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European Derivatives Regulation: Spotlight on the European Markets and Infrastructure Regulation ("EMIR")[1]

BY THE INVESTMENT MANAGEMENT GROUP

Of late it has been difficult to avoid media coverage and speculation relating to forthcoming regulatory changes in the derivatives world and the on-going discussion about cross border implications, so called "extra territoriality". In Europe, one of the current hot topics is EMIR, seen as Europe's derivatives equivalent to the Dodd Frank Act[2]. The genesis of EMIR and indeed, the majority of other key current derivatives regulatory changes, being MiFID II (together with MiFIR)[3] and the CRD IV legislative package[4] in Europe and the Dodd Frank Act in the United States was the commitment made at the 2009 G20 summit in Pittsburgh, the key objective being to increase transparency and reduce systemic risk, best captured in the following, often quoted statement[5]:

[Improving over-the-counter derivatives markets]: *"All standardized OTC derivatives 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. We ask the FSB and its relevant members to assess regularly implementation and whether it is sufficient to improve transparency in the derivatives markets, mitigate systemic risk, and protect against market abuse."*

In Europe EMIR seeks to transpose the requirements to clear certain derivatives contracts and report trade details to trade repositories and also imposes additional obligations, so called "risk mitigation techniques" for non-cleared OTC derivatives contracts. MiFIR and CRD IV address the obligation to trade certain standardised OTC derivatives on "organised venues" i.e. exchanges or electronic trading platforms and increased capital requirements.

Current status

The primary text of EMIR entered into force on 16 August 2012. Although an EU Regulation, and therefore of direct effect, the detail of most EMIR obligations is to be defined by secondary legislation comprising regulatory and implementing technical standards ("RTS" and "ITS"). To this effect, on 19 December 2012, the European Commission adopted EMIR's first 6 RTS and 3 ITS[6], which entered into force on 15 March 2013. As described below, certain requirements of these RTS and ITS will not become effective until later this year and publication of further RTS and ITS in relation to key areas such as collateral requirements for uncleared trades and EMIR's extraterritorial application is to come. More recently, on 12 July 2013, the European Commission adopted two Delegated Regulations, in relation to the fees to be charged to trade repositories and on the list of exempted entities under EMIR[7]. The European Securities and Markets Association

("ESMA") has also recently published a Discussion Paper on the clearing obligation under EMIR and a Consultation Paper (including the draft RTS) in relation to contracts having a direct, substantial and foreseeable effect within the European Union and the non-evasion provisions of EMIR[8] (the "Consultation Paper"). Since comments on both are requested by mid-September, it is likely to be some time before these issues are resolved.

I. Key obligations of EMIR

EMIR introduces three key obligations for certain counterparties, being the:

1. mandatory clearing obligation (Article 4, EMIR);
2. reporting obligation (Article 9, EMIR); and
3. risk management requirements for uncleared OTC derivatives (Article 11, EMIR).

EMIR also contains detailed provisions and requirements in relation to central counterparties, "CCPs" and trade repositories, the facilitators of obligations (i) and (ii) above.

Although EMIR does not apply to members of the European System of Central Banks and other Member State bodies performing similar functions, the Bank for International Settlements or (except with respect to the reporting obligation) multilateral development banks, public sector entities, which are owned by central governments or the European Financial Stability Facility and the European Stability Mechanism, (there are also certain exemptions for "pension scheme arrangements" (as further detailed below) and intra group transactions) it otherwise has a broad scope, capturing a range of both financial and non-financial counterparties.

II. The Clearing Obligation

Despite not currently expected to become active until the second quarter of 2014 at the earliest and even then with a likely phased implementation, the headline obligation of EMIR is the new "Clearing Obligation", which has three preconditions: (i) a declaration by ESMA that a given class of OTC derivatives is subject to the clearing obligation; (ii) such OTC derivatives were concluded between prescribed categories of counterparty[9]; and (iii) those relevant OTC derivatives were entered into at the relevant time.

Which OTC derivatives?

