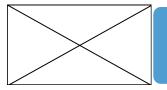
CAPMEX-Institute



EMIR - New EU Rules on Derivatives Trading

Ruediger Ruecker, Managing Partner CAPMEX-Institute

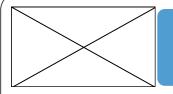
Budapest, 17 September 2013



EMIR & Emir [elmir], Arabic: المويد '

- ❖ Acronym for <u>European Market Infrastructure Regulation</u>
- Arabic for "commander", "general", or "prince"
- ❖ EMIR is a commander as well ...
- Challenging landscape for the financial and non-financial industry
- ❖ See why ...





G20 Commitment

"All standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end 2012 at the latest. OTC derivative contracts should be reported to trade repositories. Non-centrally cleared contracts should be subject to higher capital requirements."

United States, Pittsburgh, September 2009

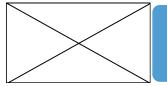




Main Objectives

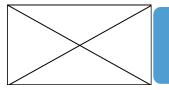
- ★ To make trading in OTC derivatives more transparent and secure. From 1 January 2014 ...
 - Standardized OTC products will be processed by a Central Counterparty (CCP)
 - > CCPs need an official authorisation
 - > OTC transactions must be reported to trade repositories (TRs)





Central Counterparty

- A CCP acts as a clearing house for the settlement of OTC derivatives between two trading parties.
 - > Past: Counterparty A & counterparty B
 - Future: Counterparty A, CCP & counterparty B plus clearing members and clients of clearing members
 - ➤ Note: There are about 20 CCPs in Europe and just 1 in the United States.



Trade Repository

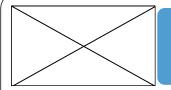
- ❖ A TR centrally collects and maintains the records of trades.
- Under EMIR the European Securities and Markets Authority (ESMA) has direct responsibilities regarding the registration, supervision and recognition of TRs.
- ❖ In particular, EMIR provides that a TR shall register with ESMA. The registration of a TR shall be effective for the entire EU.
- Once registered, the TR will be supervised by ESMA in order to ensure that it complies on an on-going basis with all EMIR requirements.



Legal Guidelines

- ❖ Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories
- ❖ The Commission Delegated Regulation (EU) No 148/2013 to 153/2013 of 19 December 2012 supplementing Regulation (EU) No 648/2012
- ❖ Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012

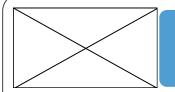




Main Obligations

- Central clearing for certain classes of OTC derivatives
- Application of risk mitigation techniques for non-centrally cleared OTC derivatives
- Reporting to TRs
- Application of organizational, conduct of business and prudential requirements for CCPs
- ❖ Application of requirements for TRs, including the duty to make certain data available to the public and relevant authorities

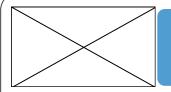




Typical Risk Mitigation Techniques

- Timely confirmation
- Portfolio reconciliation and compression
- Dispute resolution
- Marking-to-market and marking-to-model
- Exchange of collateral and adequate capital

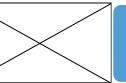




Affected Entities

- Financial and non-financial counterparties (NFCs) <u>above the clearing treshold</u>
 - > Clearing/reporting obligation, risk mitigation techniques
- NFCs below the clearing treshold
 - > (Certain) risk mitigation techniques, reporting obligation
- **❖** CCPs
 - > CCP requirements (e.g. official authorization)
- Trade repositories
 - > TR requirements

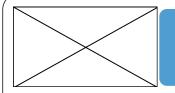




Clearing Treshold

- Critical contract value for clearing obligation
- Set by ESMA Technical Standards
- Current values (in €)
 - > 1 billion in credit derivative contracts
 - ➤ 1 billion in equity derivative contracts
 - > 3 billions in interest rate derivative contracts
 - ➤ 3 billions in foreign exchange derivative contracts
 - ➤ 3 billions in commodity derivative contracts and others





