On 16 August 2012, the European Market Infrastructure Regulation, or “EMIR”, entered into force for a large number of financial institutions. EMIR represents the European set of arrangements made in 2009 by the G-20 to govern global trade in over-the-counter (“OTC”) derivatives. EMIR aims to prevent systemic risks in the financial markets. The EU Regulation creates far-reaching obligations in respect of the use of OTC derivatives. The rules have consequences for all trading parties using OTC derivatives.

For example, effective 16 August 2012, trading parties must record data on the OTC derivatives they concluded. With effect from 12 February 2014, such data must be reported in a standardised format and be submitted to undertakings authorised by the European Securities and Markets Authority (“ESMA”) to collect and record data on OTC transactions in centralised “trade repositories”. As ESMA approved the first trade repositories on 14 November 2013, there are no longer any barriers to the timely fulfilment of the reporting obligations under EMIR.

In addition, with effect from 15 September 2013, trading parties are required to satisfy “risk mitigation techniques”, including portfolio reconciliation, portfolio compression and laying down dispute resolution mechanisms. The exact requirements to be satisfied strongly depend on the types of trading parties involved in an OTC derivative contract.

EMIR includes one more important additional obligation that has not yet taken effect. Certain categories of OTC derivatives are to be cleared centrally (hereinafter referred to as “central clearing”) if they are concluded between certain categories of parties. Central clearing requires central counterparties. ESMA has not yet authorised any parties to act as such central counterparties. In sum, to the extent that this has not already been done, parties using OTC derivatives should take action immediately, so that they can fulfil the EMIR obligations applicable to them on time. The successful implementation of EMIR in your organisation requires special expertise in the areas of risk management, IT systems and legal/regulatory.

To be able to satisfy EMIR, you should analyse, at group level, among other things, how OTC derivatives are used and what categories of OTC derivatives they are. You must fulfil reporting obligations in respect of all OTC derivatives. You must identify what data is recorded and whether it includes data to be reported with effect from 12 February 2014.

Trading parties must also agree on risk control mechanisms with their contractual counterparties. In addition, the purpose of the transactions should be identified and whether a “threshold for clearing” is exceeded. If the latter is the case, more stringent risk control mechanisms may apply to you, as well as (in the longer run) a central-clearing obligation.

How does EMIR affect you?

EMIR prescribes the central clearing of specific categories of OTC transactions. In all cases in which central clearing is not required, trading parties must implement extra stringent risk control mechanisms.

These requirements apply to all OTC transactions brought about between:

1. two financial counterparties
2. a financial counterparty and a non-financial counterparty with a derivative portfolio exceeding a specific threshold amount
3. two non-financial counterparties with derivative portfolios exceeding a specific threshold amount

In addition, EMIR requires all parties to OTC transactions to report all OTC transactions and material movements therein to a “trade repository”.

1 To what transactions does EMIR apply?

EMIR sets rules, at the European level, for transactions in OTC derivatives, i.e. transactions in derivatives that are not brought about in a regulated market in the European Union (“EU”) or an equivalent market outside the EU.

All OTC derivative transactions entered into by financial and non-financial counterparties from the EU come under the scope of EMIR. In specific circumstances, transactions entered into between EU counterparties and non-EU counterparties also come under the scope of EMIR.

2 Financial and non-financial counterparties

What requirements a party must specifically satisfy depends on the question as to whether such party qualifies as a financial counterparty or as a non-financial counterparty, and on the qualification of its counterparty. The financial counterparty/non-financial counterparty distinction is of the essence.

The parties must exchange statements on their status, i.e. whether they qualify as a financial counterparty or as a non-financial counterparty. Furthermore, a party qualifying as a non-financial counterparty must state whether the value of its OTC portfolio has exceeded a specific threshold amount.

Interaction between EMIR and MiFID II

With EMIR entering into force, regulation on derivatives has been stepped up. The environment in which market parties trade in (OTC) derivative contracts is increasingly regulated by technical obligations arising from EMIR and the European MiFID II proposals. While EMIR contains rules to clear OTC derivative contracts through central counterparties, the MiFID II proposals see to organised derivatives trade through trading venues.

In a next brochure, EY will devote special attention to the draft MiFID II, the draft MiFIR, the impact of the MiFID II proposals on market parties and the relationship between EMIR, MiFID II and MiFIR.
What parties qualify as financial counterparties?

Under EMIR, financial counterparties include the following categories of entities.
- Authorised EU banks
- Authorised EU investment firms
- Authorised EU insurance companies and reinsurers
- Authorised EU Undertakings for Collective Investment in Transferable Securities and their authorised managers
- Institutions for Occupational Retirement Provision
- Authorised (Alternative) Investment Fund Managers and authorised investment companies

All parties that do not fall into these categories are non-financial counterparties.