EMIR defines an "OTC derivative" as a derivative contract, the execution of which does not take place on a regulated market. It is expected that the first OTC derivatives to become subject to the EMIR clearing obligation will be the most liquid derivatives contracts, comprising, similarly to the US, certain interest rate and credit derivative instruments. The procedure by which an OTC derivative can become subject to the clearing obligation is either via the "bottom up" approach, i.e. ESMA acts following a notification from a competent authority that a CCP has been authorized to clear a class of derivatives or "top down", whereby ESMA on its own initiative identifies a class or classes of OTC derivatives that should be subject to the clearing obligation and notifies the European Commission of the same.

To be captured by the clearing obligation, such OTC derivatives contracts must be entered into or novated either on or after the date from which the clearing obligation takes effect or, if the remaining maturity of the OTC derivatives contract is longer than the minimum maturity specified by ESMA, on or after a National Competent Authority ("NCA") has made a notification that a CCP is clearing such class of OTC derivatives, but before the date from which the clearing obligation takes effect.

Who?

EMIR states that the relevant OTC derivatives contracts must have been concluded either between:

1. two financial counterparties ("FCs");
2. a FC and a non-financial counterparty ("NFC") above the clearing threshold referred to in Article 10 (1)(b) EMIR (an "NFC+" (as further detailed below));
3. two NFC+s;
4. (a) a FC or an NFC+ and (b) an entity established in a third country that would be subject to the clearing obligation if it were established in the EU ("Hypothetical Counterparty"); or
5. two Hypothetical Counterparties, provided that such contract *has a direct, substantial and foreseeable effect* within the EU or where such an obligation is *necessary or appropriate to prevent the evasion of any provisions of EMIR.*

"FCs" are defined to include firms, institutions and undertakings authorised or managed (as applicable) pursuant to MiFID,[10] the Capital Requirements Directive,[11] the Direct Insurance (other than life assurance) Directive,[12] the Life Assurance Directive,[13] the Reinsurance Directive,[14] the UCITS IV Directive[15] (the UCITS and where relevant, its manager), the Institutions for Occupational Retirement Provision Directive[16] and the AIFM Directive.[17] Further clarification in relation to the scope of the AIFMD limb has been requested, but this category should be considered as another means of EMIR capturing a third country entity in the form of an alternative investment fund (so called "AIF"), where its alternative investment fund manager ("AIFM") is authorized or registered under the AIFMD.

"NFCs" are defined broadly by EMIR to encompass those undertakings established in the EU other than CCPs or FCs.

"NFC+s" are, in summary, those NFCs that exceed certain thresholds for derivatives activity measured over a 30 day period, including all contracts entered into by all non-financial entities within the consolidated group, but excluding any derivatives used for hedging purposes. Once the threshold is passed (calculations should have commenced on 15 March 2013), the NFC must make a notification to its NCA (which in the UK is the Financial Conduct Authority) and ESMA. Such NFC will then become an NFC+ for all future OTC derivatives contracts and those originally excluded hedging derivatives become subject to any applicable requirements of EMIR. Should such NFC's derivatives activity subsequently fall below the threshold, a separate notification must be made.

"Third country entities" is not a term specifically defined in EMIR but "third country" is used throughout EMIR and is understood to refer to any entity established in a country outside of the EU.

Although the final RTS in relation to what constitutes "direct, substantial and foreseeable effect within the EU" and those contracts to which the clearing obligation will apply where it is "necessary or appropriate to prevent the evasion of any provisions of EMIR" are yet to be published, the Consultation Paper sets out ESMA's current position on these parameters and the draft RTS and is considered in further detail at 6. ("*Extraterritoriality, equivalence, substituted compliance and the story so far*") below.

The EMIR exemption to the mandatory clearing obligation for "pension scheme arrangements" until August 2015 has been widely publicised. However, such exemption will apply solely in relation to those OTC derivatives contracts, which are "objectively measurable as reducing risks directly relating to the financial solvency of pension scheme arrangements". It is expected that ESMA will publish on its website further detail in relation to the definition of "pension scheme arrangements" as set out in EMIR and that there will be a notification procedure pursuant to which pension scheme arrangements seeking to avail themselves of the exemption will have to notify their NCA. A similar notification procedure will exist in relation to the intra group exemption. The notification procedure for both is not expected to commence until ESMA has received the prescribed notifications from NCAs of the authorised classes of OTC derivatives currently being cleared,[18] although the FCA website has already been updated to provide for both such future notifications.

