How does EMIR impact my ISDA Master Agreement?

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Objectives

The objectives of this session are to provide you with:

> an overview of the risk mitigation techniques under EMIR

> an overview of:

– the ISDA EMIR Portfolio Reconciliation, Dispute Resolution and Disclosure Protocol and Bilateral Standard Amendment Agreement

– the ISDA 2013 EMIR NFC Representation Protocol

– the ISDA Timely Confirmation Standard Wording

– the ISDA Reporting Guidance

What is EMIR?

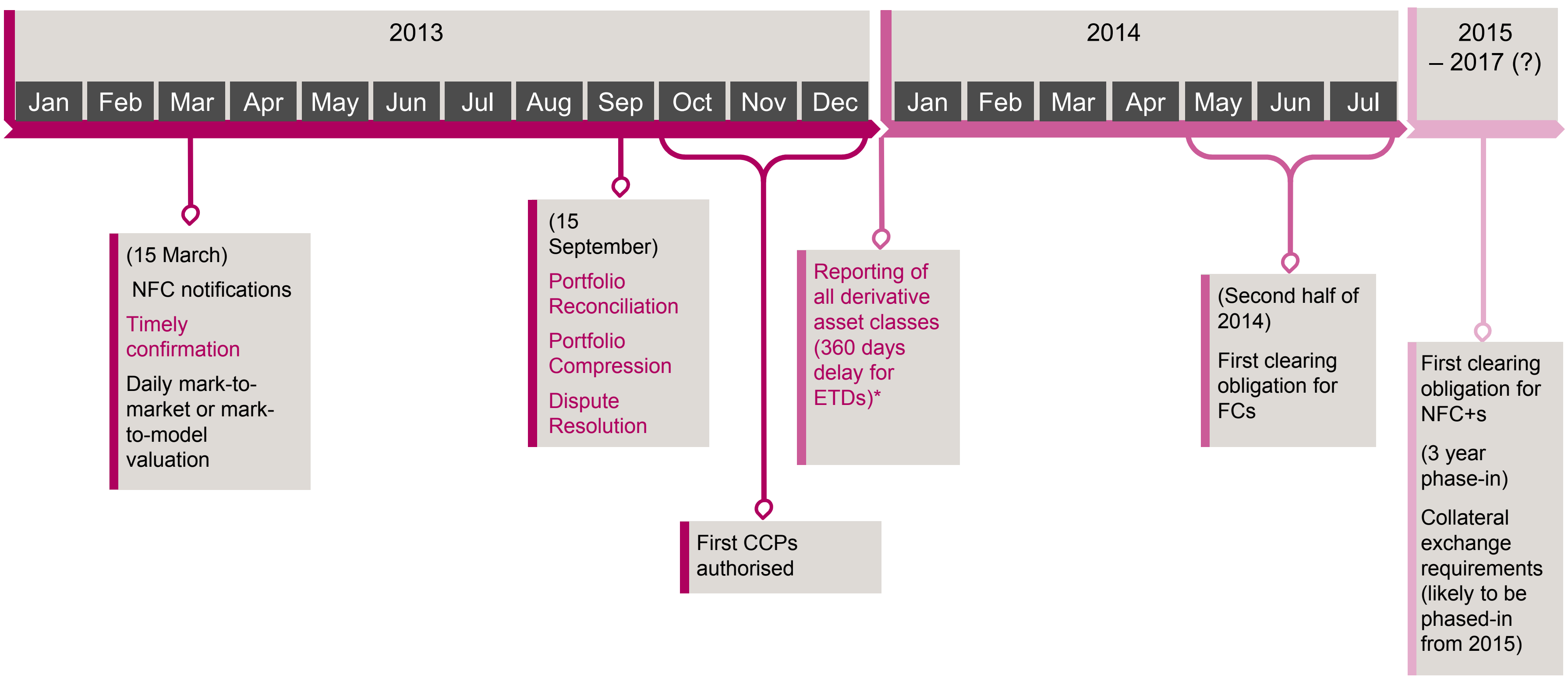
> EMIR stands for the European Market Infrastructure Regulation

> EMIR was adopted to implement G20 commitments in the EU and to make the derivatives market safer and more transparent

