European Market Infrastructure Regulation (EMIR)
Getting ready for changes to derivatives markets

March 2013
Introducing EMIR

The collapse of Lehman Bros, AIG, and Bear Stearns in 2008 exposed fundamental weaknesses in the regulation of the global US$650 trillion over the counter (OTC) derivatives market. In 2009 the G20 group of nations agreed on a set of OTC market reforms designed to reduce systematic risks and to improve market transparency: by the end of 2012 derivatives contracts would be traded on exchanges or electronic platforms, cleared through central counterparties (CCPs), reported to trade repositories (TRs) and subject to capital or other requirements to reflect the risk of transactions.

The EU is implementing most of these requirements through the European Market Infrastructure Regulation (EMIR) which came into force on 16 August 2012. EMIR introduces clearing, transaction reporting and significant risk management procedures for firms, as well as a pan-European regulatory regime for CCPs and TRs. Operational requirements for firms will be phased in from 15 March 2013.

Who is subject to EMIR?

Financial firms and non-financial firms established in the EU that are counterparties to derivatives contracts:

• ‘financial counterparties’ include banks, insurers, investment firms, fund managers, spread betting firms and pension schemes; and
• ‘non-financial counterparties’ include any counterparty established in the EU that is not defined under EMIR as a financial counterparty, including non-financial firms, CCPs, TRs and trading venues.

EMIR also contains a broad extra-territorial requirement that extends its scope to derivatives trading undertaken between entities outside of the EU, under certain circumstances.

What does EMIR require firms to do?

Clearing requirements

• Firms must arrange for all derivative contracts deemed ‘clearing eligible’ by the European Securities and Markets Authority to be centrally cleared by a CCP. Central clearing imposes a CCP between each side of a trade, thus reducing credit risk between market participants. EMIR also sets out margin and collateral standards for trades cleared through European CCPs.
• Non-financial counterparties will be subject to clearing requirements only if their derivatives positions exceed a clearing threshold set out under EMIR.

Reporting requirements

• Firms must report exchange traded and OTC traded derivative contracts to TRs. The reporting requirements will allow regulators to monitor the build-up of systemic risk through excessive risk concentrations.
• Firms must assess the data reporting requirements against their system capabilities and strategies. Firms may delegate reporting to third parties and should assess reporting services as part of a suite of clearing related services.

Risk management requirements for uncleared contracts

• Firms must comply with capital and margin requirements for derivative contracts which remain outside the clearing obligation.
• Firms must also comply with certain risk management requirements for uncleared contracts (including timely trade confirmation, daily mark-to-market or mark-to-model valuation, reconciliation, compression and dispute resolution).

Client money

• EMIR protects collateral placed with CCPs in the event of insolvency of a clearing member – and from losses from other clients. But, CASS pooling rules require such money to be returned to the customer, and that any shortfall on client money is allocated equally among all clients. UK CASS rules and EMIR are thus fundamentally incompatible.
• The FSA consultation paper 12/22, published in September, proposes amendments to the UK CASS rules to allow collateral held at CCPs to be excluded from existing pooling arrangement. Firms need to identify how these new client money rules will impact their operations and contractual arrangements with clients and service providers.
EMIR’s likely impacts on the industry

- Presents significant short-term operational and process challenges, with non-financial and smaller firms least prepared.
- OTC derivatives market will evolve into a two-tier market for centrally cleared and bilaterally cleared trades. Costs and market pressures will force a large proportion of the bilateral market onto centrally cleared platforms over time. Exchange trading is expected to grow 30% annually.
- Increased costs and higher capital charges will reshape trading and hedging strategies.
- Global squeeze on high quality collateral and development of new collateral management business models will occur as the market transitions to a more narrow range of eligible collateral. Liquidity stresses will increase due to likely short-term gross margin placements at CCPs and the loss of offsets between OTC and cleared positions.
- Firms will need systems to identify client money resources and requirements for OTC business.
- Firms will be required to disclose the level of protection offered to customers by CCPs in third countries, including a description of the main legal implications of segregation and information on the insolvency law applicable in each non-EU jurisdiction.