III. The reporting obligation

The EMIR reporting obligation applies to "any derivative contract" (see below) entered into before 16 August 2012, which remains outstanding on 16 August 2012 and those derivatives contracts that are entered into, on or after 16 August 2012 concluded between all counterparties (not defined) and CCPs.

Each counterparty will have an obligation to report certain prescribed details of each transaction to a trade repository no later than the working day following the conclusion, modification or termination of the contract. Whilst each party to a transaction and the relevant CCP will each be subject to the reporting obligation, delegation of the obligation is permitted (responsibility for ensuring such report is made remains) and it is expected that only one report will be published, avoiding any unnecessary duplication. Pursuant to the related RTS, there are two categories of reporting, the first relating to reporting for CDS and IRS and the second relating to any other derivative contracts. Although the RTS prescribe different deadlines depending on which category a derivative belongs to (generally 90 days after the registration of a trade repository), since no trade repositories are currently registered, the reporting obligation is not expected to become effective for any derivative before 1 January 2014 (as is also currently reflected on the ESMA website). A recent joint association letter to ESMA[19] on the EMIR reporting requirement expresses concern about a single go-live date and proposes a phased in approach across three classes of derivatives, phase 1 relating to credit and rates, phase 2 relating to equities, commodities and foreign exchange, and phase 3 encompassing all other asset classes, with the reporting requirement for phase 1 not starting before 20 January 2014. With respect to the reporting of any exchange traded derivative, a recent ESMA Final Report proposes to delay the proposed start date by one year until 1 January 2015.[20]

The lack of definition of "counterparty" in Article 9, EMIR creates inherent uncertainty as to the application of the reporting obligation to non-EU entities. ESMA have previously indicated that, notwithstanding such drafting, the reporting should apply to all derivatives contracts entered into by EU established FCs and NFCs irrespective of the location of its counterparty. ISDA also addressed this issue in a letter to ESMA of 29 January 2013 (asking for clarification) and we are not aware of any formal response. The common sentiment appears to be that the reporting obligation does not apply to non-EU entities or, where a contract is between an EU and non EU entity, the responsibility falls on the EU established entity to report, but we await further clarification/confirmation in this regard. There is also an alternative view that the reporting obligation should apply to at least all entities that are subject to the mandatory clearing obligation.

IV. Risk mitigation techniques for non-cleared OTC derivatives

As part of the international drive to increase the stability of the OTC derivatives market and to reduce systemic risk, OTC derivatives contracts that are not cleared by a CCP are subject to various risk management requirements, as outlined below.

Risk Mitigation Requirement	Key details	To whom does the duty apply?
Timely trade confirmation	– Duty to electronically (where available) confirm OTC derivative contracts within specified time frames, which differ depending on whether the contract is between (a) FCs and NFC+s or NFCs and (b) the type of derivative contract. Equity derivatives, FX and commodity derivatives benefit from longer deadlines than credit and interest rate derivatives.	**1. FC** **2. NFC+** **3. Any other NFC** **4. Hypothetical CP**[a]
Portfolio reconciliation (including valuation requirements)	– The terms of reconciliation must be agreed before entering into the relevant derivatives contract and must cover key trade terms, including at least the valuation attributed to each contract. – The frequency of such reconciliation differs between FCs and NFC+s, ranging from daily where there are 500 or more contracts outstanding between FCs and NFC+s, to annually for NFCs that have 100 or fewer outstanding contracts with such counterparty.	**1. FC** **2. NFC+** **3. Any other NFC** **4. Hypothetical CP**[a]
Portfolio compression	– Required to be considered at least bi-annually, where there are more than 500 or more uncleared OTC derivatives contracts outstanding. – If the decision is made not to compress, counterparties must be in a position to explain the basis for such decision to the relevant NCA.	**1. FC** **2. NFC+** **3. Any other NFC** **4. Hypothetical CP**[a]
Dispute resolution	– All FCs and NFCs must have agreed and detailed procedures and processes relating to the identification, recording and monitoring of disputes relating to the recognition or valuation of the contract and to the exchange of collateral between counterparties, the timely resolution of disputes and a specific process for disputes that remain unresolved within 5 business days. – FCs must report to the relevant NCA any relevant dispute for an amount of a value higher than EUR 15 million, which is outstanding for at least 15 business days.	**1. FC** **2. NFC+** **3. Any other NFC** **4. Hypothetical CP**[a]
Collateral exchange and provision of collateral	Risk management procedures that require timely, accurate and appropriately segregated exchange of collateral with respect to OTC derivative contracts: – (FCs only) entered into, on or after 16 August 2012; and – (NFC+s) that are entered into, on or after such NFC+ exceeds the clearing threshold.	**1. FC** **2. NFC+**
(RTS to be published)	– FCs must hold an appropriate and proportionate amount of capital to manage the risk not covered by appropriate exchange of collateral.	**FC**