> EMIR lays down rules for:

- clearing of certain over-the-counter (OTC) derivatives via a central counterparty (CCP)
- bilateral risk mitigation for OTC derivatives that are not cleared
- reporting requirements for all derivatives to a trade repository (TR)
- requirements for the performance of activities of central counterparties (CCP) and trade repositories (TR)

EMIR Implementation Timeline



- In July 2013, ESMA updated the EMIR implementation timetable on its website to indicate that ESMA's best estimate is that the registration of the first trade repositories is not likely to take place before late September 2013. Therefore, reporting for all derivatives asset classes is likely to start some time in January 2014 (i.e. 90 calendar days after the registration of a trade repository). ESMA has also asked the Commission to delay by 360 days the reporting obligation for exchange traded derivatives in time for ESMA to publish guidelines on ETD reporting.

(Obligations in magenta also apply to NFC-s)

EMIR divides the market into four categories

Financial counterparty

(bank, insurance/ assurance/ reinsurance undertaking, investment firm, UCITS and management company, pension fund, alternative investment fund managed by an AIFM)

“FC”

“Systemically important” non-financial counterparty

(undertaking established in the EU other than a financial counterparty…

…that enters into “non-hedging” derivatives above a certain amount (clearing threshold))

“NFC+”

Not “systemi-cally important” non-financial counterparty

(undertaking established in the EU other than a financial counterparty…

…that enters into no (or an amount below the clearing threshold of) derivatives other than “hedging” derivatives)

“NFC-”

Third country (non-EU) entity

(entity established in a third country — i.e. outside the EU)

Would it be subject to the obligation if it were established in the EU?

Does the contract have a direct, substantial and foreseeable effect within the EU?

“3rd CE”

EMIR really divides the market into two categories

Financial counterparties

FCs

"Systemically important" non-financial counterparties

NFC+s

Third country (non-EU) entities that would be subject to the relevant EMIR obligation if it were established in the EU and where the contract has a direct, substantial and foreseeable effect within the EU

Certain 3rd CEs*

Not "systemi-cally important" non-financial counterparties

NFC-s

** Note that although EMIR only applies directly to 3rd CEs that would be FCs/NFC+s if they were established in the EU and if the contract has a direct, substantial and foreseeable effect within the EU, certain provisions of EMIR will also indirectly impact other 3rd CEs when they enter into derivatives with EU entities*

Who is an NFC- and who is an NFC+?

- A non-financial counterparty will be an NFC+ if the rolling average of its gross notional positions over 30 working days in any of the following asset classes (at group level) exceeds:
  - EUR 1bn for credit / equity
  - EUR 3bn for IRS / FX / commodity and others
- If NFC exceeds any of the above clearing thresholds, it will be an NFC+
- If NFC is below all of the above clearing thresholds, it will be an NFC-
- When adding notional positions, NFCs may exclude “hedging” derivatives
- Will discuss ISDA 2013 EMIR NFC Representation Protocol later

ISDA EMIR Portfolio Reconciliation, Dispute Resolution and Disclosure Protocol

What is a Protocol?

- A means of amending an existing ISDA Master Agreement without bilateral negotiations/execution
- Any agreement with other adherents deemed amended
- Effected by online delivery to ISDA of an adherence letter
- Alternatively can incorporate the text bilaterally by reference or include the text of the Bilateral Standard Amendment Agreement

The EMIR Portfolio Reconciliation, Dispute Resolution and Disclosure Protocol

> Published on 19 July 2013
> Evergreen, i.e. no pre-determined cut-off date for adherence
> Covered Master Agreements:

- long-form confirmation entered into before or after Implementation Date
- pre-Implementation Date executed ISDA Master Agreement
- pre-Implementation Date umbrella agreement signed by an Agent

Except if any required consent of guarantor/security provider is not obtained

> NB does not amend agreements executed after adherence (c.f. long-form confirmations)

The EMIR Portfolio Reconciliation, Dispute Resolution and Disclosure Protocol (cont.)

