EMIR
Update and Next Steps

DILLON EUSTACE

DUBLIN CAYMAN ISLANDS HONG KONG NEW YORK TOKYO

Table of Contents

EMIR – Update and Next Steps

Introduction

In response to concerns about systemic risks in over-the-counter ("**OTC**") derivatives markets, the Group of Twenty (G20) initiated a reform programme in 2009 to reduce the systemic risk from OTC derivatives. As initially agreed in 2009, the G20's reform programme comprised four elements:-

- All standardised OTC derivatives should be traded on exchanges or electronic platforms, where appropriate;
- All standardised OTC derivatives should be cleared through central counterparties ("**CCPs**");
- OTC derivative contracts should be reported to trade repositories ("**TRs**"); and
- Non-centrally cleared derivative contracts should be subject to higher capital requirements.

In 2011, the G20 agreed to add margin requirements on non-centrally cleared derivatives to the reform programme and called upon the BCBS (i.e. the Basel Committee on Banking Supervision) and IOSCO (i.e. the International Organisation of Securities Commissions) to develop for consultation, consistent global standards for these margin requirements.

Both the EU[1] and the US[2] have adopted the primary legislation which aims to fulfil the G20 commitments that all standardised OTC derivatives should be cleared through CCPs and that all derivative contracts should be reported to TRs (and the related commitments to a common approach to margin rules for un-cleared OTC derivative transactions). However, the EU and the US regulators paused progress on their proposals for margin rules for non-centrally cleared derivatives pending the outcome of the BCBS-IOSCO consultation on common international standards.

In addition, the US legislation addresses issues relating to the execution of OTC derivative contracts on electronic trading platforms, post-trade transparency and position limits for commodity derivatives. The EU is addressing these issues (and others relating to trading and transparency of OTC derivative markets) in the proposals to replace the existing Markets in Financial Instruments Directive ("**MiFID**") with a new restated Directive ("**MiFID 2**") and a new EU Regulation ("**MiFID**"). This European legislation is expected to be adopted in the fourth quarter of this year at the earliest and will itself also require extensive implementing measures before it comes into effect.

As referenced above, the primary legislation in the EU which aims to fulfil the G20 commitments is EMIR which entered into force on 16 August 2012. EMIR introduced a new era for OTC derivative markets and introduced the following obligations;

[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 ("**EMIR**")
[2] US Dodd-Frank Wall Street Reform and Consumer Protection Act which was enacted in July 2010

- risk mitigation requirements for non-centrally cleared trades;
- reporting to TRs;
- clearing obligations relating to standard OTC derivatives; and
- requirements for CCPs and TRs.

Furthermore in March 2013, the European Securities and Markets Authority ("**ESMA**") published a series of Regulatory Technical Standards ("**RTS**") and Implementing Technical Standards ("**ITS**") which were detailed in our last EMIR Client Memorandum[3] in March 2013 titled "EMIR – Key Points and Dates Applicable to Financial Counterparties".

However the following RTS / ITS are still outstanding:-

(i) Collateral Exchange – EMIR requires procedures that provide for the "timely, accurate and appropriately segregated exchange of collateral" for non-centrally cleared OTC derivative transactions. The European Banking Authority ("**EBA**"), European Insurance and Occupational Pensions Authority ("**EIOPA**") and ESMA, collectively the European Supervisory Authorities ("**ESAs**") have been charged with drafting RTS which will determine the precise level and exact type of collateral to be exchanged. The ESAs have delayed their submission of RTS covering the collateral exchange requirements to the European Commission pending the outcome of the BCBS and IOSCO report on margin requirements for non-centrally cleared derivatives. However given this report was just finalised and issued in early September 2013, we expect that the associated EMIR consultation and technical standards may be published later this year. Until the applicable RTS enters into force, counterparties must apply their own rules on collateral but will be required to change those rules once the RTS relating to the exchange of collateral enters into force.

(ii) Extraterritoriality – EMIR provides that the clearing obligation and obligations relating to the risk mitigation techniques for non-centrally cleared OTC derivatives may apply to OTC derivative contracts entered into between non-EU counterparties (also referred to as "**Third Country Entities**" or "**TCEs**") that would be subject to such obligations if they were established in the EU provided that the contract has a direct, substantial and foreseeable effect within the EU or where such an obligation is necessary or appropriate to prevent the evasion of any provisions of EMIR. With this in mind, ESMA is obligated pursuant to EMIR to draft RTS specifying the contracts that are considered to have a direct, substantial and foreseeable effect within the EU or the cases where it is necessary or appropriate to prevent the evasion of any provision of EMIR.

