European Markets and Infrastructure Regulation (EMIR)

European Markets and Infrastructure Regulation (EMIR) was born at the trilogue meeting of, the European Parliament, the Council and the European Commission on 9 February 2012, they reached a Conesus for better regulation and supervision of OTC derivatives, central counterparties and trade repositories (the Regulation, or EMIR) as argued by the European Parliament and Council.

Under EMIR counterparties entering into OTC derivative contracts have to report their trades to Trade Repositories registered with the regulators, and eligible instruments as listed by the regulator needs to be cleared via Central Counter Parties (CCP) alone.

European Markets Infrastructure Regulation (or EMIR) regulates Over-the-Counter (or OTC) derivative trade reporting to Trade Repository (TR) in a uniform format under defined field or headers across European Union (or EU) to ensure safe and secure clearing practices. As per EMIR, clearing of all standardized OTC derivative contracts either through exchanges or electronic trading platforms is compulsory. OTC contracts which are not cleared through Central Counterparty (or CCP) will be subject to additional capital or margin requirement.

EMIR as a regulation was introduced to reduce systemic risk increasing the safety and efficiency of the OTC derivatives market. The objective of this regulation was to cover three broader areas, namely to

1. Increase transparency by obtaining complete and comprehensive information on OTC derivatives positions
2. Reduce counterparty credit risk by increasing the use of CCP clearing,
3. Reduce operational risk associated with OTC derivatives by Improve bilateral clearing practices and standardization of OTC derivatives contracts

On a broader case, counterparties to the OTC contracts are classified as Financial Counterparty (FC) and Non-Financial counterparty (NFC) under EMIR, with NFC's having few exemptions on clearing contracts till certain threshold level for each OTC derivative instrument (***see clearing threshold exemptions***). Further this classification is drilled down based on Counterparties categorisation like, membership as clearing member, firm's status (FC or NFC), and their outstanding uncleared OTC derivative position.

EMIR concentrates on the below;

1. Clearing obligation for standardized OTC trades
2. Additional capital / Margin requirement for centrally non cleared trades
3. Reporting of trade data to trade repositories

Back Loading Applicability:

OTC derivatives transactions obligated to be reported under this regulation shall include transactions entered into before 16 August 2012 and remain outstanding on that date or entered into on or after 16 August 2012.

EMIR & third country counterparty:

EMIR applies to both the EEA member registered firms entering into an OTC derivative contract or only one counterparty to the contract is an EEA member registered firm. The exemption provided for NFC is for clearing obligation alone, for reporting purpose they have to report each of their OTC derivative transactions.

Record Keeping:

Transactions has to be reported before the close of next business hours and the records are to be kept for a period of 5 years for scrutiny, including transactions that have been modified.

Reporting:

EMIR's technical standards will require firms to improve their current record keeping practices, the timeline to report the executed transactions are only between 24 hrs to 36 hrs depending upon your executed time. Firms have to rebuild their internal systems in a comprehensive way to meet the EMIR's reporting and other regulatory demands, the data sort for are significant and requires detailed information, the need for subject matter experts for better understanding is very much essential, obligated firms under EMIR have to improve their current practices and scale up future capabilities across all business areas, including recording all transaction, position and business information.

EMIR reporting data forms two parts to it, the reporting firms details & the contract details and Counterparty details, each derivative has to be reported as a separate line point in the xml format to the regulator, so if a firm enters into a normal derivative contract and a commodity one, they has to be reported in two separate line and only the relevant template fields has to be populated for transaction.

Though the obligated firms can outsource these functions, penalty for non-compliance or wrong data, will still rest with the obligated firm, than the outsourcing firm which reports the data to the regulator.

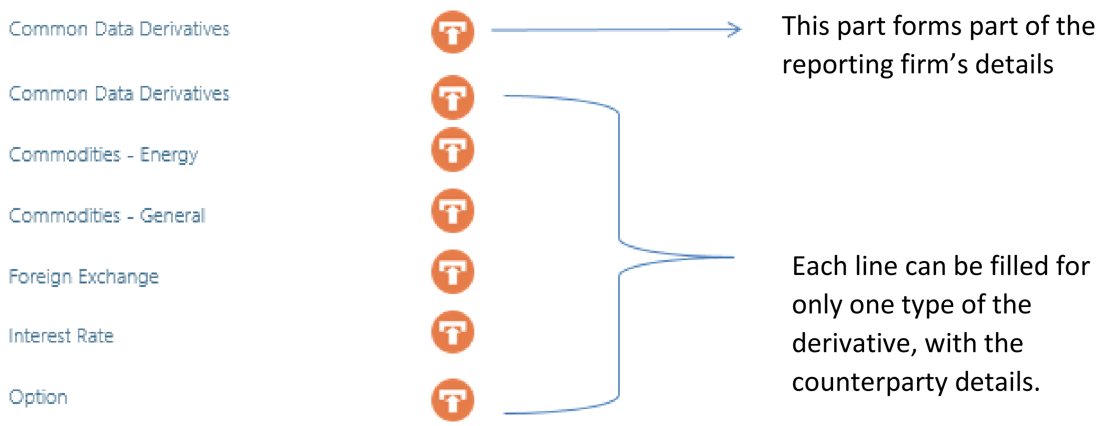
At the end of the day, firms will be under pressure to pull all these pieces together into a coherent story to reconstitute many currently irreconcilable trades and positions.

