



The business of relationships.™

EMIR and its implications for energy trading

Presenter: Brett Hillis – Reed Smith LLP

Guest Speaker: Felix Tse – Gazprom Marketing & Trading Ltd

EMIR – European Market Infrastructure Regulation

Who?

- Financial counterparties (FCs)
- Non-financial counterparties (NFCs)
- Third Country entities (TCs)

What?

- OTC derivatives
- ...and futures

How?

- Mandatory central clearing
- Mandatory risk mitigation
- Transaction Reporting
- CCP/Trade Repository regimes
- New rules for Clearing Members

EMIR - Indicative Timeline

16 August 2012

- Record keeping

15 March 2013

- Assessment against thresholds – NFC+ notification
- Processes/systems for valuing MTM positions
- Timely confirmation

15 Sept 2013

- Portfolio reconciliation
- Portfolio compression
- Dispute resolution

1 Jan 2014 (or 90 days after TR registration)

- Transaction reporting (23 September 2013 for IRS and CDS)

Mid 2014

- Mandatory Clearing

1 Jan 2015-2019

- Collateral requirements for uncleared OTC derivatives
- BCBS/IOSCO process ongoing (latest CP Feb' 13)

Other Points to Consider

- **CCP Requirements**
First authorisations could be granted Q4 2013
- **RTS - Cross Border Application/ Anti-avoidance**
Consultation Paper currently awaited
- **Intra-group exemptions**
Notification/ application forms to be published in 2013
Equivalence rulings – transitional measures by country expected later in 2013

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What is caught: transaction types?

- Most obligations apply in relation to OTC derivatives
 - Derivatives
 - OTC – not executed on a regulated market or certain equivalent non-EEA markets
 - Treatment of particular trades
 - Physical forwards
 - Block trades
 - Exchange for swaps
 - Book-outs
- Transaction reporting – applies to all derivatives



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Who is caught: Clearing?

ENTITY TYPE	COUNTERPARTY TYPE				
	FC	NFC+	NFC	TC+	TC
FC	Red	Red	Green	Red	Green
NFC+	Red	Red	Green	Red	Green
NFC	Green	Green	Green	Green	Green
TC+	Red	Red	Green	Yellow	Green
TC	Green	Green	Green	Green	Green

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Who is caught: Collateral for uncleared derivatives?

ENTITY TYPE	COUNTERPARTY TYPE				
	FC	NFC+	NFC	TC+	TC
FC					
NFC+					
NFC					
TC+					
TC					

EMIR – Any way out?

NFC+ Thresholds

- Gross notional
- OTC Derivatives
- Excluding hedges
- Threshold tripped if:
 - over for any product category
 - any NFC in group is over
 - take into account all “non-financial entities” in the worldwide group



Gross Notional

- | | |
|------------------------------|---------|
| • Credit derivatives: | EUR 1bn |
| • Equity derivatives: | EUR 1bn |
| • Interest rate derivatives: | EUR 3bn |
| • FX derivatives: | EUR 3bn |
| • Commodity and other: | EUR 3bn |

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Hedges and the threshold calculation

- **Exclusion of hedges from the threshold calculation:**

“objectively measurable as reducing risks relating to the commercial activity or treasury financing activity of NFC or that group”

- risks arising from potential change in value of assets, services, inputs, products, commodities or liabilities held by NFC/group in normal course of its business;
- risks arising from potential indirect impact on value of assets from fluctuations of interest rates, inflation rates, FX rates or credit risks; or
- qualifies as hedging contract pursuant to IFRS

Your status

- **Company structure**

- How many Group companies actively trade OTC derivatives?
- Intra-group transactions
- Active markets, Products traded and Jurisdictions covered

- **How are products traded?**

- Regulated platforms and Multilateral Trading Facilities
- Financially or physically settled
- Cleared or uncleared
- Collateral and margins exchanged

- **Hedging**

- Internal risk mandate
- Link between trading activity, VAR and the underlying commercial activity/asset
- Accounting treatment and book structure

EMIR – Risk Mitigation

- **Processes/systems for valuing MTM positions**
 - FC and NFC+: Daily mark-to-market/mark-to-model
- **Timely confirmation**
 - Where, possible, by electronic means of all the terms of OTC derivatives
 - Timelines vary by product and EMIR status
- **Record keeping**
 - Any derivative transactions concluded and any modification - at least 5 years following termination