[3] See http://www.dilloneustace.ie/download/1/EMIR%20-%20Key%20Points%20and%20Dates..pdf

On 17 July, 2013 ESMA published a consultation paper containing draft RTS (the “**Consultation Paper**”) in which it is proposed that EMIR’s clearing and risk mitigation requirements will apply to transactions between TCEs when rules in both jurisdictions are not considered to be equivalent to EMIR and either (a) one of the two TCEs is guaranteed by an EU financial counterparty for at least €8bn of the gross notional amount of OTC derivatives entered into and for an amount of at least 5% of the OTC derivatives exposures of the EU financial counterparty; or (b) both TCEs execute the transaction via their EU branches.

A summary of the scope of the application of EMIR to TCEs under the draft RTS included in the Consultation Paper and Article 13 of EMIR is as follows:

		EU Firm (including Branches established in 3rd Countries)	**Equivalent third Country**	
			EU Branch	**3rd Country Firm**
EU Firm (including Branches established in 3C)		EMIR applies	EMIR can be disapplied	EMIR can be disapplied
Non-Equivalent third Country	**EU Branch**	EMIR applies	*RTS (Not apply)*	*RTS (Not apply)*
	3C Firm	EMIR applies	*RTS (Not apply)*	*RTS (Not apply)*

		EU Firm (including Branches established in 3rd Countries)	Non-Equivalent third Country	
			EU Branch	**3rd Country Firm**
EU Firm (including Branches established in 3C)		EMIR applies	EMIR applies	EMIR applies
Non-Equivalent third Country	**EU Branch**	EMIR applies	*RTS (Apply)*	*RTS (Not covered unless substantial guarantees from EU FC)*
	3C Firm	EMIR applies	*RTS (Not covered unless substantial guarantees from EU FC)*	*RTS (Not covered unless substantial guarantees from EU FC)*

ESMA has invited comments on the Consultation Paper and will consider all those received by 16 September 2013. It is intended that ESMA will update the draft RTS following a consideration of responses to its Consultation Paper and will then send its final report to the European Commission for endorsement.

(iii) Equivalence – Under EMIR[4], the European Commission may adopt implementing acts declaring that the legal, supervisory and enforcement arrangements of a non-EU country are equivalent to the requirements laid down in EMIR relating to the clearing, reporting, non-financial counterparties and risk mitigation obligations under EMIR. In this regard, EMIR[5] clarifies that any implementing act on equivalence shall imply that counterparties entering into a transaction subject to EMIR shall be deemed to have fulfilled the above detailed obligations where at least one of the counterparties is established in that third country.
Furthermore under EMIR[6], the European Commission may adopt an implementing act determining that the legal and supervisory arrangements of a third country ensure that CCPs or TRs authorised in that third country comply with legally binding requirements which are equivalent to the requirements laid down in EMIR, and that those CCPs or TRs are subject to effective supervision and enforcement in that third country on an ongoing basis. For a CCP or a TR established in a non-EU country to provide its services in the EU, an equivalence decision is one of the requirements that must be fulfilled before ESMA will grant access of the CCP or TR to EU investors.

[4] Article 13(2) of EMIR
[5] Article 13(3) of EMIR
[6] Article 25(6) in respect of CCPs and Article 75 in respect of TRs

The European Commission requested ESMA to provide its technical advice on the equivalence of certain non-EU countries in order to assist it in formulating its equivalence decisions, starting with the US and Japan.

On 3 September 2013, ESMA published its technical advice to the European Commission on the equivalence of the legal and supervisory frameworks of the US and Japan. The scope of the advice covers the recognition of non-EU CCPs and TRs, the clearing obligation, reporting obligation, NFCs and risk mitigation obligations under EMIR (i.e. portfolio reconciliation, dispute resolution, portfolio compression and margin requirements for non-centrally cleared OTC derivatives).

ESMA's technical advice to the European Commission also included advice on the regimes for CCPs and TRs for Australia, Hong Kong, Singapore and Switzerland, despite the deadline for that advice being 1 October 2013. ESMA continues to work on the advice on other areas for these jurisdictions (i.e. the clearing obligation, reporting obligation, NFCs and risk mitigation obligations) and is also working on technical advice for the regimes in India and South Korea.

To Whom Does EMIR Apply?

An entity's obligations under EMIR vary on its categorisation under EMIR. EMIR introduces two categories of counterparty;

(i) Financial Counterparty ("**FC**") which is broadly defined as a person authorised under one of the EU's financial services directives e.g. a MiFID authorised investment firm, a bank, an insurer, a UCITS fund, an alternative investment fund ("**AIF**") managed by an authorised or registered alternative investment fund manager ("**AIFM**"). Non-UCITS funds not managed by an authorised or registered AIFM would not fall within the definition of a FC. However such funds will fall within this definition once they are managed by an authorised or registered AIFM (which should occur by 22 July 2014).

The definition of "FC" would capture a Cayman fund managed by an EU AIFM, once the EU AIFM is authorised or registered under the EU Directive 2011/61/EU on Alternative Investment Fund Managers (the "**AIFM Directive**").

