

## *Financial Services and Markets*

### *EMIR: Beware the Ides of March*

The 15<sup>th</sup> of March proved to be an inauspicious day for Julius Caesar. Friday of next week will, one hopes, prove to be much less dramatic for OTC derivatives counterparties, central counterparties (CCPs) and would-be trade repositories, but will take on significance as the day on which the provisions of the European Market Infrastructure Regulation ("**EMIR**") finally start to take effect. While EMIR has technically been in force since last summer, its substantive regulatory requirements have effectively lain dormant pending the finalisation of detailed implementing measures. Six of these implementing measures have now been published and come into effect on 15 March 2013. In this briefing, we highlight the key practical implications in terms of timing for counterparties to derivatives trades.

Our earlier (and more detailed) briefing note on EMIR is available [HERE](#).

#### **Risk mitigation and notification obligations that will apply to OTC counterparties from 15 March 2013:**

Certain risk mitigation obligations in respect of OTC derivative contracts not cleared by a CCP will apply from this date, as will the criteria which determine whether a non-financial counterparty is above, or below, the "clearing threshold" (see below).

- **Timely confirmation of trades**

Every OTC derivative contract which is not centrally cleared by a CCP must be confirmed, where available by electronic means, as soon as possible and at the latest by certain specified deadlines. These deadlines differ depending upon the nature of the derivative and, in the case of a non-financial counterparty, whether it is above or below the clearing threshold (see below). Furthermore, the deadlines will become tighter on a "phased" basis over the next year or so. In summary, as from 15 March 2013 the *starting position* will be as follows:

*Financial counterparties and non-financial counterparties above the clearing threshold:*

Derivative type	Initial deadline for confirmation
Credit default swaps and interest rate swaps	End of T+2
All other derivatives (including equity swaps, FX swaps, and commodity swaps)	End of T+3

*Non-financial counterparties below the clearing threshold:*

Derivative type	Initial deadline for confirmation
Credit default swaps and interest rate swaps	End of T+5
All other derivatives (including equity swaps, FX swaps, and commodity swaps)	End of T+5

Note that where the trade is concluded after 16.00 local time, or with a counterparty in a different time zone which does not allow confirmation by the relevant deadline, the above deadlines are extended by one further business day.

Counterparties may find themselves having to confront practical issues as to what may be taken to constitute a confirmation and in what circumstances can one say that confirmation by electronic means is "available".

EMIR also imposes an obligation on financial counterparties to have procedures to report on a monthly basis to their competent authority the number of unconfirmed OTC derivative contracts that have been outstanding for more than five business days. The FSA has indicated that financial counterparties will be contacted individually to request that a report is submitted: they do not need to submit a report unless one has been requested, but must have procedures in place to do so when requested.

- **Marking-to-market / marking-to-model**

EMIR requires financial counterparties and non-financial counterparties above the clearing threshold (see below) to mark-to-market on a daily basis the value of outstanding OTC derivative contracts that are not cleared by a CCP. Where market conditions prevent marking-to-market, counterparties may use a "reliable and prudent" mark-to-model.

The relevant delegated legislation provides that market conditions will prevent marking-to-market (and therefore marking-to-model will be permissible) only when:

- the market is inactive (the market is considered to be inactive when quoted prices are not readily and regularly available and those prices available do not represent actual and regularly occurring market transactions on an arm's length basis); or
- the range of reasonable fair value estimates is significant and probabilities of the various estimates cannot reasonably be assessed.

The relevant delegated legislation also prescribes certain criteria that must be satisfied in relation to a model used for marking-to-model.

- **Non-financial counterparties above "clearing threshold" to notify competent authority**

A non-financial counterparty that enters into positions in OTC derivative contracts that exceed certain prescribed clearing thresholds is required to notify its competent authority (and ESMA) immediately. This obligation will become active on 15 March 2013. The relevant RTS has set the clearing thresholds at a high level: €1 billion for credit and equity derivatives and €3 billion for all other derivatives (including interest rate, FX and commodity derivatives), calculated by gross notional value. In calculating positions in OTC derivatives, a non-financial counterparty only needs to include those contracts entered into by it (or by other non-financial entities within its group) which are "not objectively measurable as reducing risks directly relating to the commercial activity or treasury financing activity" of that non-financial counterparty (or of its group) i.e. which are not taken out for hedging purposes.

In readiness for 15 March 2013, the FSA has published on its website specimens of the forms that non-financial counterparties that have breached the clearing threshold will be required to submit. These will become active on 15 March 2013, along with details as to how such firms should notify the FSA. See <http://www.fsa.gov.uk/about/what/international/emir/emir-notifications-and-exemptions> for further details.

### **Risk mitigation obligations that will apply to OTC counterparties from 15 September 2013:**

The relevant delegated legislation provides that further risk-mitigation obligations will apply from 15 September. These are:

- Portfolio reconciliation
- Portfolio compression
- Dispute resolution procedures

### Reporting obligations that will apply to derivatives counterparties from 1 July 2013 (at the earliest):

Under EMIR, financial counterparties and non-financial counterparties (regardless of whether they are above or below the clearing threshold) are required to report all OTC and exchange-traded derivative contracts they enter into to trade repositories. This obligation applies to all transactions outstanding as at 16 August 2012 and any transactions entered into since that date. The relevant implementing technical standards (which have not yet been finally published) prescribe when this reporting obligation is to begin:

Derivative type	When does reporting obligation begin?
Credit default swaps and interest rate swaps	<b>1 July 2013</b> - if a trade repository has been registered for that class by 1 April 2013 or, if not <b>90 days after registration of trade repository</b>
All other derivatives (including equity swaps, FX swaps, and commodity swaps)	<b>1 January 2014</b> - if a trade repository has been registered for that class by 1 October 2013, or, if not <b>90 days after registration of trade repository</b>

The ultimate fall-back position is that, if no trade repository has been registered by 1 July 2015 for the relevant class, counterparties should instead report to ESMA from that date onwards and until a trade repository is registered. This is unlikely to happen.

### Risk mitigation obligations that will apply to OTC counterparties at some point in the future:

EMIR requires financial counterparties to have risk-management procedures that require the timely, accurate and appropriately segregated exchange of collateral with respect to OTC derivative contracts entered into on or after 16 August 2012. Non-financial counterparties are required to have such procedures with respect to OTC derivatives entered into on or after the date on which they exceed the clearing threshold. Since regulatory technical standards in relation to these requirements have not yet been developed, it is difficult to predict when the segregated exchange of collateral obligation is likely to become effective.

For further, more detailed information on how we may be able to help you with these issues and other EMIR questions please contact one of the following partners in our Financial Services and Markets department or your usual contact at Travers Smith.

Travers Smith LLP  
10 Snow Hill  
London EC1A 2AL  
T +44 (0)20 7295 3000  
F +44 (0)20 7295 3500



**Margaret Chamberlain**  
margaret.chamberlain@traverssmith.com  
+44 (0)20 7295 3233



**Jane Tuckley**  
jane.tuckley@traverssmith.com  
+44 (0)20 7295 3238



**Mark Evans**  
mark.evans@traverssmith.com  
+44 (0)20 7295 3351



**Tim Lewis**  
tim.lewis@traverssmith.com  
+44 (0)20 7295 3321



**Phil Bartram**  
phil.bartram@traverssmith.com  
+44 (0)20 7295 3437