

EMIR – New European Derivative Transaction Regulation

The new EMIR regulation ("European Market Infrastructure Regulation"); i.e. regulation of the European Parliament and the Council (EU) No. 648/2012 of July 4, 2012 on OTC¹ Derivatives², Central Counterparties and Trade Repositories and regulation of the Commission Delegated Regulation (EU) No. 149/2013 of December 19, 2012 (hereinafter the "EMIR Regulation" or "Regulation of EMIR") will significantly increase the stability, transparency and confidence in financial markets because regulatory authorities will have access to more detailed information on particular OTC transactions. Thus central regulatory authorities will have a more reliable overview of the systemic risk concentration of individual market participants. This change means an increase in the security of transactions carried out on financial markets for clients of financial institutions e.g. banks.

The EMIR Regulation imposes specific obligations on all market participants, i.e. not only on banks and financial institutions, but also on clients using hedging instruments.

According to the EMIR Regulation contracting parties are divided into three main categories:

- FC (Financial Counterparties) – financial counterparties (e.g. banks, insurance companies, investment companies, funds etc.)
- NFC (Non-financial Counterparties) – non-financial counterparties (other than FC counterparties)
- NFC+: non-financial counterparties that have exceeded the so-called "clearing threshold", see Chapter 3 Clearing Obligation

Main obligations arising from the EMIR Regulation

1. **Specific measures to mitigate risks** must be taken when concluding OTC derivative transactions

- 1.1. *Confirmation – timely confirmation of the transaction terms*
- 1.2. *Reconciliation – transaction reconciliation*
- 1.3. *Compression*
- 1.4. *Dispute resolution*
- 1.5. *Reconciliation and dispute resolution procedure between Československá obchodní banka, a. s. and its clients*

2. **Obligation to report** OTC derivative transactions to the trade repository

3. **Clearing obligations** determined by the class of OTC derivatives through the Central Counterparty

Summary of terms and obligations

- **15.3.2013** – timely confirmation of the transaction terms and conditions – it is essential that counterparties mutually confirm their confirmations (confirmation of transaction terms) as soon as possible after a transaction is concluded
- **15.9.2013** – obligation to agree with each counterparty on the method of reconciling the transaction portfolio, compression and resolving disputes
- **1.1.2014** – reporting – this date can be changed
- **15.6.2014** (not sooner) – clearing – this date can be changed

¹ Over-the-counter ('OTC') is a type of market organisation (structure). If there are OTC transactions it means that transactions are not made through an official institution that surveys the market and takes responsibility for clearing agreed transactions. Participants negotiate the terms and conditions of a contract/transaction directly between each other. The transaction terms and conditions are not usually standardised and even the risk both parties incur is generally higher than that in an organised market.

² For example FX Forward, FX SWAP, Forward foreign exchange operations with a limit rate, FX option (plain vanilla), Average Rate Forward (ARF), Combination of options (option structures), consisting of barrier, binary or other exotic options – e.g. European Forward Plus, Forward Rate Agreement (FRA), Interest Rate Swap (IRS – Interest swap), Cross-Currency Interest Rate Swap (CCIRS), Cap/Floor (plain vanilla), Swaption, Interest swap – Exotic variants, Exotic interest options – e.g. Barrier options, Futures, Commodity SWAP, Commodity option (plain vanilla), Forward with issue permissions.

1.1. Confirmation – timely confirmation of transaction terms

It is essential that the contracting parties confirm the received confirmation (confirmation of transaction terms) as soon as possible after a contract is concluded to ensure that they are understood and accepted. They must be confirmed on time especially for non-standard or complex OTC derivative transactions.

Derivative transactions must be confirmed as soon as possible, but no later than within the number of business days as given below after a transaction is concluded (unless an agreement between the parties stipulates otherwise):

Counterparty	Product	Transactions concluded	No later than (business days)
NFC	CDS, IR SWAPs	by August 31, 2013	T+5
		from August 31, 2013 to August 31, 2014	T+3
		from August 31, 2014	T+2
	equity SWAPs, FX SWAPs, commodity SWAPs and other	by August 31, 2013	T+7
		from August 31, 2013 to August 31, 2014	T+4
		from August 31, 2014	T+2
FC, NFC+	CDS, IR SWAPs	by February 28, 2014	T+2
		from February 28, 2014	T+1
	equity SWAPs, FX SWAPs, commodity SWAPs and other	by August 31, 2013	T+3
		from August 31, 2013 to August 31, 2014	T+2
		from August 31, 2014	T+1

1.2. Reconciliation – transaction reconciliation

The contracting parties will agree on the reconciliation method with each of its counterparties: portfolios will be compared accordingly so that any discrepancy in the material term of OTC derivative transactions can be identified at an early stage including its valuation. Counterparties of OTC derivative transactions reconcile portfolios; reconciliation includes comparing key trade terms and conditions that identify each specific OTC derivative transaction and comparing the valuation of each transaction.