(ii) Non Financial Counterparty ("**NFC**") is defined as an entity established in the European Union which is not a FC. NFCs are further divided into non-financial counterparties subject to the clearing obligation (each a "**NFC+**") and non-financial counterparties not subject to the clearing obligation (each a "**NFC-**"). A NFC+ means a NFC whose derivative trading positions exceeds one of the clearing thresholds which are referred to in Article 10(4)(b) of EMIR and detailed in Article 11 of the Commission Delegated Regulation (EU) No 149/2013 of 19 December 2012 supplementing Regulation (EU) No 648/2012 with regard to regulatory technical standards on indirect clearing arrangements, the clearing obligation, the public register, access to a trading venue, non-financial counterparties, and risk mitigation techniques for OTC derivatives contracts not cleared by a CCP ("**RTS 149/2013**")[7] A summary of the clearing threshold value per class of OTC derivative contract is as follows. Once the threshold value for one class of OTC derivative contract is surpassed, the NFC exceeds the clearing threshold and constitutes a NFC+.

Value of the clearing thresholds:

- EUR 1 billion* Credit derivative contracts;
- EUR 1 billion* Equity derivative contracts;
- EUR 3 billion* Interest rate derivative contracts;
- EUR 3 billion* Foreign exchange derivative contracts;
- EUR 3 billion* Commodity derivative contracts and others.

* in gross notional value

In calculating the positions referred to above, the NFC shall include all derivative contracts entered into by the NFC or by other non-financial entities within the group to which the non-financial counterparty belongs, which are not objectively measurable as reducing risks directly relating to the commercial activity or treasury financing activity of the non-financial counterparty or of that group. The term "group" is broadly defined and includes group companies established both inside and outside the EU and also captures intra-group transactions for the purposes of assessing whether the above thresholds have been breached.

NFCs are required to start calculating the clearing threshold from the date the RTS 149/2013 entered into force; i.e. from 15 March 2013, and are required to send a notification to ESMA and the relevant national competent authority when they are above the relevant clearing threshold. NFCs are required to notify the relevant national competent authority on the first day that they exceed any of the clearing thresholds. In this regard, at the date of this Memorandum, the Central Bank of Ireland (the "**Central Bank**") has not yet been appointed as the competent authority under EMIR. However, it is expected that the Central Bank will be appointed as the competent authority under EMIR in due course. In the case of a group which has legal entities which trade OTC derivatives, a single notification should be submitted to ESMA, listing all of the NFC group legal entities within the EU which trade OTC derivatives.

[7] See http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:052:0011:0024:EN:PDF

As stated above in the "Introduction" section of this Memorandum, EMIR provides that the clearing obligation and obligations relating to the risk mitigation techniques for non-centrally cleared OTC derivatives may also apply to OTC derivative contracts entered into between Third Country Entities or TCEs that would be subject to such obligations if they were established in the EU provided that the contract has a direct, substantial and foreseeable effect within the EU or where such an obligation is necessary or appropriate to prevent the evasion of any provisions of EMIR.

Status of Key Obligations under EMIR

In our last EMIR Client Memorandum[8] in March 2013 titled "EMIR – Key Points and Dates Applicable to Financial Counterparties", we gave an update on the key provisions of EMIR being the reporting obligation, the clearing obligation and the obligations relating to the risk mitigation requirements for non-centrally cleared OTC derivative contracts. The following is a further update on these obligations and the effective dates when these requirements will (or expected to) come into force:-

Reporting to Trade Repositories

Counterparties[9] to all derivative contracts (OTC and exchange-traded) are required to report to a registered TR post-trade details of any derivative contract they have concluded and of any modification or termination of the contract. Where no contracts are concluded, modified or terminated, no reports are expected to be made apart from updates to valuations or collateral if required[10]. Intragroup transactions should also be reported in the same manner as any other trades.

Initially, a phased approach to reporting was proposed, with reporting for interest rate derivatives and credit derivatives being introduced first. However, ESMA recently issued an information notice on its website indicating that reporting for all five assets classes (interest rate derivatives, credit derivatives, foreign exchange, commodities and equity derivatives) would commence on 1 January 2014 (provided that a TR has been registered with ESMA for interest rate derivatives and credit derivatives by 24 September 2013 and in the case of all other derivative classes by 1 October 2013).

Details of TRs registered with ESMA will be available on the ESMA website[11].