[a] Provided that the contract has “direct substantial and foreseeable effect within the EU” or “where such obligation is necessary or appropriate to prevent the evasion of any provisions of EMIR.”

(Except in relation to collateral exchanges associated with OTC derivative contracts) the RTS in this regard have been published. The "timely trade confirmation" requirements came into effect on 15 March 2013 and the requirements in relation to portfolio reconciliation, portfolio compression and dispute resolution will come into effect on 15 September 2013, irrespective of when such OTC derivatives contracts were entered into, and to any OTC derivatives contract concluded thereafter. FCs and NFC+s are also expected to mark-to-market the value of uncleared OTC derivatives contracts outstanding on or after 15 March 2013 on a daily basis (or, if market conditions prevent this, to use an alternative and reliable mark-to-model).

As is the case in relation to the mandatory clearing requirement and the reporting obligation, uncertainty exists as to the extra-territorial application of the risk mitigation requirements. However, the drafting of the related RTS (Article 12) provides some assistance by referring to FCs and NFCs only and a recent ESMA Question and Answer paper[21] states that the risk mitigation techniques will apply where at least one counterparty is established within the EU (irrespective of the location of the counterparty) and that it is to be the responsibility of the EU counterparty to ensure that the risk mitigation techniques are met.

Article 11, paragraph 12 of EMIR states that the obligations set out in paragraphs 1 to 11 of Article 11 shall apply to Hypothetical Counterparties provided such contract has a direct, substantial and foreseeable effect within the EU or where such obligation is necessary or appropriate to prevent the evasion of any provision of EMIR. See below for further detail in this regard.

V. EMIR's product scope

"Derivative or derivative contract" is defined[22] by reference to the MiFID[23] definition of "Financial Instruments", which includes a very general definition of derivatives instruments, including "options, futures, swaps, forward rate agreements and any other derivatives contracts relating to securities, currencies, interest rates or yields, or other derivatives instruments, financial indices or financial measures, which may be physically settled or in cash". Whilst spot FX transactions are not thought to be captured, uncertainty exists around forward FX transactions as a consequence of different applications of MiFID across EU Member States. From a UK perspective, it is thought that for FCA purposes forward FX transactions are outside the scope of MiFID and thus EMIR, provided those FX forwards are entered into for commercial purposes. However, a risk averse approach should be adopted and in the event of any uncertainty one should assume the derivative is in fact captured.

VI. Extraterritoriality, equivalence, substituted compliance and the story so far

"ISDA and our members believe that a globally harmonized approach to cross-border regulation is of paramount importance"[24]

The international application of EMIR is being closely followed, emanating from the provisions of EMIR, which impose its mandatory clearing obligations and risk mitigation techniques on certain transactions between two non EU counterparties. When considering international application, these provisions must be coupled with EMIR's separate concept of "equivalence",[25] pursuant to which the European Commission can declare that the "legal, supervisory and enforcement" arrangements of a third country are equivalent in relation to clearing, reporting and risk mitigation with the effect that counterparties shall be deemed to have fulfilled the obligations to clear, report and observe risk mitigation techniques where at least one of the counterparties is established in that third country. On 3 September 2013, in the next step for equivalence determinations, ESMA published certain technical advice to the European Commission on third country regulatory equivalence in respect of the "phase 1" (the U.S. and Japan) and "phase 2" jurisdictions (Australia, Hong Kong, India, Singapore, South Korea and Switzerland). Certain aspects of the advice are to follow and in due course the European Commission is expected to use this technical advice as its basis for making final equivalence determinations.[26]

