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EMIR
Where do you stand?

Leading business advisors

Contents

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Current status – taking stock

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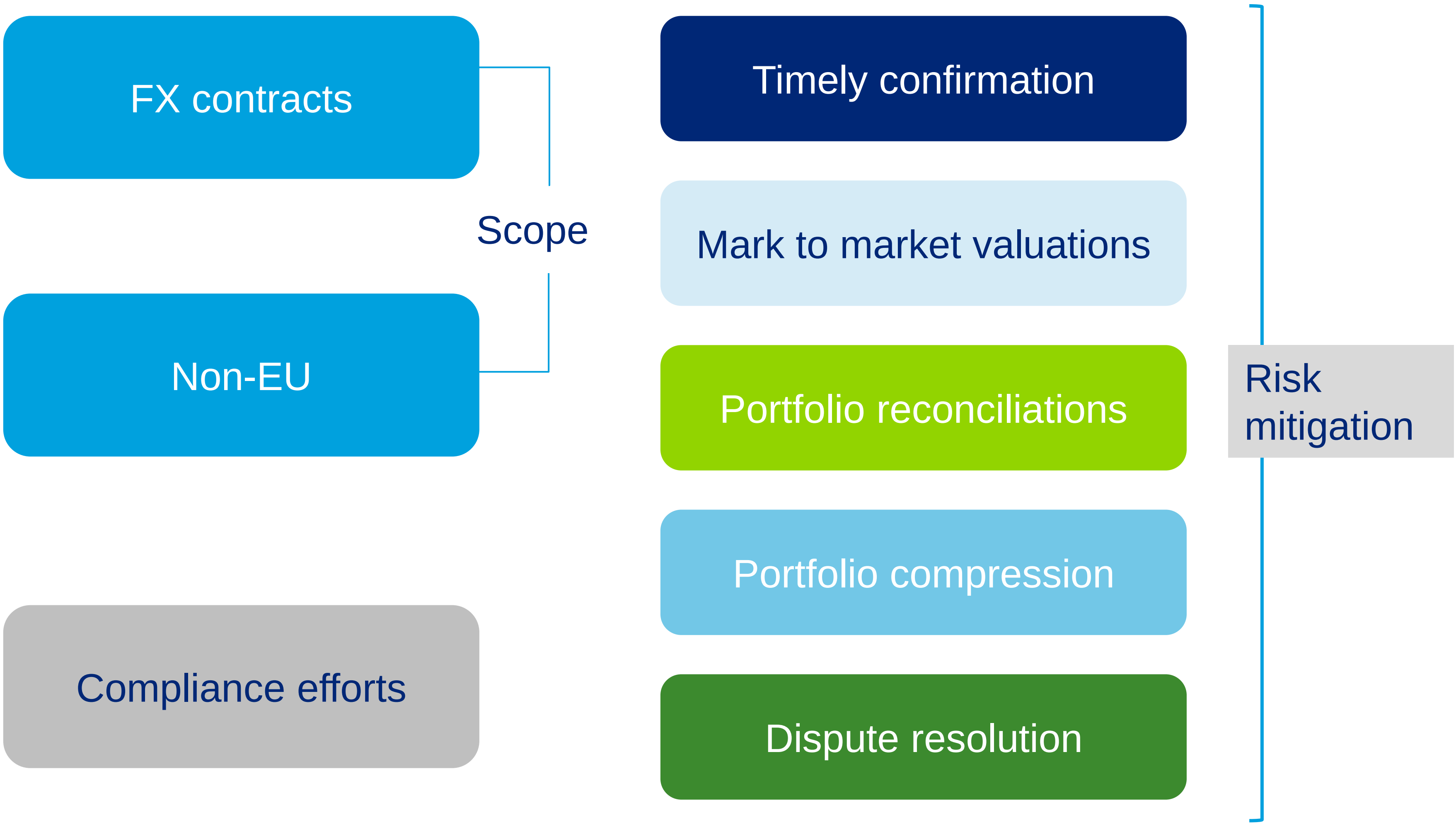