> Covered Other Agreements: other agreements relating to derivatives except if
  - any required consent of guarantor/security provider not obtained or
  - parties have entered into alternative arrangements or
  - parties expressly state that the Protocol shall not apply

> Annual revocation right to prevent amendments with future adherents

> Express reference to paragraph 3(b) of Protocol required to override it

The EMIR Portfolio Reconciliation, Dispute Resolution and Disclosure Protocol (cont.)

- Standard representations given plus a representation that adherence will not adversely affect enforceability of any third party guarantee/security
- If any adhering party has provided a guarantee/security, deemed consent with respect to adherence of underlying obligor
- Agents can adhere on behalf of:
  - all Clients
  - specifically named/identified Clients
  - all Clients except Clients specifically excluded

  New Clients will be bound unless otherwise agreed
- $500 per adhering party
- Amendments: set out in Attachment to the Protocol

Portfolio Reconciliation

EMIR: Portfolio Reconciliation

- Pre-trade obligation to agree in writing or by other electronic means arrangements to reconcile key terms of portfolios
- Applies to FCs and NFCs in respect of new and outstanding non-cleared OTC derivative contracts from 15 September 2013
- Frequency of portfolio reconciliation obligation depends on EMIR categorisation and number of trades outstanding with each other

FC/NFC+		NFC-	
No. of trades	**Frequency**	**No. of trades**	**Frequency**
≥ 500	Each business day	>100	Quarterly
51-499	Weekly	≤100	Annually
≤ 50	Quarterly		

Attachment – the key definitions

> Have to adhere as either a Portfolio Data Sending Entity or a Portfolio Data Receiving Entity

> Portfolio Data means Key Terms of all transactions subject to EMIR

- valuation
- such other information deemed relevant (e.g. effective date, scheduled maturity date, payment or settlement dates, notional, currency, underlying, position of parties, business day convention, fixed/floating rates)
- must be fresh: prepared as at close of business on immediately preceding Local Business Day

Attachment – the key definitions (cont.)