In addition to the above time frame for the reporting of OTC derivatives, ESMA is proposing an amendment to Article 5 of Commission Implementing Regulation (EU) 1247/2012[12] which lays down implementing technical standards with regard to the format and frequency of trade reports to trade repositories under EMIR ("**Commission Regulation 1247/2012**"), in order to postpone the reporting

[8] See http://www.dilloneustace.ie/download/1/EMIR%20-%20Key%20Points%20and%20Dates..pdf
[9] This includes all counterparties i.e. FCs and all NFCs (i.e. whether an NFC+ or NFC-).
[10] Mark to market valuations must be reported daily (although for cleared derivative contracts this is done by the CCP).
[11] See http://www.esma.europa.eu/page/Trade-repositories
[12] See http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:352:0020:0029:EN:PDF

start date for exchange traded derivatives by one year to 1 January 2015. Article 5 of Commission Regulation 1247/2012 sets out the reporting start date of derivatives to TRs. The current dates do not include a specification of exchange traded derivatives. According to a Final Report issued by ESMA on 6 August 2013 containing draft implementing technical standards amending Commission Regulation 1247/2012 ("**ESMA's Final Report**"), such specification would be useful as there is a risk currently that the reporting of exchange traded derivatives is not harmonised unless further regulatory guidance is issued, for example in order to address the different reporting requirements under MiFID and EMIR relating to transactions executed in a regulated market, etc. ESMA's Final Report has been submitted to the European Commission which has three months to decide whether to endorse ESMA's draft implementing technical standards.

The minimum details of the data to be reported to a registered TR are set out in both a RTS[13] and Commission Regulation 1247/2012[14]. It is clear that significant detail will need to be reported to a registered TR including details as to the parties to the contract, the beneficiary of the contract, the main characteristics of the contract including the type of underlying, mark to market value of the contract, valuation date, information regarding collateralisation, execution venue, maturity, notional amount, price and settlement date. The details must be reported no later than the working day following the conclusion, modification or termination of the contract.

The reporting party may be the counterparty to the trade, or a third-party (such as a CCP or trading platform). However where the reporting obligation is delegated, the counterparty to the trade remains legally responsible for the reporting obligation. The counterparties and/or CCPs and any other entities reporting on their behalf need to agree on the report's contents before submitting it to a registered TR given details of derivative contracts must be submitted "without duplication" according to EMIR. The ESMA Q&A on the Implementation of EMIR dated 5 August 2013[15] ("**ESMA Q&A**") contains further information on this requirement and provides that "*The requirement to report without duplication means that each counterparty should ensure that there is only one report (excluding any subsequent modifications) produced by them (or on their behalf) for each trade that they carry out. Their counterparty may also be obliged to produce a separate report and this also does not count as duplication. Where two counterparties submit separate reports of the same trade, they should ensure that the common data are consistent across both reports".*

The reporting obligations will apply to derivative contracts that were outstanding on 16 August 2012 and to derivative contracts entered into on or after that date. In this regard Article 5 (3-4) of Commission Regulation 1247/2012[16] gives a further 90 days to report derivative contracts that were

[13] Commission Delegated Regulation (EU) No 148/2013 of 19 December 2012 supplementing Regulation (EU) No 648/2012 with regard to regulatory technical standards on the minimum details of the data to be reported to trade repositories.
[14] Commission Implementing Regulation (EU) No 1247/2012 of 19 December 2012 laying down implementing technical standards with regard to the format and frequency of trade reports to trade repositories according to Regulation (EU) No 648/2012 ("EU Regulation 1247/2012").
[15] See http://www.esma.europa.eu/system/files/2013-1080_qa_iii_on_emir_implementation.pdf
[16] See http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:352:0020:0029:EN:PDF

outstanding on 16 August 2012 and are still outstanding when the reporting obligation takes effect for that particular derivative class. Article 5 (3-4) of Commission Regulation 1247/2012 further provides that derivative contracts which are not outstanding on the date when the reporting obligation comes into force for that particular derivative class do not need to be reported for 3 years from that date; (e.g. for contracts outstanding on 16 August 2012 but not outstanding on the date the reporting obligation takes effect). The ESMA Q&A clarifies that there is no need to report separately any life cycle events which occurred before the reporting start date. The contract can be reported in its final state or for contracts which are still outstanding, its state at the time the report is submitted.

Clearing Obligation

Mandatory Clearing

One of the most significant changes introduced by EMIR is to require the clearing of certain OTC derivative contracts through an authorised CCP.

The mandatory clearing obligation will apply to OTC derivative contracts entered into between any combination of (i) FCs and (ii) NFC+s. It also extends to OTC derivative contracts between an entity within (i) or (ii) above and a TCE that would be subject to the clearing obligation if it was established in the EU. Finally as stated above in the "Introduction" section of this Memorandum, the mandatory clearing obligation may apply to OTC derivative contracts between two TCEs that would be subject to the clearing obligation if they were established in the EU provided that the contract has a direct substantial and foreseeable effect within the EU or where such an obligation is necessary or appropriate to prevent the evasion of any provisions of EMIR.

The mandatory clearing obligation will only apply to OTC derivative contracts entered into or novated:-

(i) on or after the date from which the clearing obligation takes effect; or
(ii) on or after the date a competent authority notifies ESMA that it has authorised a CCP to clear a class of OTC derivatives under Article 14 or Article 15 of EMIR but before the date referred to in (i), if such contracts have a remaining maturity higher than the minimum remaining maturity determined by the Commission in accordance with Article 5(2)(c) of EMIR.