Trade reporting

EMIR: reporting to trade repositories

Emerging challenges

The what, who and when

- OTC and exchange traded derivative contracts, whether cleared or not, must be reported to a trade repository (TR) **no later than T+1** following the conclusion, modification or termination of the contract
- **What to report**: Both counterparties need to report (i) counterparty data (26 data fields); (ii) common data (varies by asset class, 59 data fields); (iii) information on collateral exchanged; (iv) beneficiaries of the contract; (v) mark-to-market valuations; (vi) confirmation Information on **historical positions** (both open and closed trades) must also be reported
- **No exemptions:** every counterparty, financial and non-financial, must report. Responsibility falls on both counterparties although counterparties can delegate reporting to a third party including CCPs
- For cleared trades executed on an exchange (where the identity of the counterparty is unknown) **the CCP must report**
- **Code systems:** Where available, code systems such as Legal Entity Identifiers will be used to identify parties, products, and trades
- **Record keeping**: Counterparties must retain records of all derivative contracts (and modifications) for at least 5 years after termination

Authorised TRs

CME: all asset classes	**DTCC**: all asset classes	**ICE**: commodities, credit, equities, interest rates	**Krajowy Depozyt Papierów Wartosciowych**: all asset classes	**Regis TR**: all asset classes	**UnaVista**: all asset classes

Timeline

12 Feb 2014
Reporting start date for all asset classes

August 2014
Start of collateral reporting

Q1 Q2 Q3 Q4 Q1 Q2 Q3 Q4 Q1 Q2 Q3 Q4

Historical contracts:

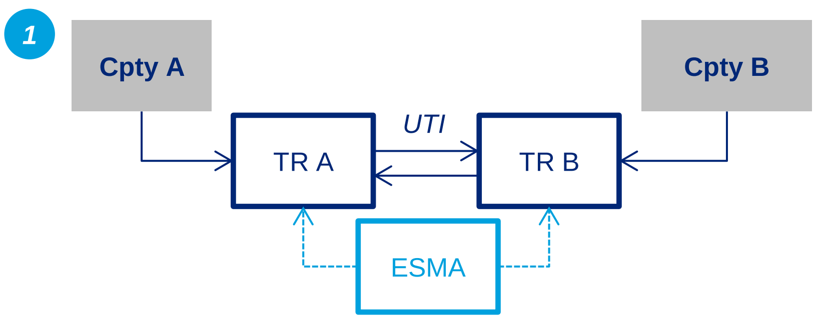
Contracts outstanding on 16/08/12 that are closed on 12/02/14: → 12 February 2017

Contracts entered into on or after 16/08/12 that are closed on 12/02/14: → 12 February 2017

2013 **2014** **2015**

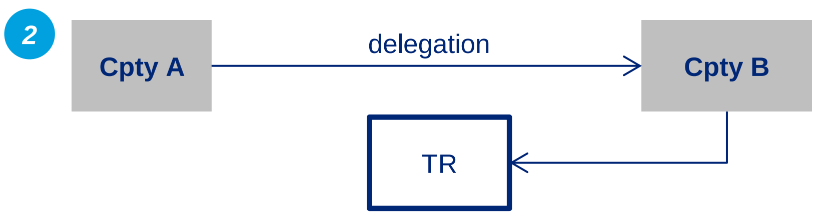
Roles and responsibilities for the reporting framework

Options	*Roles*



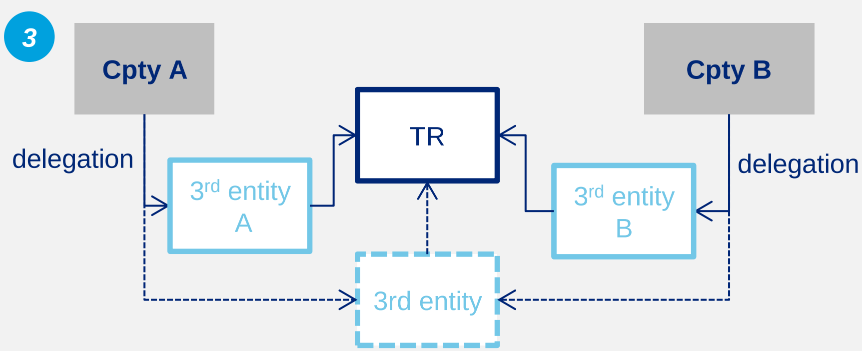
1 **Reporting by both counterparties**

- Counterparty A and B report separately to TR
- It is possible for each party to report to a different TR
- The TRs will reconcile the reported transactions via a Unique Trade ID (**UTI**)
- Both parties have to ensure that common data are consistent across both reports for the same trade