> Data Delivery Date

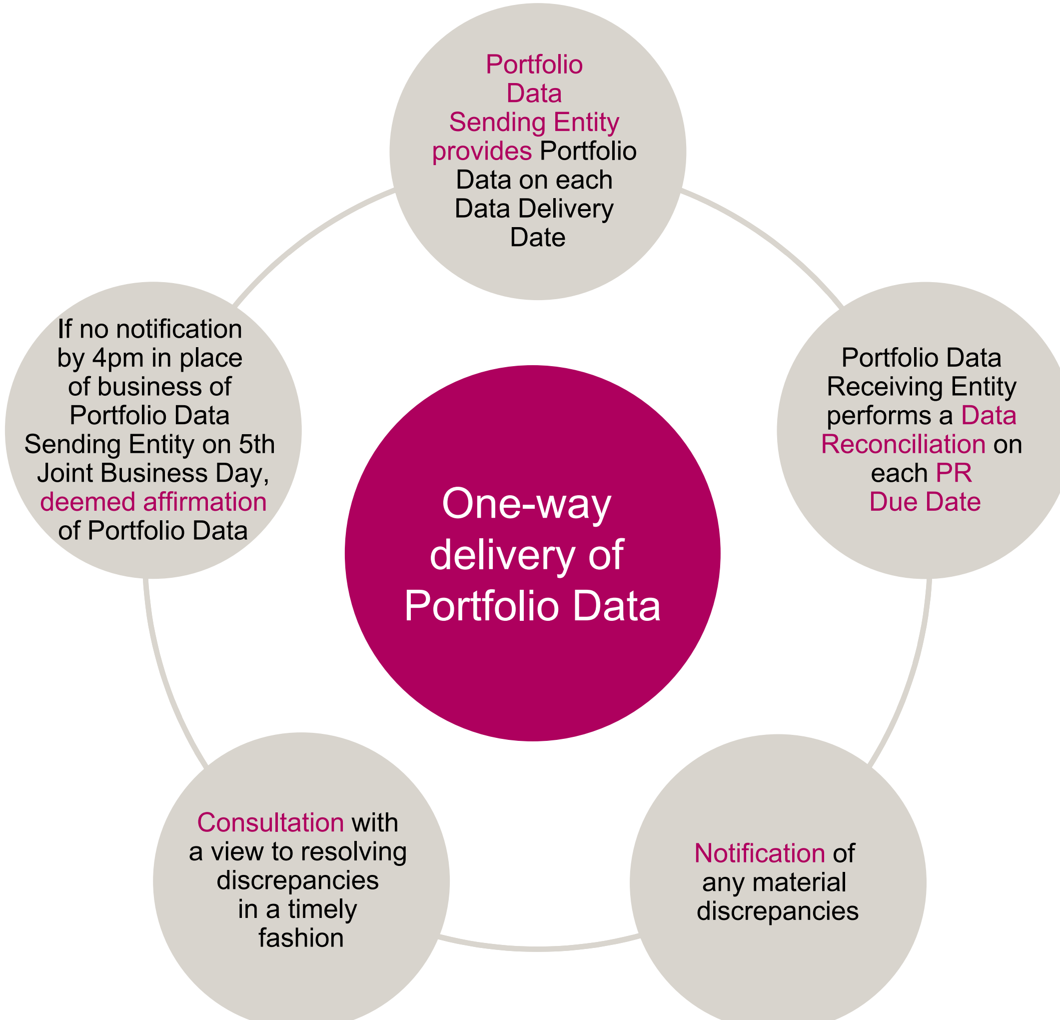
  – each date agreed

  – if no date agreed or agreed date is after required frequency under EMIR, the last Joint Business Day in PR Period (i.e. daily/weekly/quarterly/annually)

> Data Reconciliation

  – comparison against own books and records to identify promptly any misunderstandings of Key Terms

Attachment – Delivery of Portfolio Data



Attachment – Exchange of Portfolio Data

> Exchange of Portfolio Data
  - same as one-way delivery except each party sends Portfolio Data and no deemed affirmation

> Two Portfolio Data Receiving Entities: need an alternative process

> Change of designation
  - can change designation as Portfolio Data Receiving Entity or Portfolio Data Sending Entity with agreement
  - reasonable to withhold agreement if it would result in different designations in relation to counterparty and its Affiliates

Attachment

> Change of frequency
  - written notification of reasonable belief of incorrect portfolio reconciliation frequency
  - frequency revised by virtue of, and in accordance with, notification unless less frequent than required frequency

> Delegation: can appoint
  - an Affiliate as agent by notice
  - a non-Affiliate or qualified and duly mandated third party service provider with the other party's agreement

> No event of default if breach but without prejudice to other rights

Dispute Resolution

EMIR: Dispute Resolution

> Obligation to agree detailed procedures and processes to:
  - identify, record and monitor disputes relating to recognition or valuation of contract/collateral
  - resolve disputes in timely manner
  - have a specific process for disputes not resolved within five business days

> FCs also need to report disputes over EUR 15 million outstanding for at least 15 business days

> Applies in respect of new and outstanding non-cleared OTC derivatives from 15 September 2013

Attachment – Dispute Resolution

> Dispute: cross refers to EMIR and Regulatory Technical Standards

> Dispute Notice: written notice with reasonable detail of the dispute

> Dispute Date: date Dispute Notice is effective. If each party delivers a Dispute Notice, the earliest effective date

> Good faith consultation obligation to resolve Dispute in a timely manner, including:

  – Agreed Process: e.g. Section 13 ISDA Master Agreement, Paragraph 4 Credit Support Annex, Paragraph 5 Credit Support Deed

> If no resolution within 5 Joint Business Days, refer issues internally to appropriately senior members of staff

Attachment – Dispute Resolution (cont.)