There has been much high profile discussion about related existing and potential uncertainties in this regard (see for example the May AIMA paper[27]) and speculation about how the EU broad outcomes based approach of "equivalence" and the CFTC's obligation by obligation "substituted compliance" approach will marry. However, Thursday 11 July 2013 marked a significant day with respect to extraterritoriality and cross border application of EMIR and the Dodd Frank Act, with formal announcements from both the CFTC and the European Commission, each entitled "The European Commission and the CFTC reach a Common Path Forward on Derivatives". Pursuant to such announcements, the European Commission and the CFTC acknowledged simultaneous application of both sets of requirements could lead to conflicts of law, inconsistencies and legal uncertainty and a high level agreement between the European Commission and the CFTC as to the way forward was set. Although acknowledging this development, a recent ISDA paper[28] expresses concern about such "Path Forward", stating that the means of giving effect to decisions of substituted compliance and equivalence remain unclear and risk blurring the distinction between G-20 and ancillary goals. ISDA proposes a principles based substituted compliance methodology, prioritising the G20 goals, providing examples of how it considers such principles and goals can be achieved.

"But it [regulatory reform in Europe] will only reach its full potential if our rules work seamlessly with similar laws beyond our borders."[29]

ESMA's subsequently published consultation paper referred to above (on which comments are invited by 16 September 2013) applies to OTC derivatives contracts, which are entered into between two counterparties that are established in third countries and includes the draft RTS in relation to both "direct, substantial and foreseeable effect [in the EU]" and how the prevention of evasion of the provisions of EMIR will be determined. In summary, it proposes that an OTC derivative will have "direct, substantial and foreseeable effect" where (i) (a) one of the third country entity's (from a non-equivalent third country only) obligations are guaranteed by an FC in an aggregate notional amount exceeding €8 billion or the pro rata equivalent for partial guarantees and (b) such guarantee is in an amount at least equal to 5% or more of the sum of current derivatives exposures of such FC guarantor or (ii) such transaction is entered into between the EU branches of two non-EU entities established in "non-equivalent" third country entities. Note the significance of equivalence since it is suggested and clarified in the Consultation Paper that where at least one of the third country incorporated entities is from a country that can avail itself of an equivalence determination, EMIR can be disapplied (in respect of that transaction only) as the third country framework allows reaching an outcome equivalent to that of EMIR.

The draft RTS adopt a criteria based approach to determine whether the application of EMIR to a given OTC derivatives contract is "necessary or appropriate to prevent the evasion of any provision of EMIR", the key determinants being whether, having considered the transaction as a whole, avoidance or abuse of EMIR was its primary purpose and whether such transaction or related arrangements were artificial (the RTS providing guiding factors regarding the determination of "artificial"), i.e. but for such artificial arrangements the OTC derivative would ordinarily have been subject to EMIR. The Consultation Paper provides the example of a third country entity acting as derivatives counterparty solely to avoid the application of EMIR or where artificial arrangements with a similar effect are put in place.

Similarly, the CFTC, on 12 July 2013, issued an Exemptive Order Regarding Compliance with Certain Swap Regulations and Interpretative Guidance and Policy Statement Regarding Compliance (on which there was a 30 day comment period commencing 22 July 2013), effective 13 July 2013 (including temporary relief for certain entities and obligations between 13 July 2013 and 31

December 2013 or such earlier date as specified in the Exemptive Order, primarily the date on which there is a determination of substituted compliance) regarding cross border application of the Dodd Frank Act, most notably in relation to the definition of “US Person” and the circumstances in which it is expected “substituted compliance” will be available. For certain entity level requirements substituted compliance will be permitted for the requirements applicable in the EU that are comparable to and as comprehensive as those applicable in the U.S. As with the EU’s declaration of “equivalence”, the CFTC envisages making determinations of “substituted compliance” permitting substituted compliance by reason of the CFTC considering that the specific requirements applicable in the EU (or certain other specified jurisdictions) are comparable to and as comprehensive as those applicable in the U.S. Various uncertainties do remain though, for example, in relation to timing or the situation where an entity is both a US Person pursuant to the Dodd Frank Act, but is also subject to EMIR and cannot therefore seemingly avail itself of either substituted compliance or equivalence.

