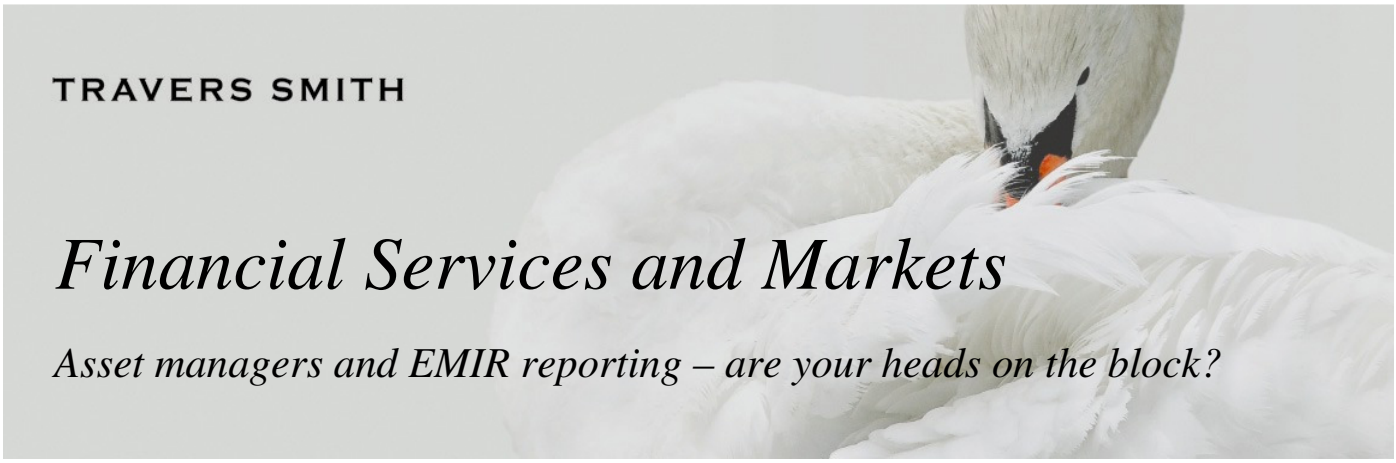

TRAVERS SMITH

Financial Services and Markets

Asset managers and EMIR reporting – are your heads on the block?

With a week to go before trade reporting under EMIR goes live, significant new concerns are emerging about how the FCA sees the obligations of an asset manager when executing a block trade that has yet to be allocated.

The position under EMIR and ESMA Q&As

As we reported in our earlier client briefing notes, from 12 February 2014, broadly all EEA counterparties to derivatives transactions, whether OTC or exchange-traded, must report the details of their trades to registered trade repositories.

It is clear from EMIR and the current version of the ESMA Q&A that the obligation to report falls on the principal counterparty to the transaction. In the case of an investment fund or other client acting by its asset manager, the principal counterparty is typically the fund or client itself (although the manager may owe a fiduciary and/or legal duty to the fund or client to ensure that the latter fulfils its EMIR obligations, including those relating to reporting). Where the fund or client is not established in the European Economic Area (for example where it is established in the United States, Cayman Islands or Channel Islands) the fund or client will not be subject to the EMIR reporting obligations, unless it is an AIF managed by an AIFM authorised or registered under AIFMD. (A non-EEA fund or client could be subject in due course to the clearing obligations under EMIR in certain circumstances and may already be required to comply with some of the Regulation's requirements by an EEA counterparty).

The FCA interpretation

It has come to our attention that senior policy officials at the UK Financial Conduct Authority are taking a surprising (and, we believe, legally incorrect) view that, in certain circumstances, **a UK asset manager, acting as agent for any client or fund wherever established, could have a reporting obligation in its own right under EMIR in respect of block trades**. This view is not stated expressly on the FCA website, nor in any official publication, but it has been put forward in a number of recent speeches by FCA staff and has been communicated to certain trade associations and law firms. We understand that the FCA does not currently intend to make any public statement about its interpretation.

The FCA takes the view that where a UK-established asset manager deals as agent in a derivative transaction on an aggregated basis for more than one client, and the transaction is not allocated at the time of execution, the asset manager must report details of the trade to a trade repository **as if the asset manager were the principal counterparty to the trade** (albeit noting its agency status in the relevant reporting field.)

We understand that the FCA is of the view this interpretation holds even if:

- the trade is subsequently allocated between principals in time for the timely reporting of the trade by or on behalf of the true principals; or

- the whole of the trade is to be allocated - and is in fact allocated - to clients who are not subject to the EMIR reporting obligations (e.g. because they are all established outside the EEA).

In the FCA's view, as and when the trade is allocated, the aggregated trade will have to be reported to the trade repository as "cancelled out", and the individual components reported by or on behalf of the principals. Where not all of the principals are subject to the reporting obligation, this will result in the sum of the "re-reported" trades being less than the amount of the initial block reportable (under the FCA's interpretation) by the manager.

In the circumstances, asset managers may wish to consider taking steps to mitigate the risk arising from the FCA's interpretation, for example by:

- not aggregating trades (although this may require changes to the manager's order handling policy which may in turn increase transaction costs); or
- pre-allocating aggregated trades and disclosing the identity of the principals to the counterparty at the point of trade; or, failing either of those steps:
- allocating between principals immediately after the trade, in time for the timely reporting of the trade by or on behalf of each relevant principal (although this would not appear to be sufficient in the FCA's view, we believe that it would be likely in practice to mitigate substantially the risk of enforcement action if the other two options are impractical).

We understand that some elements of the FCA view are still to be debated and that the FCA has been discussing its interpretation with other EU regulators. As a result, this view may gain traction at the European level, and particularly with ESMA. An update to ESMA's Q&As is expected soon, perhaps later this week. It remains to be seen whether the revised Q&As will shed more light on this issue, or will serve to intensify the gloom.

For further information on any of the issues discussed above, please contact any of the financial services partners named below.

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