Classes of derivatives subject to the clearing obligation

Before the clearing obligation procedure may begin, CCPs must be authorised (or recognised in the case of a CCP from a third country) to clear under the new EMIR regime. Once a CCP has been authorised under EMIR to clear a certain class of OTC derivative contracts, ESMA is required, within six months, to develop and submit to the Commission for endorsement draft RTS specifying (i) the class of OTC derivative contracts that should be subject to the clearing obligation; (ii) the date or dates from which the clearing obligation takes effect, including any phase in and the categories of counterparties to which the obligation applies; and (iii) the minimum remaining maturity of the OTC derivative contracts referred to in the paragraph above.

ESMA, as required by EMIR, will consider the following criteria in determining whether a class of OTC derivative contracts should be subject to the clearing obligation;

- The degree of standardisation of the contractual terms and operational processes of the relevant class of OTC derivatives;
- The volume and liquidity of the relevant class of OTC derivatives; and
- The availability of fair, reliable and generally accepted pricing information in the relevant class of OTC derivatives.

ESMA's overarching aim in determining which class of OTC derivative contracts will be covered by the clearing obligation will be to reduce systemic risk. The recitals to EMIR clarify that that the predominant risk associated with certain classes of OTC derivatives contracts, such as FX contracts, is settlement risk, rather than counterparty risk (which is addressed through clearing) and that ESMA should take this into account when determining which classes of derivative contracts are to be subject to the clearing obligation. However, as yet, it is not known whether ESMA will decide not to include FX contracts in the scope of the clearing obligation as a result of this provision.

Not all OTC derivative contracts will be subject to the clearing obligation, for instance, bespoke derivative contracts will not have the level of standardisation required for clearing and will, therefore, not be subject to the clearing obligation.

Intragroup Transactions

OTC derivative contracts that ESMA has determined are subject to a mandatory clearing obligation must be cleared by an authorised CCP. An exemption exists from the clearing obligation in relation to OTC derivative contracts that constitute intragroup transactions as described under Article 3 of EMIR. The exemption will only apply where notification has been given to the relevant competent authorities in accordance with the provisions of EMIR.

Margin Requirements – Cleared Trades

Where a contract is centrally cleared, each derivative counterparty, will be required to post (i) initial margin and (ii) variation margin to the clearing member (if it accesses a CCP through a clearing member), which in turn will be required to post initial and variation margin to the CCP. EMIR requires that a CCP can accept only highly liquid collateral with minimal credit and market risk to cover its initial and ongoing exposure to its clearing members.

The foregoing means that it is likely that OTC derivative contracts cleared by CCPs will involve the posting of higher amounts of margin, (for example by making a default fund contribution) than an equivalent contract that is not currently cleared by a CCP. It is also likely that CCPs will charge fees for clearing services provided by them to clearing members, which in turn will be passed on to derivative counterparties. In this way, the cost implications of EMIR for derivative counterparties will likely be significant.

Timing of Clearing Obligations

On 12 July 2013, ESMA published a discussion paper (the "**Discussion Paper**") regarding the clearing obligation under EMIR and particularly the RTS which it is required to draft under Article 5(2) of EMIR which will deal with the following;

- The class of OTC derivatives that should be subject to the clearing obligation;
- The date or dates from which the clearing obligation takes effect; including any phase in and the categories of counterparties to which the obligation applies; and
- The minimum remaining maturity of OTC derivative contracts subject to the clearing obligations.

The Discussion Paper provides a description as to how ESMA will determine whether a class of OTC derivatives should be subject to the clearing obligation and the date from which the clearing obligation takes effect. The Discussion Paper is open for feedback until 12 September 2013. ESMA will use the feedback received to draft its technical standards on the clearing obligation, which will be presented in future public consultations.

In relation to timing, ESMA have six months, from the date of authorisation of CCPs by the National Competent Authorities ("NCAs") under EMIR, to submit draft RTS to the European Commission on the clearing obligation. On the basis that CCPs established in the EU had 6 months to submit their application for authorisation under EMIR from the 15th March 2013 (i.e. a deadline of 15 September 2013) and that NCAs have six months following a complete application to determine whether or not to authorise the CCP under EMIR (i.e. authorisation on or around 15 March 2014 at the latest), this suggests that ESMA has until 15 September 2014 at the latest to submit draft RTS to the European Commission on the clearing obligation. Following the submission by ESMA of the draft RTS referred to above, these draft RTS will need to be endorsed by the European Commission (which usually takes one to three months) and not-objected to by the European Parliament and the Council (a process which usually takes one to three months). The actual date of application of the clearing obligation will depend on the date of entry into force of these RTS and the expected phase-in period per type of counterparty, to be defined in the RTS. However based on the above timeframe, it is expected that the clearing obligation will not therefore come into effect until late 2014 / early 2015.

Risk Mitigation Requirements for Non-Centrally Cleared OTC Derivatives

FCs and NFCs who enter into OTC derivative transactions not cleared by a CCP must "*ensure, exercising due diligence, that appropriate procedures and arrangements are in place to measure, monitor and mitigate operational risk and credit risk*"[17].

