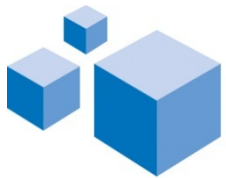


FUNDS AND EMIR COMPLIANCE

Global Fund Distribution Conference
17 June 2014



CUMMINGS
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Background to EMIR

Global Financial Crisis:

- Lack of transparency in OTC derivatives market – regulators unable to establish where exposure lay in the market
- Build-up of systemic risk
- Regulatory tools unable to cope

G20 statement in Pittsburgh:

- All standardised OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate
- All standardised OTC derivatives contracts should be 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.

EMIR – What is it?

- EMIR and its related technical standards are EU Regulations which apply directly in each Member State. They do not require local governments or regulators to bring them into force. It also has a number of technical standards (also regulations)
- EMIR has 4 strands, the first 3 of which directly affect funds:
 - mandatory risk mitigation requirements for uncleared OTC trades relating to timely confirmation, daily valuations, portfolio reconciliation, portfolio compression, dispute resolution, and margin;
 - a trade reporting obligation requirement for all transactions in OTC derivatives and ETDs to be reported to a trade repository registered or recognised under EMIR;
 - mandatory clearing of “eligible” OTC derivatives contracts via a central clearing house authorised or recognised under EMIR
 - a common regulatory regime for central clearing houses and trade repositories across Europe.

EMIR – Current state of play

What's already in force?

- 15 March 2013 – Risk mitigation for uncleared OTC derivatives - timely confirmations and daily valuations
- 15 September 2013 – Risk mitigation for uncleared OTC derivatives - portfolio reconciliations, portfolio compression and dispute resolution
- 12 February 2014 – Trade reporting start date, further backloading in May
- 18 March 2014 – First CCP authorised - front-loading period began (subject to further discussion at EU level)

EMIR – Current state of play

What's to come?

- 11 August 2014 – Reporting of valuations and collateral by FCs and NFCs to trade repositories
- 18 September 2014 – last date for delivery of first draft RTS on mandatory OTC clearing to EU Commission by ESMA
- Q4 2014/Q1 2015 – Mandatory OTC derivative clearing (subject to potential phase-in)
- 1 December 2015 onwards – variation margin requirements and phase in of initial margin requirements for uncleared OTC derivatives
- 2016 – new transparency requirements and trading requirements for OTC derivatives under MiFIR

EMIR – Hot Topics

Forward FX

- Differences in interpretation of MiFID mean that member states have implemented different definitions so that it varies from T+3 to T+7
- EU commission consultation in March/April 2014

Front-loading

- ESMA letter to EU Commission regarding intention to ease front-loading requirement

Reporting valuations and collateral

- Can broker's valuation and collateral information be used?

Choice of CCP accounts for clearing

- EMIR compliant accounts being offered by authorised CCPs for ETD clearing
- Should funds change accounts now?

EMIR – Application to Funds

- **Counterparty Categorisation (ESMA Q&As General Questions 3 and 4)**
 - UCITS – will always be FCs
 - AIFs – will only be FC's once their AIFM is authorised or registered under AIFMD
 - Issues regarding the application of EMIR when a fund becomes an AIF still to be clarified
- **Requirements apply at sub-fund level (ESMA Q&As General Question 1)**
 - Sub-fund will be the counterparty if derivative concluded at sub-fund level
 - LEIs, and application of portfolio reconciliation and compression, dispute resolution, clearing account set up, trade reporting should be considered at sub-fund level
- **Valuations and margin requirements for bi-lateral trades (Article 11(2) and (3) EMIR)**
 - Who's valuation should be used?
 - Proposed requirement on segregation of IM received – impact on funds
- **Pension fund exemption (Article 89(1) and (2) EMIR)**
 - When could it apply to a fund: Article 2(10)(a) or (d) EMIR
 - Front-loading and application of Article 89(2) EMIR

EMIR – Application to Funds

- Delegation
- Article 9 of EMIR
- Can the fund/manager cannot off-load its legal responsibilities for reporting?
- Who can be the delegate?
- Industry responses include ISDA/FOA EMIR Reporting Delegation Agreement
- Delegates may report themselves or via third parties
- Consider indemnification and liability of the delegate
- Consider who decides when a reporting requirement has arisen and what data should be reported

EMIR – What applies to whom?

	FC	NFC+	NFC-
Clearing	Yes	Yes	No
Timely confirmation	Yes	Yes – no reporting	Yes – different and no reporting
Reconciliations	Yes	Yes	Yes - different
Valuation	Yes	Yes	No
Compression	Yes	Yes	Yes
Disputes	Yes	Yes – no reporting	Yes – no reporting
Exchange of collateral	Yes	Yes	No
Reporting	Yes	Yes	Yes – no exposures

EMIR – Third country entities

EMIR applies to non-EU counterparties:

- EEA entities will be covered when regulation implemented locally
- Non-EU/EEA entity may fall within definition of FC e.g. non-EU AIF
- Entity would be subject to clearing or bi-lateral requirements if established in EU/EEA (a TCE) and:
 - Clearing: contract concluded with FC or NFC+
 - Clearing and bi-lateral requirements: contract between 2 TCEs which has a “direct, substantial and foreseeable effect” within EEA or necessary or appropriate to apply obligation to prevent evasion of EMIR (see RTS (EU) No. 285/2014)
- EU FC or NFC requires TCE to comply with EMIR requirements in order to ensure own compliance

EMIR – Documentation

Changes required to fund documentation:

- Investment management agreements – extent of authority of fund manager to undertake activities in order to comply with EMIR for fund
- Fund administration agreements - to reflect any EMIR requirements to be picked up by fund administrator (e.g. valuations or reporting)
- Counterparty documentation – ISDAs and Prime brokerage agreements will need to be amended to deal with risk mitigation requirements (Note: ISDA EMIR Protocol) and in due course margin requirements for bi-lateral OTC trades
- Fund prospectus may need to be amended to reflect requirements in respect of clearing
- Derivatives risk management policies may need to be amended to reflect clearing arrangements and new margin requirements, in particular
- Amendments to ETD clearing agreements to cover EMIR requirements

EMIR – Documentation

New documentation required:

- Agreements with Trade repositories to open accounts for trade reporting
- Where trade reporting to be delegated, agreements required with counterparties or other suppliers regarding trade reporting services
- Execution agreements for OTC trades subject to clearing (to cover where clearing does not happen)
- Clearing agreements with OTC Clearing members
- Documentation with CCPs and custodians, where required, in relation to derivatives clearing accounts
- Documentation and procedures to deal with requirements relating to variation and initial margin for bi-lateral trades