Non-financial counterparties

For non-financial counterparties, the question is whether the value of their OTC portfolio exceeds a specific threshold amount. The central clearing of OTC derivative transactions and the implementation of risk mitigation techniques will not be mandatory until the total value of the transactions entered into in a certain category of OTC derivatives exceeds the threshold amount in question (see the overview on the following page).

Non-financial counterparties entering into OTC transactions in several categories must centrally clear transactions in all categories as soon as any threshold value is exceeded to the extent that ESMA has prescribed central clearing for those categories. OTC derivative transactions entered into by non-financial counterparties - to hedge operating risks, e.g. exchange-rate fluctuations or interest-rate risks - need not be included in calculating the value of an OTC derivative portfolio. However, it must be laid down, with justification, that such hedging transactions serve to hedge operating risks.

If the value of OTC derivative transactions in a certain category (see the overview on the following page) exceeds the threshold amount over a 30-day period, the non-financial counterparty should so notify the Netherlands Authority for the Financial Markets (Autoriteit Financiële Markten, “AFM”). It should also notify the AFM if the value drops below the threshold amount.

Centrale afwikkeling

Central clearing is effected through the intermediary of a central counterparty - a new category of authorised legal entities to be created under EMIR by the Member States. A central counterparty positions itself between the counterparties to an OTC derivative contract, acting as the buyer for each seller and as the seller for each buyer. “Clearing” means the process of establishing positions, including the calculation of net obligations, and ensuring that financial instruments, cash, or both, are available to secure the exposures arising from those positions.

Central clearing will lead to higher transaction costs. Additionally, regarding centrally cleared transactions, more stringent requirements will be set in respect of the collateral the parties must make available. For OTC transactions between such financial counterparties as banks, insurers and investment firms, central clearing will be the starting point. However, in specific circumstances, central clearing will also be required for transactions in which non-financial counterparties are involved.
All transactions in specific categories of OTC derivatives as yet to be designated by ESMA are to be cleared centrally if they are entered into between:

1. two financial counterparties
2. a financial counterparty and a non-financial counterparty that has exceeded the threshold for clearing
3. two non-financial counterparties that have exceeded the threshold for clearing

Non-financial counterparties contribute to systemic risks to a lesser extent and are partly exempted from the EMIR's central clearing requirements. They are required to clear OTC transactions centrally only if the notional value of their portfolio's OTC contracts exceeds the threshold for clearing.

<table>
<thead>
<tr>
<th>Type of derivatives</th>
<th>Threshold</th>
</tr>
</thead>
<tbody>
<tr>
<td>Credit derivatives</td>
<td>Notional value of over EUR 1 billion</td>
</tr>
<tr>
<td>Equity derivatives</td>
<td>Notional value of over EUR 1 billion</td>
</tr>
<tr>
<td>Interest-rate derivatives</td>
<td>Notional value of over EUR 3 billion</td>
</tr>
<tr>
<td>Forex derivatives</td>
<td>Notional value of over EUR 3 billion</td>
</tr>
<tr>
<td>Commodity derivatives</td>
<td>Notional value of over EUR 3 billion</td>
</tr>
<tr>
<td>Other OTC-derivatives</td>
<td>Notional value of over EUR 3 billion</td>
</tr>
</tbody>
</table>

Average Notional value over 30 working days threshold

NO clearing

Clearing mandatory for all OTC-Derivative Contracts
6 Risk mitigation techniques and valuation

All parties - regardless of category - involved in a transaction are required to implement risk mitigation techniques for all OTC transactions that need not be centrally cleared. However, a party’s status is relevant in terms of how the risk mitigation techniques are to be fleshed out.

Financial and non-financial counterparties alike are required to introduce risk mitigation techniques and procedures in their business operations. More stringent obligations commonly apply to financial counterparties. Likewise, more stringent requirements apply to non-financial counterparties that have exceeded a threshold for clearing than to non-financial counterparties that have not exceeded a threshold for clearing.

As part of the mandatory risk control procedures, a confirmation duty applies to OTC transactions on the grounds of which the parties to an OTC transaction mutually confirm the contents of the transaction on time, so as to be able to correct any errors at an early stage.

Financial counterparties and non-financial counterparties required to centrally clear derivative transactions must daily value any outstanding derivative contracts at market value (mark-to-market). If valuation is impossible on the basis of mark-to-market, e.g. in the event of illiquid instruments, the contracts may also be valued on the basis of a model (mark-to-model) as long as that model satisfies the requirements set in that respect.

