the group included within a regulatory consolidation under CRR for a number of reasons, including:

- The “group” may include additional entities not included in a regulatory consolidation.
  - E.g.: the regulatory consolidation is restricted to entities that are institutions, financial institutions or ancillary services undertakings. The EMIR “group” is not similarly restricted (but see Article 3(2)(a) EMIR for the purposes of the intragroup exemption).
- The regulatory consolidation may include additional entities not included in the “group”.
  - E.g. The parent or another of its subsidiaries may hold a “participation” (such as 20-50% stake) in an entity which is not a subsidiary but is included in the regulatory consolidation on a proportional basis.
- This is the case even though CRR also uses the Accounting Directive definitions of parent and subsidiary undertaking to define the scope of regulatory consolidation.
- There may be additional differences between the “group” and an entity's regulatory consolidation where regulatory consolidation is carried out under another regulatory regime (e.g. a non-EU banking supervisory regime).



# Intragroup exemption

For the purposes of the intragroup exemption under EMIR it is not enough that two entities are members of a “group” applying the tests in the Accounting Directive.

- Both entities must also be included in a qualifying regulatory or accounting consolidation “on a full basis”.
- A regulatory consolidation under the CRR or an accounting consolidation under IFRS (at least if it is EU adopted IFRS) would be a qualifying consolidation.

## Therefore:

- For the purposes of the intragroup exemption, the two entities must be both members of an EMIR “group” and included in a qualifying regulatory or accounting consolidation; and
- They must both be included in the regulatory or accounting consolidation on a “full basis” – which rules out entities that are e.g. only included in a regulatory or accounting consolidation on a proportional basis.

## Notes:

- In addition, to qualify for the intragroup exemption, entities must meet the other conditions in Articles 3, 4(2) and 11(5) to (11) EMIR.
- See our briefing *EMIR: When are exemptions available for intragroup transactions?* (February 2014), available at [www.cliffordchance.com](http://www.cliffordchance.com)



- **AIF:** alternative investment fund within the meaning of the AIFMD
- **AIFMD:** Alternative Investment Fund Managers Directive
- **CRD4/CRR:** the capital requirements directive and regulation implementing Basel III in the EU
- **EMIR:** the EU regulation on OTC derivatives, central counterparties and trade repositories
- **ESA:** European Supervisory Authority (i.e. EBA, EIOPA or ESMA)
- **ESMA:** European Securities and Markets Authority
- **EU:** European Union
- **IFRS:** International Financial Reporting Standards
- **MiFID2/MiFIR:** the EU directive and regulation replacing the 2004 markets in financial instruments directive
- **NFC:** non-financial counterparty as defined in EMIR, i.e. an undertaking established in the EU which is not a financial counterparty or a CCP
- **NFC+:** a non-financial counterparty whose positions in OTC derivatives (excluding positions reducing risks directly relating to commercial or treasury financing activity) exceed the clearing threshold under EMIR
- **OTC derivative:** over-the-counter derivative as defined in EMIR, i.e. a derivative executed outside a regulated market or equivalent non-EU market
- **OTF:** organised trading facility
- **RTS:** regulatory technical standards proposed by an ESA and adopted by the Commission under powers conferred by an EU regulation or directive
- **SPV:** special purpose vehicle

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