A practical guide to EMIR

THE REGULATION ON OTC DERIVATIVES, CENTRAL COUNTERPARTIES AND TRADE REPOSITORIES

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MUFG Investor Services

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About us

MUFG Investor Services provides asset servicing solutions to the global investment industry. Leveraging the financial and intellectual capital of MUFG – one of the largest banks in the world with $2.4 trillion in assets – we provide clients access to a range of leading solutions from fund administration, custody, foreign exchange, trustee services and depository to securities lending and other banking services.

MUFG Investor Services leverages its deep market expertise and industry leading technology to partner with clients throughout the investment lifecycle. Our solutions are developed with our clients' needs firmly at the heart of the partnership.

MUFG Fund Services is the global fund administration arm of MUFG Investor Services and has been partnering with the investment industry for over 25 years. Through our partnership driven model we provide clients a comprehensive and customized fund administration solution, underpinned by our market leading technology platform. Our clients range from mutual funds, hedge funds, fund of funds, private equity and real estate funds across all investment strategies, asset types and fund structures.

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OVERVIEW

EMIR entered into force on 16th August 2012. ESMA has published a series of Regulatory Technical Standards (RTS) and Implementing Technical Standards (ITS).

EMIR introduced the following obligations

- Reporting of derivative contracts to trade repositories (TRs)
- Clearing obligations for OTC derivatives
- Risk mitigation requirements for non-centrally cleared OTC derivatives
- Requirements for central clearing counterparties (CCPs) and TRs

Obligations depend on an entity's EMIR classification:

- Financial Counterparty (FC) – broadly defined as an entity authorized under one of the EU's financial services directives – a MiFID authorized investment firm, a bank, a UCITS fund, an AIF managed by an AIFM. Non UCITS funds not managed by an authorized or registered AIFM do not fall within the definition of a FC. An example of a FC is a Cayman fund managed by an EU AIFM.
- Non Financial Counterparty (NFC) – defined as an entity established in the EU that is not a FC. An example of a NFC is an Irish fund managed by a US manager. NFCs can be either a NFC+ which is subject to the clearing obligation, or a NFC- which is not subject to the clearing obligation. A NFC+ is a NFC where the rolling average position of its derivative trading positions over 30 days exceeds one of the following clearing thresholds (in gross notional value):
    - 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
- NFCs are required to start calculating the clearing threshold from 15th March 2013 (when the RTS entered into force). They are required to send a note to ESMA and the national competent authority when they are above the relevant clearing threshold.

REPORTING TO TRADE REPOSITORIES

- Counterparties to all derivative contracts (OTC and exchange-traded) are required to report to a registered TR. Details of TRs registered with ESMA are available on the ESMA website. Reporting commenced on 12th February 2014.
- The details must be reported no later than the working day following the conclusion, modification or termination of the contract. The minimum details to be reported are set out in the RTS.
- All derivative contracts that have been entered into after 16th August 2012 have to be reported. Those that are still outstanding on 12th February 2014 must be reported to a TR after this date. Those transactions that are no longer outstanding must be reported within 3 years.
- The reporting party may be the counterparty to the trade or a third party, however both counterparties need to agree on the reporting as the report must be submitted 'without duplication'. There are 5 possibilities for reporting:
    1. Each counterparty reports directly to the TR
    2. One counterparty will report on behalf of the other
    3. One counterparty outsources the reporting requirement to a third party and the other reports itself
    4. Both counterparties outsource the reporting requirements to different third parties
    5. Both counterparties outsource the reporting requirements to the same third party
- In order to report a trade to a TR, the fund must obtain a Legal Entity Identifier (LEI).

CLEARING OBLIGATIONS

Certain OTC derivative contracts are required to be cleared through an authorized Central Counterparty (CCP). The use of a CCP eliminates the risks associated with a party defaulting on the contract. There will be a phased in approach for the clearing obligation, and it is expected that the obligations will apply to some entities from August 2015.

RISK MITIGATION REQUIREMENTS FOR NON-CENTRALLY CLEARED TRADES

The risk mitigation requirements do not apply to OTC derivative contracts which are cleared by a CCP.

1. Timely confirmation – All FCs and NFCs are required to confirm uncleared OTC derivatives via electronic means if possible. Confirmation should be as soon as possible and the RTS (Article 12) outline deadlines for confirmation depending on the EMIR classification of the entity and the type of derivative. Confirmation refers to the documentation of the agreement of the counterparties to all the terms of an OTC derivative contract.
2. Dispute resolution – counterparties must agree detailed processes and procedures for the identification, recording and monitoring of disputes and their timely resolution (including a specific process and procedure for disputes lasting longer than 5 days).
3. Portfolio reconciliation – counterparties must agree in writing the portfolio reconciliation process. The frequency depends on the number of OTC contracts which are not centrally cleared and the EMIR classification of the entity.

   FC and NFC+

   - each business day when the counterparties have 500 or more OTC derivative contracts outstanding with each other
   - weekly when the counterparties have between 51 and 499 OTC derivative contracts outstanding with each other
   - quarterly for 50 or less OTC derivative contracts outstanding with each other

   NFC-

   - quarterly for 100 or more OTC derivative contracts outstanding with each other
   - yearly for less than 100 OTC derivative contracts outstanding with each other
4. Portfolio compression – counterparties with 500 or more OTC derivative contracts outstanding with any single counterparty which are not centrally cleared must have procedures in place to analyze the possibility to conduct a portfolio compression exercise regularly, and at least twice a year.
5. Daily valuation – a FC and a NFC+ must mark to market on a daily basis its outstanding derivative contracts. This does not apply to a NFC-. Where marking to market is not possible, a mark to model valuation may be performed.
6. Recordkeeping – records for any derivative contract must be retained for at least 5 years after termination of the contract.

EXTRATERRITORIALITY

The clearing and risk mitigation obligations for non-centrally cleared OTC derivatives may apply to OTC derivative contracts entered into between non-EU counterparties (third country entities) that would be subject to such obligations if they were established in the EU provided that a contract has a direct, substantial and foreseeable effect within the EU or where such an obligation is necessary to prevent the evasion of any provisions of EMIR.

MUFG Solutions

FOR CLIENTS MUFG CAN:

- Report derivative transactions to an approved Trade Repository on behalf of clients (a counterparty can outsource the daily reporting to a third party).
- Back load historical trades where necessary.
- Assist in obtaining the LEI for the fund.
- Create the reporting template depending on the type of derivative.
- Gather all static data necessary for the reporting template by reviewing applicable documentation and liaising with the other counterparty.
- Keep up to date with any amendments to the reporting requirements and making any necessary amendments to the data or template.
- Liaising with the other counterparty where necessary if transaction details are not matched.

For further information and contact details please refer to:
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