Risk mitigation techniques for non-centrally cleared OTC derivatives provided for in EMIR include timely confirmations, portfolio reconciliation and compression, dispute resolution, marking-to-market and marking-to-model, the exchange of collateral and adequate capital to cover the exposures arising from OTC derivatives not cleared by a CCP. Greater information on these requirements was included in in our last EMIR Client Memorandum[18] in March 2013 titled "EMIR – Key Points and Dates Applicable to Financial Counterparties".

As stated in the "Introduction" section of this Memorandum, the draft technical standards related to the exchange of collateral and adequate capital are in the process of being developed.

Currently no OTC derivative transactions are subject to the clearing obligation under EMIR and consequently all OTC derivative transactions are subject to the risk mitigation requirements.

The following is a summary of the various risk mitigation requirements clarifying the class of counterparty to whom the requirement applies and the effective date of that requirement:-

Risk Mitigation Requirement	**Counterparties to whom the Requirement Applies**	**Effective Date of the Requirement**
Timely Confirmation	FCs, NFC-s and NFC+s	15 March 2013
Daily Marking to Market	FCs and NFC+s	15 March 2013
Portfolio Reconciliation	FCs, NFC-s and NFC+s	15 September 2013
Portfolio Compression	FCs, NFC-s and NFC+s	15 September 2013
Dispute Resolution	FCs, NFC-s and NFC+s	15 September 2013

[17] For the avoidance of doubt, the Risk Mitigation Requirements do not apply to OTC derivative transactions which are cleared by a CCP.
[18] See http://www.dilloneustace.ie/download/1/EMIR%20-%20Key%20Points%20and%20Dates..pdf

Collateral exchange and capital requirements[19]	Likely to apply where both parties are FCs or NFC+s – however as yet to be confirmed.	No RTS drafted as yet

As you will note from the above, the portfolio reconciliation, portfolio compression and dispute resolution requirements apply to OTC derivative contracts which are outstanding on 15 September 2013 (irrespective of the date on which they were entered into) and apply to any contract concluded thereafter.

In order to assist market participants to comply with the risk mitigation requirements of EMIR, the International Swaps and Derivatives Association, Inc ("**ISDA**") has developed a means by which market participants can reduce the amount of amendments required to their derivatives documentation in order to address certain of EMIR's requirements. In this regard, ISDA has published two protocols; (i) ISDA 2013 EMIR NFC Representation Protocol and (ii) ISDA 2013 EMIR Portfolio Reconciliation, Dispute Resolution and Disclosure Protocol.

Note, there is no obligation for counterparties to adhere to the protocols although it is expected that counterparties on the sell side will look for such adherence. If both counterparties do not adhere to a protocol or if only one counterparty adheres, it will be necessary for the counterparties to negotiate and agree procedures to ensure compliance with the risk mitigation obligations regarding portfolio reconciliation, portfolio compression and dispute resolution by 15 September 2013.

ISDA 2013 EMIR NFC Representation Protocol

ISDA published the ISDA 2013 EMIR NFC Representation Protocol (the "**Representation Protocol**") on 8 March 2013. As outlined above, a counterparty's obligations under EMIR vary depending on its categorisation under EMIR (i.e, a FC, NFC+ or NFC-). The Representation Protocol is designed to facilitate the process by which participants are able to identify the category of their counterparties under EMIR.

The Representation Protocol applies to ISDA Master Agreements which have been executed by two parties prior to adherence to the Representation Protocol, and to "deemed" master agreements which have arisen by two parties signing long form confirmations (prior to adherence to the Representation Protocol) deeming the parties to have entered into a standard ISDA Master Agreement until such time as the parties actually execute an ISDA Master Agreement (hereinafter collectively referred to as an "**ISDA Master Agreement**").

[19] As outlined above, the RTS on collateral exchange have yet to be drafted by ESMA.

Parties wishing to adhere to the Representation Protocol should complete an adherence letter on the Protocol Management section of ISDA's website[20]. An adhering party is required to pay a one-time fee of $500 to ISDA upon or before submitting its adherence letter. Once the signed Adherence Letter has been approved and accepted by ISDA, the party will receive an e-mail confirmation of the party's adherence to the Representation Protocol. Following adherence by both parties to the Representation Protocol, the ISDA Master Agreement is deemed to be amended by incorporating the Representation Protocol into the Schedule of the ISDA Master Agreement.

The Representation Protocol contains a mechanism whereby a party can represent that (i) it is a NFC or to the best of its knowledge and belief would be a NFC if it were established in the EU and (ii) it is not subject to the clearing obligation (i.e. it is an NFC-). If an NFC is above the clearing threshold (i.e. it is an NFC+), it will make the applicable representation confirming the representation in (ii) above is not applicable to it. FCs not making the representation described above can also adhere to the Representation Protocol in order to take the benefit of the representations made by their NFC (and, in certain circumstances, TCE) counterparties under the Representation Protocol. Therefore, FCs, NFCs and TCEs can all adhere to the Representation Protocol.

