EMIR EDGES NEARER

WITH EUROPEAN REGULATION OF DERIVATIVES COMING INTO FORCE IN 2014, DAVID RETANA OUTLINES SOME POINTERS FOR CHOOSING A TRADE REPOSITORY

The past few years have been awash with a continuing tsunami of new regulations. Understanding fully what it means to both financial and non-financial organisations is proving a challenge – not only in terms of what the regulations mean and how they all fit together, but also in terms of what needs to be done in order to comply with the changing environment.

It is no wonder that the back offices of financial services providers and corporate treasurers are anxious. The implementation cost of complying with all these regulations is swallowing a huge chunk of their investment budget. Some market players estimate that around 70% of their budget is currently being disbursed on internal projects focused solely on regulatory compliance. It is not unusual to see multimillion-euro bills for IT development alone.

Setting the financial considerations aside, uncertainty also exists over the specifics of these new rules and, although this is slowly being ironed out, it is a cause for concern. Earlier this year, the European Market Infrastructure Regulation (EMIR) published its Commission Delegated Regulations, which entered into force on 15 March 2013. Although there are still possible question marks around the timing for the implementation of EMIR, we now have a clear indication as to what this regulation will mean to the derivatives industry and what we must do to prepare.

What will EMIR mean for you?

The European Securities and Markets Authority (ESMA) is the regulator responsible for the publication and implementation of EMIR, which was originally proposed to come into force earlier this year. Due to various hold-ups, the timeline has slipped into 2014, with an enforcement date currently set at 1 January, nearly a year later than originally expected. While this delay will undoubtedly offer some relief to many – particularly buy-side players – complacency would be a mistake. Time is running out and once the trade repositories have been granted their licence by ESMA – now scheduled from the end of September – there will first be the sizeable task of backloading the reporting of any trades undertaken since 16 August 2012. If organisations have not yet chosen their trade repository it is now time to do so or, at least, be well advanced in the process.

If you need a recap on what EMIR entails, here is a quick summary: EMIR will require that certain standardised, OTC derivatives be cleared through central counterparties (CCPs). Furthermore, all derivative trades – exchange-traded as well as OTC, whether or not cleared through a CCP – will have to be reported to a trade repository within the next business day. Any organisation – financial or non-financial – active in these instruments within the EU will be obliged to comply.

Choosing a repository

A number of trade repositories, such as REGIS-TR, a European-based repository, are already established. Each has a different scope of services and range of derivative types that they can handle. Choosing the right one will depend partly on how much you want your trade repository to do. For example, some will process exchange-traded as well as OTC-traded derivatives across all product classes; service corporates from within the EU; hold customer data exclusively in the EU; and, in future, will offer value-added services such as centralised collateral management and portfolio reconciliation. Other key selection criteria to take into consideration are the level of data protection, location of the database (EU-based or outside), service fees and simplicity in the communication and handling of the system, for example, mass uploads in XML and CSV. Certainly, whichever trade repository you choose must support your reporting obligations, handle reporting to regulators and provide you with a record of your registered contracts.

Another point to consider during your trade repository selection process is whether you want to undertake the trade reporting yourself or whether you would prefer to have your respective counterparty or counterparties handle it for you. This question very much depends on the extent of your activity with regard to the different product classes, the range of counterparties and their willingness to take on

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this reporting obligation of cleared and non-cleared derivative transactions at a reasonable price.

Like it or not, time is ticking and it may not be as simple as: "My bank or counterparty will do this for me." Have you actually checked with your bank yet? Delegation could be complex and it is worth remembering that the legal obligation to report always remains on the corporate's side. Do you yet know if your company falls under the category of 'non-financial corporate plus' (NFC+), meaning clearing, risk-mitigation and reporting obligation, or 'non-financial corporate minus' (NFC-), meaning reporting and some risk-mitigation obligation only, as defined in ESMA's final report? Have you thought about the likely system changes that will be necessary to accommodate the new processing chain? Without a doubt, there is a lot to do in a short space of time.

What will these changes bring?

So far, I have emphasised the challenges involved in preparing for EMIR. Now let us look at the benefits EMIR will bring to the financial services industry as a whole, some of which will apply to non-financial corporates as well, depending on their use of OTC derivatives and their existing processes. The biggest impact organisations should find post-EMIR is that they will have to deal with less paperwork. Long, complicated paper trails – as seen currently in the OTC derivatives market – will become confined to the wastebasket. EMIR's requirement that large numbers of OTC derivatives be cleared through central counterparties, confirmed on electronic platforms where available and reported to trade repositories, necessitates a much greater level of standardisation than can be seen currently in back offices.

In the past, OTC derivative trading has been a complicated and bilateral world. This is now set to change as standardisation will naturally result in a much more efficient process. This, in turn, will lead to less risk and greater security while the reduced paperwork will mean quick and lean processing – which will be far more environmentally friendly, too. And, for your company, having a centralised view of all your exposures that can be accessed at any time via a reporting and query tool will undoubtedly bring rewards.

Looking for neutrality

Neutrality should also be an important aspect of a trade repository's service to its clients. EMIR, and its US counterpart Dodd Frank, will require all market participants to share their derivatives data, structures and strategies with trade repositories. Exchanging information in this way may leave some players a little worried that they may be giving information to a trade repository affiliated with a competitor.

So organisations may prefer to search for a trade repository that is not participating directly on its own account in the derivatives market and is therefore completely neutral to the information received, and which already has experience in data capturing and storage.

In conclusion, it is important to select your trade repository wisely because repositories will be here for a long time and all indications are that their scope will increase beyond derivative contracts. Many of the upcoming regulations, such as shadow banking regulation, the Regulation on Energy Market Integrity Transparency, the Markets in Financial Instruments Directive II and others, appear to indicate that trade repositories will be the EU regulators' data hub of choice for a range of other financial instruments, such as asset-backed securities, repo and lending transactions, wholesale energy contracts and more. You and your trade repository are set to have a long-term relationship.

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