- Agreement to have internal procedures and processes in place to record and monitor any outstanding Dispute
- No event of default if breach but without prejudice to other rights

Bilateral Standard Amendment Agreement based on ISDA 2013 EMIR Portfolio Reconciliation, Dispute Resolution and Disclosure Protocol

ISDA Amendment Agreement

> Published on 20 August 2013
> Bilateral amendment by inserting substance of PDD Protocol into Part 5 of ISDA Schedule
> Main differences:
  – Does not extend beyond ISDA Master Agreement
  – No third party credit support provider safety mechanism
  – No possibility for two Portfolio Data Receiving Entities
  – Have to specify Local Business Day
> Not the only method of bilateral incorporation

Portfolio Compression

EMIR: Portfolio Compression

> Obligation to consider possibility of conducting portfolio compression exercise and engage in compression exercise if so
  - Applies:
  - to all EU derivative market participants with 500 or more non-cleared OTC derivatives outstanding
  - in respect of new and outstanding non-cleared OTC derivatives from 15 September 2013

> No ISDA publication because internal process to consider possibility of portfolio compression

ISDA 2013 EMIR NFC Representation Protocol

ISDA 2013 EMIR NFC Representation Protocol

> Published on 8 March 2013

> Evergreen

> Covered Master Agreements:

- long-form confirmation entered into before or after Implementation Date
- pre-Implementation Date executed ISDA Master Agreement
- pre-Implementation Date umbrella agreements (although new clients bound)

> No concept of Covered Other Agreements as under PDD Protocol

> Same approach for adherence by Agents, revocation right and representations as PDD Protocol

> Express reference to paragraph 3(b) of Protocol required to override it

Attachment – NFC Representation

> NFC Representation comprised of two limbs:
  - (i) either NFC or 3rd CE that would be an NFC
  - (ii) not NFC+ or 3rd CE that would be NFC+

> Continuously repeated representation

> Can adhere as:
  - party representing limb (i) and (ii) (*NFC Representation*) (i.e. NFC-)
  - party representing limb (i) only (*NFC+ making NFC Representation*) (i.e. NFC+)
  - party not making NFC Representation (i.e. FC) (NB FC does not represent that it is FC)

Attachment – NFC Representation (cont.)

> Second limb of NFC Representation
  - is not subject to a clearing obligation pursuant to EMIR
  - assumption that transaction is of a type subject to clearing obligation
  - transitional provisions in EMIR are ignored
  - i.e. representation that below clearing threshold and not a representation that the transaction must not be cleared

Attachment – Change of Status

- Representing Party can switch off second limb (i.e. NFC- to NFC+): Clearing Status Notice
- Representing Party can switch off both limbs (i.e. NFC+/- to FC): Non-Representation Notice
- Representing Party can switch on second limb (i.e. NFC+ to NFC-): Non-Clearing Status Notice
- Non-Representing Party can
  - switch on both limbs (i.e. FC to NFC-): NFC Representation Notice
  - switch on first limb (i.e. FC to NFC+): NFC+ Representation Notice

Attachment – Breach of NFC Representation

> Breach of second limb (i.e. not NFC-), use reasonable efforts:
  - if transaction clearable and clearing deadline not yet occurred:
    - amend to ensure transaction is cleared
    - agree Balancing Payment Amount
  - if transaction not clearable (i.e. subject to risk mitigation techniques)
    - amend to ensure risk mitigation techniques adhered to
    - agree Balancing Risk Mitigation Payment Amount

Attachment – Breach of NFC Representation (cont.)

> If transaction not cleared/risk mitigation techniques not adhered to by deadline, Additional Termination Event
  - either party can trigger
  - Change of Status Party is Affected Party
  - deem both limbs to apply (i.e. NFC-)
  - Loss rather than Market Quotation will apply under 1992 Master Agreements

> No Event of Default for incorrect representation/failure to use reasonable efforts but can still rely on Additional Termination Event
  - No consequence if NFC+ is actually NFC-
  - Over-compliance
  - No obligation to de-clear

Timely Confirmation

EMIR: Timely Confirmation – Scope

> Obligation to confirm terms of non-cleared OTC derivatives within certain deadlines (Commission FAQs confirmed not hard deadlines)

> FCs must also be prepared to report on monthly basis to their national competent authority the number of unconfirmed transactions for more than 5 business days

Timely Confirmation Deadlines – Credit and Interest

	Both parties are FCs/NFC+s	One party is an NFC-
Credit default swaps and interest rate swaps	Entered into:	Entered into:
	before 28 Feb 2014 T+2	before 31 Aug 2013 **T+5**
	after 28 Feb 2014 **T+1**	from 31 Aug 2013 to 31 Aug 2014 T+3
		after 31 Aug 2014 **T+2**