7 Transaction reporting

All financial and non-financial counterparties must fulfil transaction reporting obligations, under which they must provide information to a central “trade repository” - a new category of entities authorised by ESMA to act as a trade repository under EMIR. On 14 November 2013, ESMA authorised the first trade repositories. The parties are required to report information on every OTC derivative transaction entered into and on every change or termination of an OTC derivative contract. This obligation applies to all categories of OTC derivatives. Whether the parties involved are financial or non-financial counterparties and whether they have exceeded a threshold for clearing is irrelevant to this reporting duty.

8 Huidige ontwikkeling omtrent EMIR

EMIR entered into force on 16 August 2012. It being an EU Regulation, it need not first be implemented in the EU Member States’ laws and regulations. However, it constitutes a framework broadly setting out obligations.

On 15 March and 15 September 2013, a large share of ESMA’s Technical Standards - enabling market parties to satisfy the EMIR requirements - entered into force. ESMA is as yet to adopt Technical Standards for a number of key subjects and/ or the European Commission is as yet to endorse Technical Standards already adopted, such as the Technical Standards on OTC derivative transactions entered into with parties from third countries having “a direct, substantial and foreseeable effect within the Union” and Technical Standards in respect of central clearing. As soon as ESMA has authorised the first central counterparty, ESMA will draw up the Technical Standards specifying the categories of OTC derivatives to which the central-clearing obligation applies.

On 15 September 2013, the following risk-control obligations from the Technical Standards took effect.

- The two parties to an OTC derivative contract must regularly reconcile the data kept by each party in respect of the OTC derivative transactions they entered into, so that the OTC derivative transactions match properly and discrepancies are identified at an early stage.
- Counterparties with outstanding portfolios of 500 or more not centrally cleared OTC derivative transactions must regularly compress such portfolios. Counterparties must have procedures to analyse on a regular basis whether the portfolio may be compressed to reduce risk.
- Counterparties to an OTC derivative contract must have a dispute resolution scheme geared to identifying and resolving disputes at an early stage and to monitoring the value of outstanding contracts.
How can we help you?

If you are an OTC derivatives trader, you will very likely be liable to fulfil a reporting obligation. In addition, you may have to adjust your business operations in order to satisfy the risk mitigation techniques. Should your company qualify as a financial counterparty, or should the value of any OTC derivatives your company concluded exceed a specific threshold amount, you must (in the longer run) centrally clear your OTC transactions.

EY is ready to support your organisation throughout the EMIR implementation process. EY has gained ample experience supervising EMIR implementation projects for financial and non-financial counterparties alike, both in the Netherlands and abroad.

We would like to discuss with you the solutions EY can offer. In concrete terms, this will result in your completion of the implementation of EMIR on time and in a cost-efficient manner.

EY has gained extensive experience with respect to various EMIR issues. We can assist you in respect of the following subjects, providing the services specified in this area, among other services.

- **What transactions come under EMIR?**
  - Gap analyses for financial and non-financial counterparties
  - Identification of any OTC products you use that qualify as OTC derivatives within the meaning of EMIR

- **Central clearing**
  - Support in calculating whether a threshold for clearing is exceeded
  - Advice in respect of exempted transactions
  - Support in implementing mechanisms enabling parties to monitor when a threshold for clearing is exceeded
  - Advice in respect of how you can comply with the central-clearing obligation in a cost-efficient manner
  - Supervising negotiations with central counterparties, and reviewing contracts with central counterparties and clearing members
  - Advice in respect of the IT infrastructure required for central clearing
  - Review of current transaction documentation
  - Revision of current contracts and advice in respect of model contracts
  - Advice in respect of margin obligations
  - Support in communicating with the Netherlands Authority for the Financial Markets (Autoriteit Financiële Markten, “AFM”) or the Dutch central bank (De Nederlandsche Bank, “DNB”)

- **Risk mitigation techniques and valuation**
  - Valuation of OTC derivatives
  - Preparation of OTC derivatives valuation models
  - Advice regarding - the design of - risk management
  - Advice in respect of margin obligations
  - Support in communicating with the AFM or DNB

- **Transaction reporting**
  - Support in selecting IT/reporting service providers
  - Review of current contracts and arrangements with IT/reporting service providers
  - Advice as to the applicable transaction reporting requirements
  - Advice regarding the creation and reliability of reports
  - Supervising negotiations with trade repositories, and reviewing contracts with trade repositories and service providers
  - Support in communicating with the AFM or DNB
About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate Legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

© 2014 Ernst & Young Accountants LLP.
All Rights Reserved.

ED None

This publication contains information in summary form and is therefore intended for general guidance only. It is not intended to be a substitute for detailed research or the exercise of professional judgment. Neither EYGM Limited nor any other member of the global EY organization can accept any responsibility for loss occasioned to any person acting or refraining from action as a result of any material in this publication. On any specific matter, reference should be made to the appropriate advisor.

ey.com