2 **Reporting by one counterparty on the behalf of the other**

- Counterparty B reports the Counterparty data of each party and only one copy of the common data
- The full set of details should still be provided by Counterparty A to B, as long as the information is available



3 **Reporting by a (single / different) 3rd party on behalf of 1 or both counterparties**

- Conduct due diligence process of the reporting 3rd party
- Data liabilities remain on the counterparty
- Voluntary delegation agreement, however the national authority can revoke the utilisation of a third party
- Written agreement between the parties

EMIR: Reporting to trade repositories

Emerging challenges

As reporting requirements start, the following challenges crystallise

Meeting supervisory expectations

Supervisors expect to see compliance on best efforts basis, and will gradually begin to ask more demanding questions of firms regarding data accuracy and timeliness.

Slower-than-expected uptake on LEIs

Some firms may not be aware of their need to register for an LEI or how to do this. Inclusion of an LEI in a trade report is essential for reconciling and aggregating data. Without it firms are not able to report.

Unique Trade Identifiers

Each trade report must be accompanied with a UTI. This enables TRs and counterparties to reconcile trades. There is some confusion regarding how to generate a UTI. The industry is working towards a uniform solution.

Data fragmentation

Reconciling data between trade repositories is still very much at an early stage. It will be quite some time before regulators have a clear and accurate view on a global basis .

Practical issues with on boarding to the TRs

Delays by firms in selecting trade repositories lead to a significant back log for client on-boarding. This is starting to improve.

Delays in delegated reporting offering

Some global dealers have delayed offering delegated reporting, raising questions on whether demand from the market can be met

Uncertainty regarding the treatment of FX derivatives

For the purposes of EMIR, MiFID I defines what constitutes a derivative. MiFID has been transposed in different ways by member states and there is no uniform view on the treatment of FX derivatives. ESMA has asked the EU Commission to provide a definitive view. In the meantime firms are facing uncertainty.

Future outlook – impacts on the asset management industry

EMIR: Centrally cleared derivatives

Scope and consequences

All 'standardised and liquid' OTC derivatives must be centrally cleared

1. Exemptions are available

Exemptions

- **Non-financial counterparties** using OTC derivatives for hedging
- Non-financial counterparties with **small non-hedging business**
- **Intragroup transactions** subject to meeting a number of criteria. Prior regulatory permission required

2. Products in scope are defined by ESMA

Early indication of derivative classes eligible for clearing

- **Credit:** European, North American and Emerging Markets untranched index CDS and European, North American and South American single name CDS
- **Interest rate:** Fixed-to-float, basis swap, forward rate agreements, overnight index swaps, interest rate options
- **Equity:**
  - Vanilla single name Europe and North America classes; Vanilla Index Europe, North America and Other (FTSE Russia) classes;
  - Dividend single name North America and Dividend Index Europe classes
- **FX:** Non deliverable forwards, cash settled forwards
- **Commodity:** Total of 17 classes from agriculture, energy, environmental, freight, index and metals
- **Asset classes cleared by CCPs:** All five asset classes are currently cleared by at least 2 CCPs, with commodity derivatives being cleared by 7 CCPs, credit – 5, equity – 4, interest rate – 6, and FX – 2
- **Timelines**: ESMA process could take from 9 to 16 months from notification date to entry into force of the clearing obligation.

3. Firms need to post margin for cleared trades

Collateral requirements

- Trades will be subject to **initial margin (IM)** (deposit on opening) and **variation margin (VM)** (to match mark-to-market exposures) on a daily and even intra-day basis
- Firms will need to meet IM payments with **highly liquid, high quality collateral** e.g. cash, OECD government bonds, blue chip equities
- VM will need to be posted in **cash**, potentially multiple times a day

4. Enhanced client assets protection

Segregation requirements

- CCPs and Clearing Members that offer indirect clearing arrangements must be able to facilitate:
  - **omnibus segregation**: separate records and accounts enabling each client to distinguish its assets and positions from those of its indirect clients; or
  - **individual segregation**: separate records and accounts enabling each client to distinguish the assets and positions held for an indirect client from those held for other indirect clients