.

The Representation Protocol also contains a mechanism which allows an adhering party to notify counterparties of a change in status (e.g. from a NFC+ to a NFC-). This mechanism could be used for example where a non-UCITS fund signs up to the Representation Protocol as a NFC, and is later required to notify counterparties that it is no longer a NFC but a FC because it is managed by an authorised or registered AIFM in accordance with the AIFM Directive. It would do so by notifying its counterparty that it is a non-representing party.

There is currently no cut off date for adherence to the Representation Protocol, but ISDA reserves the right to designate a closing date of this protocol by giving 30 days' notice on the ISDA website.

ISDA 2013 EMIR Portfolio Reconciliation, Dispute Resolution and Disclosure Protocol

ISDA has published its EMIR Portfolio Reconciliation, Dispute Resolution and Disclosure Protocol (the "**Risk Mitigation Protocol**") which allows both parties to an ISDA Master Agreement or other derivatives agreement covered by the Risk mitigation Protocol (a "**Risk Mitigation Protocol Covered Agreement**") to simultaneously amend the terms of any such agreement to reflect certain of EMIR's September 15 requirements (i.e. requirements relating to portfolio reconciliation and dispute resolution) provided both parties adhere to the Risk Mitigation Protocol.

Following adherence to the Risk Mitigation Protocol by both parties to a Risk Mitigation Protocol Covered Agreement, the latter is deemed to be amended by incorporating the following parts of the attachment to the Risk Mitigation Protocol into the Risk Mitigation Protocol Covered Agreement:-

[20] See http://www2.isda.org/functional-areas/protocol-management/open-protocols/

- Part I contains an agreement between the adhering parties as to (i) the arrangements for the reconciliation of portfolios and (ii) a dispute resolution process;
- Part II contains a confidentiality waiver intended to facilitate compliance with reporting obligations under EMIR; and
- Part III contains remedies for breach of the Risk Mitigation Protocol.

The Risk Mitigation Protocol may also be relevant to certain TCEs, because FCs, NFC-s and NFC+s who transact with TCEs will be obliged to ensure that those TCEs comply with the requirements of EMIR which are referred to in the Risk Mitigation Protocol, in order to facilitate their own compliance[21].

The Risk Mitigation Protocol is available on the ISDA website. Parties may adhere to the Risk Mitigation Protocol by completing an adherence letter via the Protocol Management section of ISDA's website[22].and by paying a once off fee of $500 to ISDA.

Counterparties need to be aware that the Risk Mitigation Protocol is not sufficient to address all of EMIR's risk mitigation requirements relating to non-centrally cleared OTC derivatives and therefore need to take steps to ensure compliance with these additional requirements by 15 September 2013. Such additional requirements include the following obligations:-

(i) EMIR requires FCs to report to their national competent authority any dispute relating to an uncleared OTC derivative contract, its valuation or the exchange of collateral for an amount or a value higher than €15 million and outstanding for at least 15 business days[23];

(ii) EMIR requires both FCs and NFCs to have detailed procedures and processes in place in relation to (a) the identification, recording, and monitoring of disputes relating to the recognition or valuation of the contract and to the exchange of collateral between counterparties (recording at least the length of time for which the dispute remains outstanding, the counterparty and the amount which is disputed) and (b) the resolution of disputes in a timely manner with a specific process for those disputes that are not resolved within five business days[24].

[21] However as stated in the "Introduction" section, if the European Commission adopts implementing acts declaring that the legal, supervisory and enforcement arrangements of a non-EU country are equivalent to the requirements laid down in EMIR relating to inter alia the risk mitigation obligations under EMIR, EMIR clarifies that any implementing act on equivalence shall imply that counterparties entering into a transaction subject to EMIR shall be deemed to have fulfilled the relevant obligations where at least one of the counterparties is established in that third country.

[22] See http://www2.isda.org/functional-areas/protocol-management/open-protocols/

[23] See Article 11 of EMIR and Art 15(2) of RTS 149/2012

[24] See Article 11 of EMIR and Art 15(1) of RTS 149/2012

Parts I (4) to (6) of the attachment to the Risk Mitigation Protocol set out the arrangements between adhering parties as to the identification and resolution of disputes. Where any dispute is not resolved within 5 business days, parties are required to refer issues internally to appropriately senior members of staff.

An FC or NFC that adheres to the Risk Mitigation Protocol is also required to agree that it will have internal procedures and processes in place to record and monitor any dispute for as long as the dispute remains outstanding. Consequently FCs and NFCs should ensure that they establish such procedures and processes.