Counterparties can be divided into for reconciliation:

- portfolio data receivers (Portfolio Data Receiver) – usually NFC
- portfolio data senders (Portfolio Data Sender) – usually FC

The reconciliation frequency depends on the type of the counterparty and the number of outstanding derivative transactions.

Counterparty	Frequency of reconciliations	Number of outstanding transactions
NFC	Quarterly	More than 100
	Annually	Less than 100
FC, NFC+	Daily	More than 500
	Weekly	51-499
	Quarterly	Less than 51

1.3. Compression

NFC and FC with a particular counterparty with 500 or more outstanding OTC derivative transactions that are not cleared by a CCP must have procedures in place to enable them regularly and at least twice a year to analyze the possibility of portfolio compression to reduce counterparties' credit risk and make the portfolio compression.

1.4. Dispute resolution

The aim of resolving disputes is to reduce the risks from contracts that are not centrally cleared. When concluding particular OTC derivative transactions the counterparties should have a 'framework agreement' on how to resolve any disputes that may arise. This framework agreement should refer to dispute resolution mechanisms. The object is to prevent unresolved disputes escalating and exposing counterparties to other risks. Disputes should be identified, managed and adequately communicated.

1.5. Reconciliation and dispute resolution procedure between Československá obchodní banka, a. s. and its clients

Reconciliation procedures and resolving disputes arising from transactions concluded with Československá obchodní banka, a. s. ("ČSOB"), but only for EMIR purposes and unless an agreement stipulates otherwise will be as follows:

Counterparties must reconcile portfolios at the frequency specified by the EMIR Regulation (depending on the number of transactions and type of counterparty). The client will receive an overview of outstanding derivative transactions, including its valuation from ČSOB at the required frequency.

If the client does not agree with key trade terms (as of the valuation date) listed in a reconciliation report sent by ČSOB it has to contact ČSOB to clarify any discrepancies within five business days of receiving the reconciliation report. Otherwise, ČSOB will consider the key trade terms approved.

If the discrepancies are not resolved after communication between the counterparties the rules agreed between the client and the ČSOB will apply. If no rules exist the client has the right to inform ČSOB about the dispute in writing. A dispute that is not settled within five business days (business days of the Client's and ČSOB's registered offices) after the date of the counterparty receiving the dispute notice will be internally assigned to ČSOB's senior staff.

2. Obligation to report transactions

- The obligation to report OTC derivative transactions shall apply to all derivative transactions concluded before August 16, 2012 and remain outstanding on that date and derivative transactions concluded on or after August 16, 2012. Currently mandatory reporting will be launched on January 1, 2014.
- The reporting obligation applies to both derivative transaction counterparties. The counterparties can agree to delegate this obligation. **ČSOB is currently intensively setting up procedures to enable it to completely take over its clients' duty from January 1, 2014.**
- The report recipient will be the so-called trade repository determined by the European Securities and Markets Authority (ESMA). Several entities have applied for a license; ČSOB is negotiating a contract with one of them, REGIS-TR (see www.regis-tr.com).
- Together with the Czech Banking Association and the Czech National Bank we are currently discussing the technical requirements for reporting transactions. Essentially a unique identification of each counterparty valid in and outside the EU (the so-called LEI) is needed.

3. Clearing obligations

Validity

Deadlines/dates have not yet been precisely determined, only time ranges are available. Mandatory clearing will **not** be launched **before June 15, 2014**. This applies to both new and previously concluded transactions (but transactions made after September 16, 2013 inclusive).

Who has to meet the obligation and for what transactions

This obligation applies to **all Financial counterparties** ("FC") and **selected Non-financial counterparties** ("NFC +") that exceed a specified clearing threshold. The regulator can be asked to exempt intragroup transactions from the clearing obligation. The clearing obligation may initially apply only to certain types of OTC derivative transactions, first of all to interest and credit derivatives.

NFC+ clearing threshold

The **clearing threshold** means EUR 1 billion open positions of credit or equity derivatives and EUR 3 billion of interest, currency or commodity derivatives. **Under certain conditions derivatives** objectively measurable as risks reducing directly related to commercial activities or corporate financing **are not included**. For details, see the 'EP' and Council Regulation No. 648/2012 (Article 10) and Regulation of the Commission No. 149/2013 (Articles 10 and 11).

What to do if an NFC+ threshold is exceeded?

If the clearing threshold is exceeded the NFC+ must notify the CNB and ESMA.

More information

ESMA

<http://www.esma.europa.eu/page/European-Market-Infrastructure-Regulation-EMIR>

CNB – legal regulations

<http://www.cnb.cz>

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