EMIR – Risk Mitigation

- **Portfolio reconciliation**

- Process by which parties confirm that their records of the trades are the same.
- Frequency of reconciliation depends on the number of outstanding trades between the counterparties and the status of each under EMIR (maximum = each business day)

- **Portfolio compression**

- Process of netting trades to reduce the number of outstanding contracts and their gross notional value
- FC and NFC (+ or -) with more than 500 uncleared OTC derivative contracts outstanding to single counterparty
- Required to analyse possibility of compression twice per annum
- Reduction of gross notional

EMIR – Risk Mitigation

- **Dispute resolution**

- FC and NFC (+ or -) - agree detailed procedures and processes in relation to:
 - Identification, recording and monitoring of disputes
 - Resolution of disputes in timely manner - specific process for disputes outstanding for more than 5 business days
- Reporting obligations on FCs



EMIR - Transaction Reporting

- **Transaction reporting obligations**
 - Applies to any derivative contract (not just OTC)
 - Report any derivative contract concluded, modified or terminated
 - What to report
 - Counterparty data
 - Common data (must be agreed between parties)
 - Over 60 data fields

EMIR – Transaction Reporting

- **Scope and timings**

- Applies to all derivatives contracts entered into
 - Before 16 August 2012 and which were outstanding on that date (“backloading”)
 - On or after 16 August 2012
- Phase –in for contracts entered into before the reporting obligation begins – longer time period to report historic trades
- Reporting obligations likely to begin earlier for interest rate and credit derivatives

Systems and Processes

- **Are existing business processes and IT systems compliant?**
 - Capturing information
 - Threshold monitoring, Portfolio Reconciliation, Portfolio Compression, Transaction Reporting, Recordkeeping
 - Data gap analysis
 - Single contained system
 - Uniform data point
 - Front, middle and back office systems alignment
 - Integration of separate processes
 - What are the cost and risks involved in adapting or re-engineering existing workflows?
 - Is a dedicated resource for regulatory compliance required?
- **Simultaneously address REMIT, MiFID2 and other Regulatory Change requirements**

Systems and Processes

- **Reliance on others**
 - Can rely on counterparty or third party to report for you
 - Outsourcing
 - Selection
 - Regulatory actions
 - Agreeing report contents
 - Reporting without duplication
- **Issues**
 - Partial trade reporting or as required for a particular asset class
 - Security and reliability



Collateral Requirements for uncleared derivatives

- **Policy**
 - Credit risk management
 - No incentives against using clearing
 - Level playing field internationally (BCBS/ IOSCO work)
- **Application**
 - FCs and NFC+ dealing between themselves?
 - Intra-group transactions
- **Substitutive compliance**
- **Contents**
 - Variation margin
 - Initial margin
 - Margin thresholds
 - Initial margin – ring-fence and re-use

Intra-group exemptions

Clearing and collateral

- **Clearing**

- Both counterparties subject to same consolidation
- Subject to appropriate centralised risk evaluation, measurement and control procedures
- Equivalence assessment for non-EU countries

- **Collateral**

- Can apply to competent authorities for exemptions
 - Adequate risk management procedures
 - Prompt transfer of own funds or repayment of liabilities between counterparties

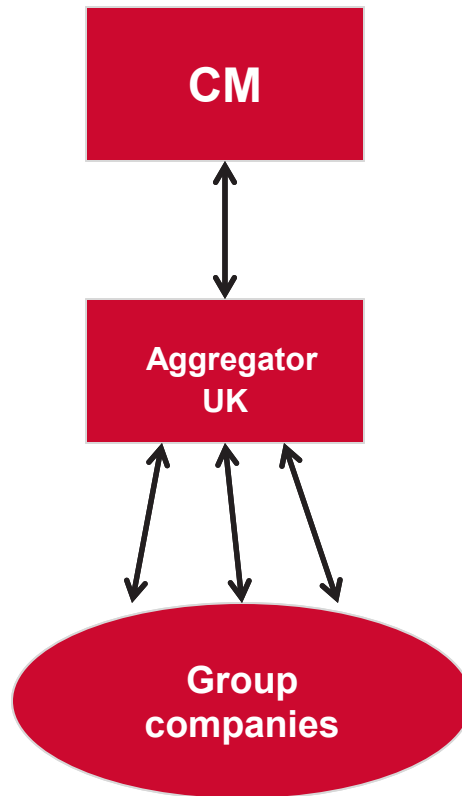
EMIR - Clearing

- **Margin efficiency/credit risk calculation**
 - CCP or clearing member?
 - How many clearing members?
- **Intra-group trades**
- **Segregated accounts and client money?**
- **Portability and margin**



