Business-friendly Solutions

European Market Infrastructure Regulation (EMIR) - Impact on Market Participant's Business Operations & Technology Landscape

Over-the-Counter (OTC) derivatives constitute 95% of the derivatives market and while they play a crucial role in an economy, they occupied a central place in the 2008 economic meltdown. The G20 began the process of positioning regulations to standardize and bring transparency in OTC derivatives trading; bringing in central counterparties and trade repositories into trade processing.

One such regulation passed by the European Union is the European Market Infrastructure Regulation (EMIR). EMIR imposes requirements on all organizations that enter into a derivative contract, irrespective of type or size. This includes organizations not involved in financial services businesses as well and indirectly applies to non-EU firms trading with EU firms as well.

The EMIR rules have been designed to reduce counterparty and systemic risks in OTC trading, standardize OTC derivative contracts and enhance transparency. This paper aims to look at the impact of the regulation on derivatives market participants from their business operations and technology landscape.

1 Impact on the Derivatives Market Participants

The EMIR regulations have highly impacted the European OTC Business Processes in 3 areas:

1. OTC Trade Clearing – To reduce counterparty risk in the markets, institutions should clear their OTC Derivatives contracts through a Central Counterparty Clearing House

2. Collateral Management – Increased Collateral requirements for CCP Clearable OTC Trades and more stringent requirements for non-clearable OTC trades

3. Trade Reporting – With the new regime, all derivative trades whether 'Cleared' or 'Non-Cleared' should be reported through a Trade Repository.

Objectives of EMIR

Increase Transparency	Reduce Counterparty Risk	
Reporting (Trade Repository)	Clearing (CCPs)	Non-Clearable Trades
▪ Details of OTC OR Exchanged trade derivative trades to be reported by all financial parties to a designated trade repositories ▪ Non-Financial counterparties also need to report to trade repositories once they meet " information Threshold" ▪ Trade repositories will come under Regulatory purview	▪ All OTC trades done among financial counterparties should be cleared via CCP ▪ Establish interoperability of CCPs ▪ CCPs will be coming under regulatory purview ▪ Initial and Variation margin will be applicable	▪ Non-clearable trade will have to provide collateral in both initial and variation margins ▪ Timely confirmation to mitigate the counterparty exposure ▪ Enhanced dispute resolution of collateral ▪ Enhanced controls to overcome exceptions in core economics and collateral valuations ▪ Portfolio compression rule to mitigate gross exposure to counterparties

Requirements

The various business functions in financial services firms that are impacted by EMIR regulations are detailed as below:

1.1 Transaction Reporting Requirements

Trade Reporting	■ All counterparties to an applicable derivative contract (OTC or Exchanged traded) must report details of that trade to a trade repository by T+1 ■ There are timelines for the interest rates and credit derivatives by 2013 and then by 2014 for equities, FX and commodities ■ 90 days to start reporting from the day the trade repository is available for reporting a new derivative asset class
Real-time Reporting	There is NO real-time reporting requirement in EMIR
Back Dated Reporting	■ Trade executed on or after 16 August 2012, should back-report these trade ■ There is 90 days to report contracts that are still live on the date the reporting commences and 3 years to report contract that are matured/terminated on the date the reporting obligation commences
Valuation	■ The mark-to-market/Model and collateral valuation must be reported daily ■ Requirements to report collateral valuation should start 180 days after the reporting start date of that specific asset class
Record Retention	5 years after the termination of the trade
3rd Party Reporting	Firms can delegate reporting to the counterparty of their trade or deploy it to the 3rd party

1.2 Trade Clearing

Cleared Products	OTC derivatives should be centrally cleared through CCPs
Front loading	EMIR allows ESMA to enforce the retrospective clearing of traders. This will apply between the date regulator authorizes the CCP and the date from which the clearing commences
Secondary Clearing	Where a clearing member offer the service to clear for the clients of a bank's client. There are number for new set of rules to define these
Client Accounts, Segregation and Porting	At a minimum all clients must be offered individual or omnibus client account segregation
OTC Execution venues	EMIR does not mandate the requirement of a central trade execution facility currently

1.3 Un-cleared Trades

Margining and Collateral	■ EMIR requires that the counterparties should provide Initial as well as variation margin in case of the un-cleared OTC trades ■ Recommendation is a two way exchange
Mark-to-Market /Model	■ All OTC derivatives contract must be Mark-to-Market on a daily basis ■ EMIRS will specify the conditions under which marking-to-model will be permitted
Timely Confirmation	■ EMIR mandates a tight confirmation periods with a phase-in period by asset class ■ Any trade which is not confirmed by the 5th day must be reported to the local regulatory body
Reconciliation	■ All counterparties must undertake a regular reconciliation (frequency based on clients profile) of key trade terms, including valuations
Compression	■ Any client portfolio greater than 500 OTC derivative contracts must be analyzed and documented twice a year to determine if it can be compressed or not
Dispute Resolutions	■ Counterparties must have processes to identify record and monitor contracts and collateral valuations disputes. Any dispute not resolved and valued more that EUR1.5 mn, should be reported to the local regulators.