Timely Confirmation Deadlines – Others

	Both parties are FCs/NFC+s	One party is an NFC-
Equity swaps, FX swaps, commodity swaps and all other derivatives	Entered into:	Entered into:
	before 31 Aug 2013 **T+3**	before 31 Aug 2013 **T+7**
	from 31 Aug 2013 to 31 Aug 2014 **T+2**	from 31 Aug 2013 to 31 Aug 2014 **T+4**
	after 31 Aug 2014 **T+1**	after 31 Aug 2014 **T+2**

ISDA Timely Confirmation Standard Wording

> Not a Protocol

> Form of amendment agreement
  for ISDA Master Agreement

> Published to facilitate bilateral agreement

> 4 elective provisions

ISDA Timely Confirmation Standard Wording (cont.)

> First elective
  - Amendment of Section 9(e)(ii) of ISDA Master Agreement
  - The parties intend that they are legally bound by the terms of each Transaction from the moment they agree to those terms (whether orally or otherwise). A Confirmation will be entered into as soon as ~~practicable~~ possible and may be executed and delivered in counterparts (including by facsimile transmission) or be created by an exchange of telexes, by an exchange of electronic messages on an electronic messaging system or by an exchange of e-mails, or by other method intended by the parties to be effective for the purpose of confirming or evidencing such Transaction which in each case will be sufficient for all purposes to evidence a binding supplement to this Agreement. The parties will specify therein or through another effective means that any such counterpart, telex, electronic message or e-mail constitutes a Confirmation

ISDA Timely Confirmation Standard Wording (cont.)

> Second elective
  - Either absolute or reasonable efforts obligation
  - Ensure each Relevant Confirmation Transaction (i.e. uncleared, entered into after 15 March 2013)
  - Confirmed by Timely Confirmation Deadline

Timely Confirmation Standard Wording (cont.)

Third elective

Documenting Party delivers Confirmation by Confirmation Delivery Deadline (i.e. 1 business day prior to Timely Confirmation Deadline if T+2 deadline or 2 business days prior if >T+2 deadline

Receiving Party will (or will use reasonable efforts to) confirm or deliver a Not Confirmed Notice by Timely Confirmation Deadline

If Not Confirmed Notice delivered, parties attempt to resolve differences as soon as possible

Timely Confirmation Standard Wording (cont.)

> Fourth elective

- Negative affirmation
- i.e. deemed acceptance by Receiving Party if Confirmation delivered by Confirmation Delivery Deadline and no response provided by Timely Confirmation Deadline

Reporting

EMIR: Reporting

- All derivatives (OTC and exchange-traded) will have to be reported – including intragroup
- Parties need to ensure that details of derivative contracts (identity of parties which includes Legal Entity Identifier (LEI), features of transaction, detail of collateral) and any modification/termination are reported to a Trade Repository authorised by ESMA
- No later than the working day following the conclusion, modification or termination
- Parties must ensure the details are reported without duplication; certain parties may wish to delegate the reporting function to 3rd party or their counterparty
- Common Data and Counterparty Data must be reported

Key dates for phased-in reporting obligation

> Provided that a trade repository for the relevant asset class is in place on 1 October 2013
  > entered into since 16 August 2012 and outstanding on 1 January 2014 — By 1 January 2014
  > outstanding on 16 August 2012 and outstanding on 1 January 2014 — By 1 April 2014
  > entered into since, or outstanding on, 16 August 2012 and no longer outstanding on 1 January 2014 — By 1 January 2017
> Collateral reporting (for all asset classes) extended — 6 months later
> Reporting of exchange traded derivatives — 360 days later

Disclosure under ISDA EMIR Portfolio Reconciliation, Dispute Resolution and Disclosure Protocol

> Consent to disclosure of information
  - to the extent needed under EMIR for reporting and retention of transaction information
  - to and between head office, branches or Affiliates
  - including trade repositories, regulators and third party service providers
> Waiver of legal disclosure, confidentiality, bank secrecy, data privacy, law protections to the extent possible
> Similar to provision in ISDA 2013 Reporting Protocol published on 10 May 2013 and replicated in form of bilateral amendment agreement
> Doesn't overcome specific jurisdictional unwaivable prohibitions on disclosure