Banks and other market participants are assessing EMIR’s impacts on their business and operational models and developing a strategic response. Getting ready for the 2013 deadlines represents a huge challenge.
**Preparation checklist**

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<tr>
<th>Date</th>
<th>Event Description</th>
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| 16 August 2012        | - EMIR came into force  
                        | - Historic transaction reporting period commenced                                                                                       |
| 1 January 2013        | - First rules affecting UK client money came into force                                                                                     |
| 1 July 2013 (est.)    | - Commencement of reporting obligation for the majority of interest rate swaps and credit derivatives asset classes                         |
| 15 September 2013     | - Dispute resolution, portfolio compression and portfolio reconciliations for uncleared derivatives in effect                                |
| 1 January 2014        | - Reporting obligation commences for other asset classes                                                                                   |
| 31 August 2014 (onwards/phased) | - Confirmations for equity swaps, FX swaps, commodity swaps and others  
                               | - T+1 confirms for all other derivatives (FC/NFC+)                                                                                       |
| 31 August 2014 (onwards/phased) | - T+2 credit and interest rates and all other derivatives (NFC)  |
| 28 February 2014      | - T+1 confirms for CDS, IRS (financials, NFC+)                                                                                               |
| Q1 2014 (est.)        | - First set of clearing obligations commence                                                                                               |

**31 August 2014**
- Confirmations for equity swaps, FX swaps, commodity swaps and others
- T+1 confirms for all other derivatives (FC/NFC+)
- T+2 credit and interest rates and all other derivatives (NFC)

- T+2/T+5 confirmations for uncleared contracts in CDS, IRS
- T+3/T+7 for equity swaps, FX swaps, commodity swaps and others

**Assess collateral required for clearing arrangements**
- Identify client money requirements for OTC business
- Date likely to slip to TR authorisation + 90 days
- Client on-boarding processes designed and implemented
- Client reporting requirements identified and implemented

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* EMIR came into force on 16 August 2012, but its implementation requires completion of underlying regulatory technical standards. Dates above are subject to change depending on the progress of finalising EU legislation.
# How we are helping our clients

We offer a breadth of services to assist you in meeting the EMIR requirements. We have significant experience working with investment banks, brokers, asset managers and other key participants in the derivatives market on a range of commercial and operational issues.

<table>
<thead>
<tr>
<th>EMIR requirement</th>
<th>Some of the areas where we can help</th>
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| **Clearing**                      | - Identifying derivatives subject to the clearing obligation  
- Assessing the application of exemptions for intra-company transactions  
- Undertaking a cost benefit analysis of different CCPs to establish costs of membership  
- Designing, testing and documenting business and operational clearing processes, capability and infrastructure  
- Designing new management reports to monitor and control confirmation processes  
- Improving processing efficiency and control                                                                                                                                                                                                 |
| **Reporting**                     | - Gathering business requirements for data interface and migration processes  
- Reviewing and adapting trade capture processes, to gather required transaction reporting data and to develop connectivity with trade repositories  
- Designing, implementing and testing regulatory, treasury and transaction reporting systems                                                                                                                                                           |
| **Risk management for uncleared contracts** | - Adapting the firm’s operational, credit and market risk strategy and appetite in light of new collateral arrangements  
- Enhancing or extending current processes to measure and mitigate risk  
- Designing, building and implementing management information systems to monitor different risk types  
- Supporting the development of your cash and liquidity management services                                                                                                                                                                       |
| **Capital and collateral**        | - Developing front-to-back strategic collateral management technical architecture solution to optimise the use of collateral and improve your liquidity and reduce funding costs  
- Evaluating collateral transformation process                                                                                                                                                                                                 |
| **Client money**                  | - Assessing impact of new CASS regulations on current systems and controls, compliance arrangements and customer and service provider contracts  
- Developing updated processes and controls reflecting amended CASS rules                                                                                                                                                                                                                          |
| **Wider support**                | - Gap analysis/health check tools that benchmark your readiness against the EMIR requirements  
- Providing regulatory, operational and strategic advice to help firms navigate through the uncertain and complex regulatory environment  
- Programme management  
- 3rd party assurance – controls reporting to demonstrate to your clients the robustness of your end-to-end environment                                                                                                                                 |

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