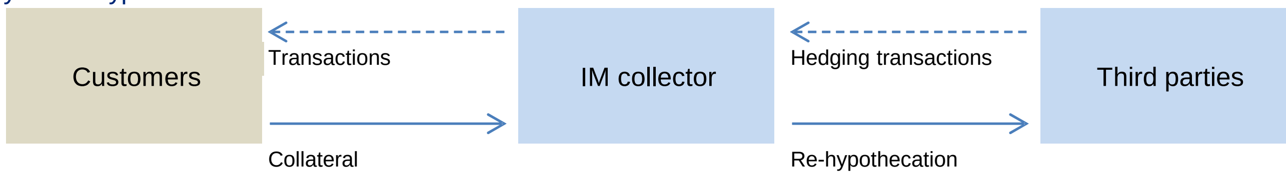
EMIR: Non-cleared derivatives
Emerging international position for margining

BCBS/IOSCO policy framework on margins for non-cleared derivatives are expected to be reflected in EMIR

- **Initial Margin (IM) and Variation Margin (VM) must be exchanged by all financial firms and systemically-important non-financial entities**
- **IM** should be exchanged by both parties on a gross basis
  - Counterparties can choose to collect €50 million less IM than technically required (on consolidated group basis)
  - Requirements phased in from December 2015 to December 2019 according to volume of trades, starting with institutions trading over €3trln
  - Margin must be immediately available and fully protected
  - Firms can use a quantitative portfolio margin model (supervisor approved) or a standardised schedule to calculate IM
- **VM:** must be calculated and collected frequently (e.g. daily) for all non-cleared derivatives (starting December 2015)
- **Eligible collateral:** Cash; high quality government and central bank securities; high quality corporate and covered bonds; equities included in major stock indices and gold
- **Exemptions:**
  - **Products:** Physically settled FX swaps and forwards are exempted from IM requirements
  - **Counterparties:** Non-financial entities that are not systemically-important, sovereigns and central banks

Re-hypothecation of initial margin collateral

IM collateral can only be re-hypothecated under strict **conditions**



Re-hypothecation of collateral is only permitted for the purpose of **hedging** the IM collector’s derivatives position arising out of customer transactions

Main conditions:

- Customer has to express **consent** with re-hypothecation in writing
- Collateral has to be **segregated** from the IM collector’s assets and re-hypothecated collateral has to be segregated from the third party’s assets
- Re-hypothecation is only permitted **once**: the third party is not allowed to re-hypothecate the collateral again
- The customer and the third party may **not** be within the **same group**
- The IM collector and the third party must keep appropriate **records**

Key challenges for investment managers

- **Process / execution / reporting:**
  - Enhancement of IT systems to meet confirmation requirements and daily-margin call → STP processing
  - Re-drafting of existing ISDA / CSA and new procedures to be put in place to meet credit mitigation requirements (e.g. reconciliation, portfolio compression, etc.) → increased oversight
  - Operational costs for managing derivatives instruments will increase on a daily basis (e.g. FTE or services dedicated to collateral management) → increased cost for some MO tasks
  - This may lead to overall strategic review for some asset managers:
    - Reviewing existing cost structure and current partnerships and services provided by intermediaries (e.g. segregation of accounts and fees paid/received to brokerage firm);
    - Out-sourcing of MO tasks in relation to derivatives and cash/collateral management, reporting, etc.
    - Internal re-organisation and further centralisation of MO team and cash/collateral management

- **Risk and collateral management:**
  - For both cleared and non-cleared trades, the collateral requirements will increase, notably through Initial Margin ("IM") posting and generalisation of daily Variation Margin ("VM") to all OTC trades (including asset swaps);
  - Daily Variation Margin requirements represent a huge challenge and will require:
    - Monitoring of aggregated collateral positions and needs as well as allocation of costs linked to collateral management by sub-entities and funds
    - Proactive funding strategy (i.e. use of repo and other collateral enhancement techniques)

Overall, EMIR is likely to lead to an increased pressure on costs and may require some asset managers not only to review their internal organisational but their funding and investment strategies as well.

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