Transaction Reporting:

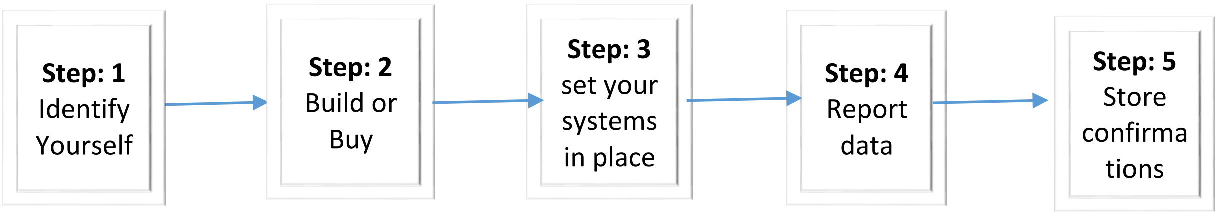
Regulators under EMIR are more interested in collecting data in a compressed form to check the systematic risk to EU, the obligated firms should report specified data as per EMIR technical standards to the TR about the trades with values as per the validation level. All reportable trade data has to be filed to the TR within the close of business of the next business day

All derivative contracts need to be reported to Trade Repository (TR), and reporting of data will be of;

ANNEX	Data Type	Information	Fields
ANNEX - Table 1	Relating to parties to the Contract	Who & whom	26
ANNEX - Table 2	Data about the contract	what, when, where, how & how many	59



What firms need to analyse?



Clearing threshold exemptions:

While calculating the threshold, gross notional value shall be taken into account, excluding cash position; spot FX transactions and transactions for hedging purpose shall be exempted from trade reporting, but will be considered for calculating threshold level. Clearing threshold is calculated at notional level.

Value of the clearing thresholds :	
Threshold	Instrument
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

OTC derivatives are subject to counterparty risk exposure limits as per the Directive,

EMIR Collateral Models

1. **Individual client segregation Model**

Is considered less risky or no risk, since the CM will transfer the collateral placed by FIRMS to other CM or will liquidate its position, in case of scenarios of default by CM.

CM attempt for "Porting" the collateral placed by FIRMS under Individual Client Segregation model.

2. **Omnibus client segregation Model**

Omnibus Model is a collective net obligation for CM, so any collateral placed by firms to CM may be on individual basis, but the collateral placed by CM in turn to CCP will be at net obligation.

In case of this model, the collateral risk is similar for both OTC & ETD.

In case of default by the CM or by any of its affiliates or any client, CCP will transfer collateral placed, after liquidating or closing the position. So the risk of firms not getting the collateral posted or denied exposure on the placed collateral are very high.

Authorization or Recognition of CCP and TR

EMIR implies to both the parties of any derivative transactions traded on Exchange or OTC, daily reporting of exposure is compulsory to institutions which exceed the threshold specified in EMIR. Delegation of transaction reporting to third party service providers in and out of EU is allowed as per EMIR, but the liability to report trade data shall be vested with the obligated institutions to report.

Counterparty:

Any person or institution entering into a derivative contract is considered a counterparty; EMIR classification of Counterparties is under 2 broad categories;

1. Financial Counterparty (or FC)
2. Non-Financial Counterparty (or NFC)

NFC - (minus) are those institutions that are below the threshold limits as per EMIR

NFC + (plus) are those institutions that are above the threshold limits as per EMIR

Why should you bothered:

1. Each firm needs to understand in which category they fall into, (**there are totally 4 category as specified by the regulator**) and what their obligations are for reporting, clearing and risk mitigation.
2. Being an NFC is not going to be an easy escape here, you need to know your thresholds and keep a close watch on it, you need to check your positions and thresholds on a daily basis to determine reporting and clearing obligations. Proving transactions as a hedge to claim exemption (***as per Article 11 (5) (7) (9) & (10))*** at individual or group level will also be a nightmare