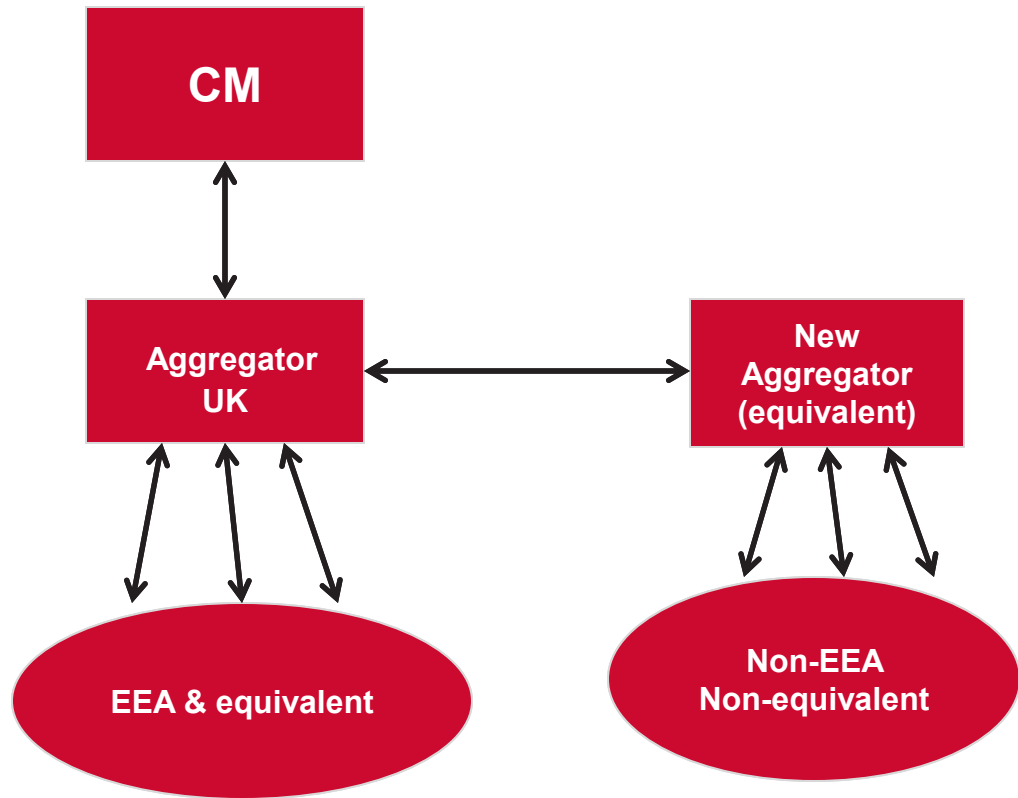
EMIR – Intra-group clearing

Aggregator
(Current model)



EMIR – Intra-group clearing

EMIR Aggregation?



NB This relies on indirect clearing (affects account structures).

EMIR - Clearing

- Segregated Accounts
 - Omnibus/individual
 - Excess margin (IM) up to CCP
 - Client disclosure & fees
- Segregation means?
 - Ring-fencing (netting/margin)
 - Does not mean *trust*
- Porting and Margining Issues
 - Net margin (omnibus accounts)
 - IM and title transfer
- NB HMT Proposals for amendments to “Part VII” regime and default rule requirements under RRRs

Client Money?

- CASS 7 (title transfer margin)
- Depends on contractual framework
 - Terms of business
 - CCP/exchange terms
- NB FSA proposals for sub-pools
 - Separate CM pool for each sub-account
 - Can't mix client money and firm money

Strategic Decisions

- **More margin or less business?**
 - Smarter use of margin
 - Less trades and smaller ticket size means firms need to identify trading platforms where liquidity is likely to be maintained
 - What clearing relationships will be required? Will as many OTC counterparties be needed?
 - Start voluntary clearing
- **Plan Ahead**
 - Higher costs an unavoidable consequence of regulation
 - Sources of funding
 - Headstart in addressing MiFID2, CRDIV and other Regulatory Change requirements
- **Role for Credit departments?**



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