Affected Instruments

- OTC derivatives
 - > Clearing obligation and risk mitigation techniques
- All derivatives
 - > Reporting obligation
- All financial instruments
 - > CCP requirements

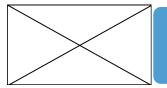




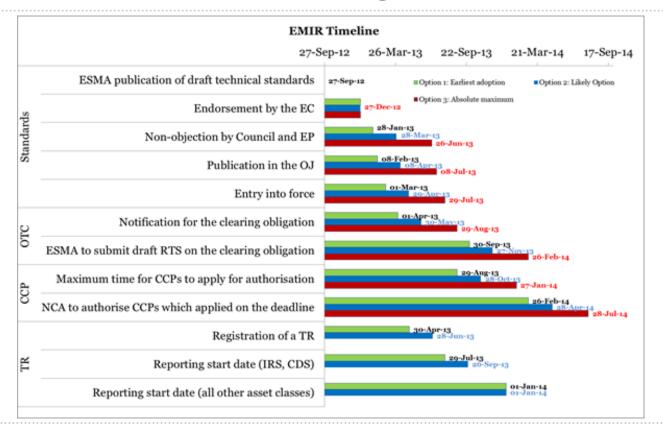
Exemptions

- Pension scheme arrangements
 - ➤ No clearing obligation until August 2015
 - > But exchange of collateral and reporting obligation
- Intragroup transactions
 - ➤ No clearing obligation, following a positive decision or non-objection by the competent authority
 - ➤ No exchange of collateral, following a positive decision or non-objection by the competent authority
 - But reporting obligation





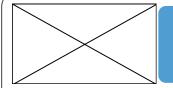
Timing





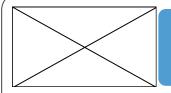
Reality Check on Pension Funds

- Hedging challenge
 - Most occupational pension funds have a <u>temporary</u> exemption from key parts of EMIR.
 - ➤ But EMIR will still have a major impact on them. EMIR will affect everything from documentation and reporting requirements to, crucially, the cost of using derivatives to hedge pension scheme liabilities, and even pension fund investment strategies as a whole.



Reality Check on European Clearers

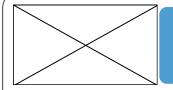
- Segregation Challenge
 - ➤ EMIR requires clearing members to provide a minimum of two types of accounts: an <u>omnibus client segregation</u> account and an <u>individual segregation account</u>.
 - ➤ But due to a lack of detailed standards, clearing members may have to support many more the these two account types.



Segregation Consequences

- Considerable account management costs
- Considerable compliance management costs
- ❖ Intensive operational risk
- Possible variation between EMIR and Dodd-Frank regimes
- ❖ Fallout challenges, like ...
 - > Increased number of CCP accounts
 - Increased payment flows
 - Reduced netting capability
 - ➤ More complex asset allocation

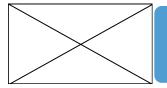




Reality Check on Real Economy

- Application/Classification Challenge for NFCs
 - > Hedging derivatives vs. non-hedging derivatives
 - > Has direct influence on potential clearing obligation
 - ➤ But no influence on given reporting obligation and risk mitigation techniques

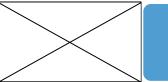




Résumé

- Move into right direction in order to make OTC derivatives trading transparent and secure
- ❖ Big overall challenge for all users of OTC derivatives
- Regardless, if financial or non-financial counterpart
- Application/classification of clearing treshold is critical
- ❖ Half way through, but much more is yet to come.
- Tendency that everything has to be regulated and authorized
- Further regulation and taxes will make trading even less attractive.





Thank you!

The CAPMEX-Institute is a highly exclusive and greatly experienced Eurasian training and certification body focusing solely on the capital market industry. Based on over 20 years of industry record, the CAPMEX-Institute developed a proven training and certification portfolio that is representing the upto-day needs of notable capital market participants. Understanding the sensitivity of its mission, the CAPMEX-Institute is building its reputation on the foundation of an independent advisory board consisting of leading representatives of the relevant capital market industry.

