

EMIR: An Overview of the New Framework

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The “European Market Infrastructure Regulation,” known as EMIR, was adopted on July 4, 2012, as the Regulation on OTC Derivatives, Central Counterparties and Trade Repositories (EU 648/2012), and took effect in all EU Member States on August 16, 2012. As an EU Regulation, EMIR is effective in EU Member States without the need for national regulations or legislation.

The EMIR regulatory framework is made up of Regulation EU 648/2012 (the “Regulation”) and several European Commission Implementing Regulations and Delegated Regulations which set out technical standards addressing matters of detail under the Regulation. The Implementing Regulations and Delegated Regulations were published in the *Official Journal of the European Union* on February 23, 2013, and became effective on March 15, 2013.

What Does EMIR Require?

EMIR is the EU measure implementing the September 2009 Pittsburgh G-20 Summit agreement that all standardized OTC derivatives contracts should be cleared through a central counterparty (CCP) and be reported to a trade repository (TR). Financial counterparties and non-financial counterparties whose aggregate OTC derivatives positions exceed the clearing threshold (see below) are subject to obligatory clearing and reporting of transactions and risk mitigation requirements. Non-financial counterparties with aggregate OTC derivatives positions below the clearing threshold are subject to certain reporting obligations and certain risk mitigation requirements. EMIR also sets out authorization standards for EU-based CCPs and TRs and recognition standards for non-EU CCPs and TRs.

Who Is Within the Scope of EMIR's Clearing and Reporting Requirements?

EMIR's clearing and reporting requirements apply to any entity established in an EU Member State that enters into (is a legal counterparty to) a derivatives contract and to a non-EU entity that enters

into a derivatives contract with an EU counterparty. In principle, where both parties to a transaction are located outside the European Union, they are not subject to EMIR's requirements. However, EMIR's requirements do apply where two non-EU entities (that would be subject to the obligation if they were entities established in the European Union) enter into an OTC derivatives contract that has "a direct, substantial and foreseeable effect" within the European Union or where "necessary or appropriate to prevent evasion" of EMIR's provisions.

Who Is a Financial Counterparty/Non-Financial Counterparty?

Financial counterparties include EU authorised banks, investment firms, funds and fund managers, insurance undertakings, spread betting firms and pension schemes. A non-financial counterparty is any corporate or other counterparty that is not a financial counterparty, including an entity which is not involved in financial services.

What Is the Clearing Threshold?

The following clearing thresholds apply to a party's rolling average position over 30 working days (excluding hedging transactions):

- €1 billion in gross notional value for OTC credit derivatives;
- €1 billion in gross notional value for OTC equity derivatives;
- €3 billion in gross notional value for OTC interest rate derivatives;
- €3 billion in gross notional value for OTC foreign exchange derivatives; and
- €3 billion in gross notional value for commodity derivatives and other OTC derivatives not listed above.

What Is the Clearing Obligation?

The clearing obligation applies to all OTC derivatives contracts once the applicable thresholds above are reached. It ceases to apply when the gross notional value of a party's positions remains below the applicable threshold for 30 working days. Effective March 15, 2013, a non-financial counterparty is required to notify the national regulator under whose jurisdiction it falls when it exceeds the clearing threshold and when it no longer exceeds it.

The clearing obligation pertains to OTC derivatives transactions which meet eligibility criteria established under EMIR under a "bottom up" or "top down" approach. Under the top down approach

the European Securities and Markets Authority (ESMA) mandates classes of contracts to be cleared by CCPs; under the bottom up approach CCPs decide to clear certain classes of contracts subject to approval by ESMA. All transactions in a contract subject to mandated clearing entered into by financial counterparties or by non-financial counterparties whose aggregate OTC derivatives positions exceed the clearing threshold must be cleared through a CCP which is EU-authorised or established in a third country and EU-recognised.

When Will the Clearing Obligation Begin?

The clearing obligation cannot commence until CCPs are authorised or (in the case of a non-EU CCP) recognised. Transitional provisions apply to CCPs that are currently providing clearing services in the European Union provided that they apply for authorisation or recognition under EMIR within six months after March 15, 2013 (the date the technical standards come into force), in order to benefit from the EMIR transitional provisions.

What Is the Reporting Obligation?

All derivatives contracts, both OTC and exchange-traded, entered into by financial counterparties and by non-financial counterparties after August 16, 2012, are required to be reported to a trade repository which is EU-authorised or established in a third country and EU-recognised.

When Will the Reporting Obligation Begin?

ESMA will issue technical standards specifying the date the reporting obligation begins. Subject to the authorisation or recognition of TRs, ESMA has stated that reporting obligations for credit and interest rate derivatives are expected to take effect July 1, 2013 at the earliest, and January 1, 2014 at the earliest for derivatives contracts in all other asset classes.

What Are the Risk Mitigation Obligations?

Risk mitigation requirements apply to all uncleared OTC derivatives transactions. Different detailed requirements apply to counterparties depending on whether they are subject to the clearing obligation (financial counterparties and above-the-threshold non-financial counterparties) or are not subject to it (below-the-threshold non-financial counterparties). EMIR's risk mitigation requirements apply where two non-EU entities (that would be subject to the obligation if they were entities established in the European Union) enter into an uncleared OTC derivatives contract that has "a direct, substantial and foreseeable effect" within the EU or where "necessary or appropriate to prevent evasion" of EMIR's

provisions.

The following risk mitigation requirements apply to all counterparties in respect of uncleared OTC derivatives transactions:

- Timely confirmation (effective March 15, 2013);
- Portfolio reconciliation (effective September 15, 2013);
- Portfolio compression (effective September 15, 2013); and
- Dispute resolution processes and procedures (effective September 15, 2013).

In addition, financial counterparties and above-the-threshold non-financial counterparties are subject to:

- Daily valuation and mark to market or mark to model (effective date to be announced).
- Timely, accurate and appropriate segregated exchange of collateral (effective date to be announced).

What Issues Should I Be Considering if I Trade OTC Derivatives?

Anyone trading OTC derivatives should consider a range of potential questions, including, for example:

- Are you complying with the timely confirmation obligations?
- Do you have access to clearing either as a member of a CCP or a client of a clearing member?
- Do you have agreements in place under which you can provide required collateral?
- Do you have sufficient eligible collateral available?
- Do you have systems for reporting reportable transactions through a TR?
- If you are a non-financial counterparty, do you have systems in place for assessing on an ongoing basis whether you are above or below the clearing threshold?
- Are you required to notify your national regulator that you have exceeded the clearing threshold?
- Do you have the required procedures in place for the applicable risk mitigation techniques?

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