VII. Market Initiatives

March 2013 marked the start of ISDA’s response to the new post EMIR world, primarily through the publication of various Protocols as detailed below. Further initiatives are expected, in particular in relation to collateral, once the relevant RTS are published.

A. The ISDA 2013 EMIR NFC Representation Protocol (the “Representation Protocol”).

On 8 March 2013, ISDA published the Representation Protocol to facilitate the process of categorizing counterparties to OTC derivative contracts.

By adhering to the Representation Protocol, a party incorporates into its ISDA Master Agreements (as well as into any of its “deemed” ISDA Master Agreements under a long form confirmation) with other adhering parties an amendment pursuant to which it: (i) may make a representation that it is a NFC or to the best of its knowledge and belief would be a NFC if it were established in the EU; (ii) is not subject to the mandatory clearing obligation (the latter is a mechanism to indicate that it is not a NFC+); and (iii) is able to notify its counterparty of any changes to its status under EMIR. The Representation Protocol also sets out the consequences in the case where a representation proves to have been incorrect or misleading and which has led to the parties failing to comply with their respective obligations under EMIR.

Counterparties not making the representation described above can also adhere to the Representation Protocol, in order to take the benefit of the representations made by their NFC counterparties under the Representation Protocol. Therefore, FCs, NFCs and Hypothetical Counterparties can all adhere to the Representation Protocol.

B. The Timely Confirmation Amendment Agreement (the “Amendment Agreement”).

As set out above, Article 11(1), EMIR requires all FCs, NFCs and NFC+s to establish “appropriate procedures and arrangements” to ensure the timely confirmation of the terms of all non-cleared OTC derivative contracts.

On 8 March 2013 ISDA published a helpful guide to possible amendments to the ISDA Master Agreement in the form of its Amendment Agreement. Although the Amendment Agreement is unlikely to be specific enough to form the basis of an executable amendment, it does highlight the following issues, which counterparties will need to consider when amending their documentation to comply with this EMIR obligation:

- Specification of each party's responsibilities and deadlines for the production and agreement of confirmations, by transaction type if required;
- Facilitation of both positive and negative affirmation of confirmations (whereby a transaction will be regarded as confirmed if the party receiving the confirmation fails to positively approve/reject the confirmation within a specified deadline); and
- The suggestion of alternative wording depending on whether breaches should constitute Events of Default, Termination Events or have other consequences.

C. The 2013 ISDA Reporting Protocol (the "Reporting Protocol").

On 10 May 2013, ISDA published its Reporting Protocol, which allows adhering parties to amend the terms of their ISDA Master Agreements (or any other agreement governing the terms of their derivative transactions) to address possible restrictions to a party's ability to comply with mandatory trade reporting requirements imposed by EMIR and MiFIR. Where relevant agreements are secured or guaranteed by a third party and consent or other action by such third party is expressly required for amendments to be made to such agreements, such agreements will not be covered by the Reporting Protocol unless consent or other action has been procured.

The Reporting Protocol aims to assist parties in overcoming any limitations and restrictions arising by virtue of existing statutory, regulatory contractual obligations or other legal limitations (under non-disclosure, confidentiality, bank secrecy or other laws) and which prevent parties from disclosing information in relation to derivative contracts by providing for counterparty consent to disclosure of restricted information. In the accompanying FAQs, ISDA does concede that in certain cases, the consent language in the Reporting Protocol may be insufficient to fully address any applicable disclosure limitations.

For parties who do not wish to adhere to the Reporting Protocol, but prefer to amend the bilateral terms of their agreements with each relevant counterparty, ISDA has also published a form of side letter incorporating the same consent provisions set out in the Reporting Protocol.

