# KNOW THE RULES

**COMPANIES THAT USE OTC DERIVATIVES WILL NEED TO REPORT TO TRADE REPOSITORIES FROM FEBRUARY 2014 TO COMPLY WITH EMIR. DAVID RETANA EXPLAINS WHAT THIS MEANS FOR YOUR COMPANY**

The European Market Infrastructure Regulation (EMIR) has been in force since 16 August 2012. But do you really understand what the implications of this EU-wide regulation are for your organisation?

Whatever your organisation's size, the reporting obligation is one element of EMIR that all companies will need to comply with from February 2014 when OTC derivative trades become reportable. Many treasurers still believe their bank will, on their behalf, undertake the regulatory obligations for all their derivative transactions, including reporting to a trade repository (TR). While some banks indicate they will offer such services, many will not. And what makes the reporting obligation difficult to outsource is the necessity to report both market-facing transactions and intragroup transactions. However the reporting is done, ultimately, the corporate retains full responsibility and liability for what is reported to the European regulators.

While this article addresses questions arising from the reporting requirement of EMIR, it is worth noting the three main pillars of the regulation that are applicable to corporates or so-called non-financial institutions:

**1.** The requirement to clear standardised OTC derivatives via central clearing counterparties (CCPs) in the event that the non-hedging activity exceeds defined clearing thresholds;

**2.** The introduction of risk mitigation techniques for those transactions that are not cleared via a CCP – so-called bilateral OTC derivative transactions; and

**3.** The requirement to report all derivative contracts (be they OTC or exchange-traded derivatives) to a TR.

When it comes to the final point, a couple of principles should be noted:

- The reporting obligation applies, without exception, to all corporates;
- All derivative transactions outstanding on 16 August 2012 and/or initiated since – whether 'live' or matured – will need to be 'backloaded'/reported to a TR;
- Reporting must be done on a transaction date + one business day (T+1) basis after completion of the trade; and
- Both market-facing and intragroup activity must be reported.

One cannot dispute the fact that EMIR will have a far-reaching impact on the corporate world, which is only now being realised. And uncertainty on even basic questions, such as 'what needs to be reported and when' are still being raised on a daily basis. With the reporting start date roughly four months away, we hope to be able to shed some light on the major concerns and, in doing so, alleviate some of the anxiety.

## Can the reporting obligation be outsourced?

Under EMIR, both counterparts to a derivative transaction are obliged to report. But the reporting obligation can be outsourced, either entirely or partially, to financial counterparts, third-party middleware vendors, execution, matching and/or clearing platforms, or carried out directly by the trading counterparts.

The choice to outsource depends on a range of factors, not least of which is the ability and/or willingness of a third party to report on a trading company's behalf. A major issue is whether this counterpart possesses all the information required to report 'on behalf'. Trading platforms or counterparts, for instance, have an incomplete set of data and the corporate would be required to complete that set. This may

include potentially sensitive information, such as end beneficiary data or exposure valuation details. Completing the data requires additional information flows possibly negating the operational streamlining delegation should deliver. Another aspect is a company's ability to delegate the reporting of its intragroup and cross-border trades, which are not typically captured by a single counterpart. So, while delegation may appear attractive, a detailed benefit analysis should be undertaken.

### What about reconciliation?

As the company retains full responsibility for what has been reported, it is vital that it maintains a complete overview. TRs should provide real-time individual trade reporting status reports as well as regular end-of period reports that recapture aggregate positions and transaction details at the end of the day, week or month. An archiving system, maintaining full reporting details for a period of 10 years, should complement this. A TR should also enable systematic reconciliation with trades lodged by counterparts, whether with them or another authorised TR. Finally, links should be offered to providers to facilitate regular portfolio reconciliation exercises as mandated under EMIR.

### What needs to be reported?

Reporting directly to a TR can be relatively straightforward where the required data is extracted from treasury management systems. In addition, each reporting counterparty and transaction requires a legal entity identifier (LEI) and unique trade identifier (UTI).

The LEI is a unique, 20-character ID that enables regulators to identify entities involved in financial market transactions. While agreement on an internationally recognised global LEI (GLEI) is still under way, 'pre-LEIs' can be obtained. UTIs should be communicated at the earliest possible stage of trading. The question of generating UTIs for intragroup transactions remains. Some TRs can generate UTIs for backloaded contracts and may look at doing it on behalf of market participants.

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### How can a corporate connect directly with a TR?

There is a full gamut of connectivity channels. Smaller customers may prefer manual input via a secured, web-based GUI or upload of CSV files while larger players may opt for an automated exchange of XML files via Swift FileAct, SOAP API, SFTP or leverage SWIFT FINinform – where suitably enriched copies of FX confirmation messages are used. In addition, support should be provided with technical documentation, a help desk and free access to a full test environment.

The choice of the most appropriate connectivity pathway will depend on a number of factors, including size of activity, in-house systems and IT capabilities, and level of integration of trading, accounting and middle-office systems. Corporates without IT development expertise should look for a TR that has developed partnerships with software and system providers.

### Which costs are involved in choosing a particular reporting route?

These usually include a one-off cost for building the data aggregation module and connectivity link plus ongoing maintenance costs and reporting fees. There may also be the one-off cost for backloading; although some TRs will carry out backloading prior to the reporting start date for the respective derivative class free of charge.

### Must a corporate report to one or multiple jurisdictions?

While corporates will report to the competent authorities of the jurisdiction they are domiciled in, European regulator the European Securities and Markets Authority and the European Commission are negotiating with their global counterparts, for example, the Commodity Futures Trading Commission and the Securities and Exchange Commission in the US, on the principles of extraterritoriality and equivalent regulation. Market participants want to limit reporting in multiple jurisdictions. So far this question remains unresolved, but US and European regulators hope to agree a common approach based on the principle of 'substitute compliance' before the end of the year. This should limit duplicate reporting under multiple jurisdictions, ie where an EU-based corporate centralises its treasury management and regulatory reporting obligations, it would have only a reporting obligation under EMIR.

In conclusion, the start date for reporting derivative transactions under EMIR is fast approaching. Corporates should not be caught out nor decide by default. Rather, treasurers should take a strategic perspective and examine the full range of solutions available to them.

**David Retana is managing director of REGIS-TR. Contact him at dretana@regis-tr.com. For more information, see www.regis-tr.com**