(iii) An FC or NFC, in each case, with 500 or more OTC derivative contracts outstanding with any single counterparty, is required to have procedures in place to regularly, and at least twice a year, analyse the possibility of conducting a portfolio compression exercise in order to reduce its counterparty credit risk[25]. In addition, FCs and NFCs must ensure that they are able to provide a reasonable and valid explanation to the relevant competent authority for concluding that a portfolio compression exercise is not appropriate.

Legal Entity Identifiers

Recent G20 summits have stressed the importance of a global legal entity identifier system ("**LEI"**) which would clearly and uniquely identify a legal entity that engages in a financial transaction. In 2012, the task of coordinating the global LEI system was given to the Financial Stability Board ("**FSB**") by the G20. The FSB recommended the establishment of a three tier structure comprising a Regulatory Oversight Committee ("**ROC**"); a Central Operating Unit ("**COU**"); and a series of country based Local Operating Units ("**LOU**"). The ROC is a standalone committee whose membership is derived from a large number of authorities across the world and aims to coordinate and oversee the development of a LEI system. The Central Bank, as the regulatory oversight body in Ireland, is a member of the ROC. The COU is in the process of being established and will be the operational arm of the LEI system. The COU will be responsible for ensuring how the system will work to uniform standards and procedures. The COU will also ensure that LOUs agree to adhere to uniform standards and procedures. The LOU will be the local implementer of the LEI system and in particular will offer local registration, validation and maintenance of the LEI system.

As outlined above the COU is not yet fully operational and therefore there are no fully functional LOUs as yet. However, there is a pre-LEI process in place which allows entities apply for a pre-LEI code. The Irish Stock Exchange ("**ISE**") has been designated as a pre-LOU in Ireland, and in this capacity expects to issue pre-LEIs from 30 September 2013. The ISE issued guidance in June 2013 regarding the pre-LEI application process and the documentation required to apply for a pre-LEI. Firms can apply online for a pre-LEI on www.isedirect.ie and the cost per pre-LEI is €150. There is

[25] See Article 11 of EMIR and Art [] of RTS 149/2012

also an annual renewal cost per pre-LEI (€100). An entity can make an application for a pre-LEI on behalf of another entity provided that the other entity signs a letter authorising that entity to make an application on its behalf; e.g. a management company or a general partner (whichever is applicable) will be able to apply for a LEI on behalf of a fund in addition to any LEI which it may require in its own right for proprietary trading.

This interim system of pre-LOUs and pre-LEIs will continue until the COU is set up, at which point the LEIs will become fully operational. It is expected that the pre-LOUs will convert to LOUs and the pre-LEIs will convert to LEIs. In addition, it is expected that the LOUs will start issuing LEIs at that point.

Currently only certain financial transactions involving OTC derivatives in the US use pre-LEIs for reporting purposes. These pre-LEIs are known as CICIs and are issued by the DTCC and SWIFT, following their designation by the U.S. Commodity Futures Trading Commission ("**CFTC**") as the provider of entity identifiers for CTFC reporting purposes in July 2012. In Europe, firms that will be required to report under EMIR will be obliged to have a pre-LEI number[26] and this will coincide with the reporting obligation to TRs further detailed in the section above titled "Status of Key Obligations under EMIR".

Dated: 10 September 2013

[26] See Table 1 of the Annex to Commission Implementing Regulation (EU) No 1247/2012 of 19 December 2012 laying down implementing technical standards with regard to the format and frequency of trade reports to trade repositories according to Regulation (EU) No 648/2012 which sets out the information that is required to be reported to a TR and which can be found at the follo0wing link
http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:352:0020:0029:EN:PDF

CONTACT US

Our Offices

Dublin
33 Sir John Rogerson's Quay
Dublin 2
Ireland
Tel: +353 1 667 0022
Fax: +353 1 667 0042

Cayman Islands
Landmark Square
West Bay Road, PO Box 775
Grand Cayman KY1-9006
Cayman Islands
Tel: +1 345 949 0022
Fax: +1 345 945 0042

Hong Kong
604, 6/F, Printing House
6 Duddell Street
Central
Hong Kong
Tel: +852 35210352

New York
245 Park Avenue
39th Floor
New York, NY 10167
United States
Tel: +1 212 792 4166
Fax: +1 212 792 4167

Tokyo
12th Floor,
Yurakucho Itocia Building
2-7-1 Yurakucho, Chiyoda-ku
Tokyo 100-0006, Japan
Tel: +813 6860 4885
Fax: +813 6860 4501

e-mail: enquiries@dilloneustace.ie
website: www.dilloneustace.ie

Contact Points

For more details on how we can help you, to request copies of most recent newsletters, briefings or articles, or simply to be included on our mailing list going forward, please contact any of the team members below.

Brian Kelliher
E-mail: brian.kelliher@dilloneustace.ie
Tel : + 353 1 673 1721
Fax: + 353 1 667 0042

Michele Barker
E-mail: michele.barker@dilloneustace.ie
Tel : + 353 1 673 1886
Fax: + 353 1 667 0042