D. The Client Cleared OTC Derivatives Addendum (the "Addendum").

On 11 June 2013, ISDA and the Futures and Options Association (the "FOA") published the Addendum, which is anticipated to become the market standard for documenting the client clearing relationship between clients and clearing members for clearing their OTC derivative transactions. The Addendum aims to amend existing client documentation (i.e. the Addendum forms a single agreement with existing OTC derivatives trading documentation such as the ISDA Master Agreement or a set of futures and options terms based on the FOA's Professional Client Agreement) to allow for clearing of OTC derivatives in compliance with EMIR and leaves a number of elections open for negotiation between a client and clearing member, which are documented in the Annex to the Addendum (similarly to the ISDA Schedule).The key features of the Addendum are as follows:

- The Addendum provides for clearing through multiple CCPs under a single document;
- Following a clearing member or CCP default, the Addendum creates separate sets of transactions per CCP service (so called "netting sets", which the Addendum defines as "Cleared Transaction Sets");
- A client's termination rights upon a clearing member default are very limited; and
- A client is given pre-default porting rights enabling the client to switch clearing member prior to a clearing member default.

E. The 2013 EMIR Portfolio Reconciliation, Dispute Resolution and Disclosure Protocol (the "Portfolio Reconciliation Protocol")

On 19 July 2013, ISDA published its Portfolio Reconciliation Protocol, which enables parties to amend the terms of their ISDA Master Agreements (or any other agreement governing the terms of their derivative transactions) to reflect the portfolio reconciliation and dispute resolution requirements imposed by EMIR as well as to include a disclosure waiver to help ensure parties can meet the various reporting and record keeping requirements under EMIR without breaching confidentiality restrictions that they may be subject to. For those parties to an ISDA Master Agreement who wish to make such changes bilaterally, on 20 August 2013, ISDA published a standard amendment agreement with the same substantive content as the Portfolio Reconciliation Protocol, facilitating compliance with EMIR's portfolio reconciliation and dispute resolution requirements and addressing related EMIR disclosure requirements.

Each of the Representation Protocol, the Reporting Protocol and the Portfolio Reconciliation Protocol (the "Protocols") are open to ISDA members and non-members and parties wishing to adhere should complete the relevant adherence letter on the Protocol Management section of ISDA's website. There is no cut-off date for adherence, but ISDA may designate a closing date for the relevant Protocol by giving thirty days' notice on its website. Subject to the terms of the relevant Protocol, an agent may complete and upload an adherence letter on behalf of some or all of its principals (for example, an investment manager acting on behalf of a number of investment vehicles). An adhering party is required to pay a one-time fee of U.S.$500 to ISDA upon or before submitting its adherence letter. Each Protocol envisages that a party may wish to revoke its adherence and to do so a party must submit a revocation notice to ISDA with respect to the relevant Protocol during the month of October in any year.

VIII. Conclusions

On the basis that the core EMIR obligations are yet to come into effect and a large volume of secondary legislation remains outstanding, various uncertainties and unknowns remain and only with the passage of time will clarity form. However, what is already known is that EMIR will create many new and often previously untested obligations on a range of different entities, certain of which are necessarily better equipped to ensure adherence. Given the ongoing parallel worldwide developments including in the United States, Australia, Canada, Hong Kong and Japan to address the same G20 commitments, which although following similar principles are manifesting themselves in different ways and at different speeds, many counterparties will need to consider EMIR's obligations in a global context. Consequently, what also seems certain is that there is a long way until any finish line and it could take a significant amount of time before a status quo is achieved.

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[1] Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties (CCPs) and trade repositories (TRs).

[2] The Dodd-Frank Wall Street Reform and Consumer Protection Act, 2010.

[3] European Commission proposals for a Directive on markets in financial instruments repealing Directive 2004/39/EC of the European Parliament and of the Council, and for a Regulation on markets in financial instruments amending Regulation 648/2012 [EMIR] on OTC derivatives, central counterparties and trade repositories as adopted on 20 October 2011.

[4] Directive 2013/36/EU of the European Parliament and of the council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directive 2006/48/EC and 2006/49/EC and Regulation 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.

[5] G20 Leaders Statement: The Pittsburgh Summit – September 24-25,2009 (http://www.g20.utoronto.ca/2009/2009communique0925.html).