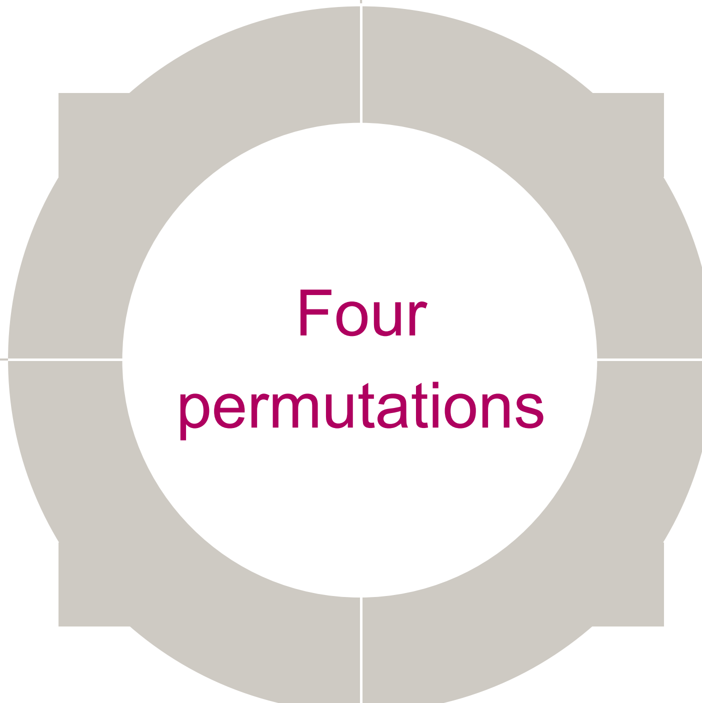
ISDA Reporting Guidance

- Published on 19 July 2013
- Not a Protocol
- Examples of language to facilitate bilateral agreement

Reporting Roles

1. Each party (or Reporting Delegate) reports its Counterparty Data and the Common Data

2. Each party (or Reporting Delegate) reports its Counterparty Data and one party reports Common Data

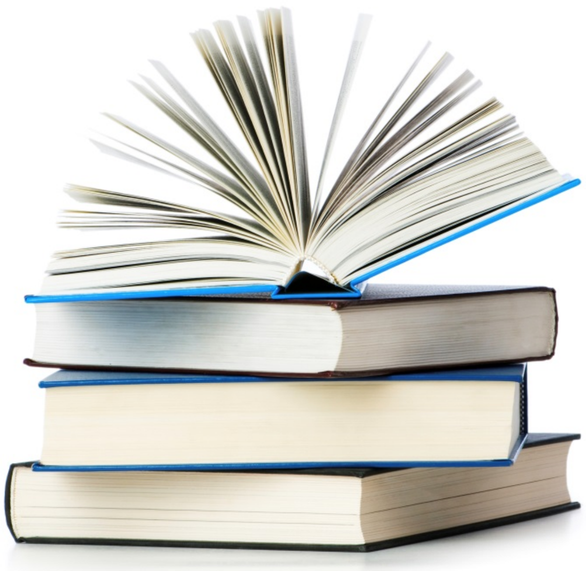


3. One party reports each party's Counterparty Data and the Common Data

4. One party reports its Counterparty Data and the Common Data

Reporting Obligations and Confidentiality Waiver

- Act in good faith to agree Common Data before reported
- If reporting of Counterparty Data performed by other party:
  - must be provided in time
  - accuracy representation
- Confidentiality waiver provision similar to PDD Protocol, Reporting Protocol
- Likely to be a stand-alone agreement where reporting obligation assumed by one of the parties



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A Partner since 2007, is a specialist in structuring and documenting OTC derivative transactions. His recent experience includes advising on a number of primarily private and confidential transactions covering the full spectrum of OTC derivative asset classes, including strategic corporate equity derivatives, balance sheet driven credit derivatives and liability driven strategies for pension funds. He has acted for ISDA on a template emerging markets equity option confirmation and the 2011 Equity Derivatives Definitions.

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