[6] (a) Commission Delegated Regulations (EU) No 148/2013, No 149/2013, No 150/2013, No 151/2013, No 152/2013, No 153/2013 of 19 December 2012 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories with regard to regulatory technical standards: (i) on the minimum details of the data to be reported to trade repositories; (ii) on indirect clearing arrangements, the clearing obligation, the public register, access to a trading venue, non-financial counterparties, and risk mitigation techniques for OTC derivatives contracts not cleared by a CCP; (iii) specifying the details of the application for registration as a trade repository; (iv) specifying the data to be published and made available by trade repositories and operational standards for aggregating, comparing and accessing the data; (v) on the capital requirements for central counterparties; and (vi) on requirements for central counterparties, and (b) Commission Implementing Regulation (EU) No 1247/2013, No 1248/2013 and No 1249/2013 laying down implementing technical standards with regard to the format of the records to be maintained by central counterparties, the format and frequency of trade reports to trade repositories and the format of applications for registration of trade repositories according to Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories. (a) and (b) each as published in the Official Journal on 23 February 2012.

[7] Commission Delegated Regulation supplementing Regulation (EU) No 648/2013 of the European Parliament and of the Council with regard to fees charged by the European Securities and Markets Authority to trade repositories and Commission Delegated Regulation amending Regulation (EU) No 648/2013 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories with regard to the list of exempted entities.

[8] 2013/925 Consultation Paper – The Clearing Obligation under EMIR (12 July 2013) and 2013/892 Consultation Paper (17 July 2013) – Draft Regulatory Technical Standards on contacts having a direct, substantial and foreseeable effect within the Union and non-evasion of provisions of EMIR.

[9] Article 4(1)(a), EMIR, which is broken down into five sub-categories.

[10] The Markets in Financial Instruments Directive, Directive 2004/39/EC

[11] Directive 2006/48/EC

[12] Directive 73/239/EEC

[13] Directive 2002/83/EC

[14] Directive 2005/68/EC

[15] Directive 2009/65/EC

[16] Directive 2003/41/EC

[17] Directive 2011/61/EU

[18] Pursuant to Article 89(5) paragraph 1, EMIR

[19] Letter dated 31 July 2013 submitted to ESMA by AIMA, ISDA, the British Bankers Association, *Associazione Italiana Intermediari Mobiliari* (ASSOSIM) and the German Banking Industry Committee.

[20] ESMA, Final Report, Draft implementing technical standards amending Commission Implementing Regulation (EU) No 1247/2012 laying down implementing technical standards with regard to the format and frequency of trade reports to trade repositories under Regulation (EU) No 648/2012, 6 August 2013.

[21] Questions and Answers, Implementation of the Regulation (EU) No 648/2012 on OTC Derivatives, central counterparties and trade repositories (EMIR), 5 August 2013, ESMA/1080 (first version published on 20 March 2013 and second version published on 6 June 2013).

[22] Article 2(5), EMIR.

[23] The Markets in Financial Instruments Directive, Directive 2004/39/EC.

[24] Page 7, Testimony of Stephen O'Connor, Chairman, ISDA, Before the US House of Representatives Committee on Agriculture, May 21, 2013.

[25] Article 13, EMIR.

[26] The full technical advice is publicly available at http://www.esma.europa.eu/page/Post-trading- documents. See also related press release and ESMA letter to Jonathan Faull, Director General, Internal Market and Services, European Commission: (i) http://www.esma.europa.eu/system/files/2013 1169_press_release_esma_advises_commission_on_equivalence_of_non european_derivatives_rules.pdf; and (ii) http://www.esma.europa.eu/system/files/2013 1163_letter_to_ec_technical_advice_on_third_country_regulatory_equivalence_under_emir.pdf.

[27] AIMA, "Addressing Overlaps between EMIR and CFTC OTC Derivatives Regulation", 24 May 2013.

[28] ISDA, "Methodology for Regulatory Comparisons, Interjurisdictional recognition of derivatives regulation through a Principles Based Substituted Compliance Methodology", August 2013.

[29] Michael Barnier (European Commissioner for the Internal Market and Services), "Interdependent swaps markets need interactive cross border rules", Brookings Institution – Restoring Momentum in Transatlantic Cooperation on Financial Reform, Washington DC, 15 July 2013.