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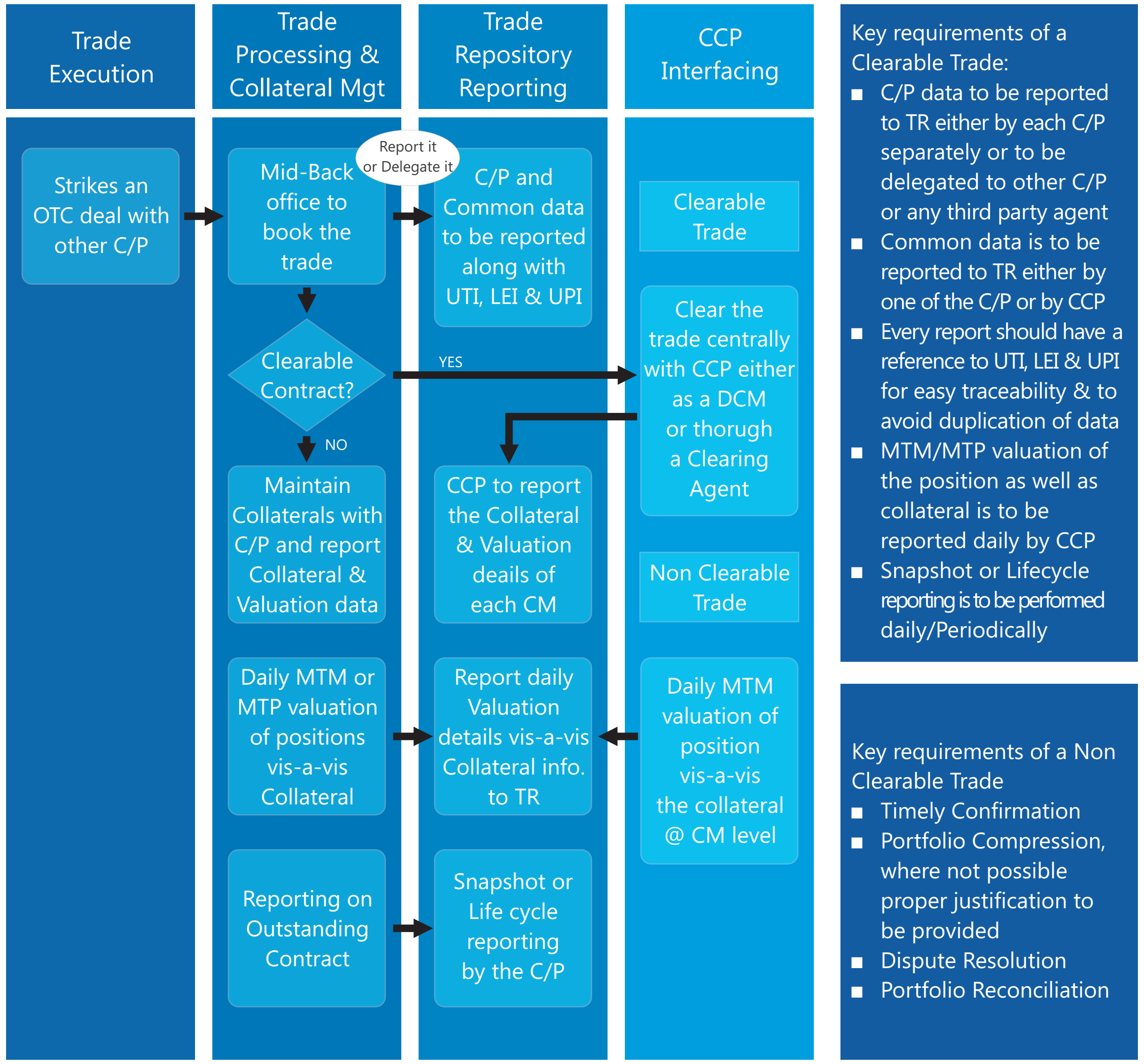
Impact of these requirements on Business Process and Technology Landscape

In lieu of these EMIR requirements, firms need to look critically at their business processes and IT infrastructures for the emerging new landscapes. They need to be mindful in terms of leveraging and capitalizing on technology investments made for similar compliance needs such as DFA.

The business divisions, and their IT landscape, impacted due to EMIR regulation are:

1. Collateral Management
2. Clearing
3. Transaction Reporting

OTC Trade Flow post EMIR Reporting Needs



2.1 Collateral Management

The biggest requirement will be an integrated and enterprise-wide solution for collateral management process. Generally treated as a SILO unit till now, collateral teams have to be well integrated with the front and back office decision making activity for better margin management, enabling a single view of the collateral availability and usage.

This approach will help firms to:

- Manage collateral efficiently across trades (better utilization)
- Help treasury to better manage liquidity position
- Break SILO in the bank and thus enhance information flow culture in the bank
- Help to optimally use collaterals in the trade process
- Help reduce counterparty credit risk

IT Focus Areas

To make sure that changes can be effectively managed, there will be technological challenges that have to be overcome by financial firms –

- A robust and centralized Collateral data warehouse with collateral and collateral provider data
- A thorough integration of the Collateral Management System with the FO and MO systems
- Data flow from upstream to downstream systems, and each downstream system should acknowledge the data and the enrichment it has received from the earlier system.
- Connectivity to the valuation engine
- A well-informed and integrated workflow system
- Optimization engine
- Robust and real-time dashboard

2.2 Clearing World

With the new EMIR regulations, counterparties will be required for OTC trades to perform clearing activities through a CCP. This regime will help in reducing counterparty risks as the risks are controlled by the CCP. Apart from novation of trades, the other major role of a CCP will be to help the counterparties in settling trades, netting and managing margin calls.

IT Focus Areas

These will require significant changes in the current business processes and in the technology infrastructure. One of the main challenges will be to manage different clearing workflow for different trades such as Client's trades and Bank's own trade. This will require developing new infrastructure in the bank, which will include interfaces to the different CCPs in the market, and manage and integrate multiple workflows with these clearing platforms. With the advent of the new initial margin and variation margin requirements, real-time dashboards will be required to understand and handle multiple margin requirements for the 'Cleared' and 'Un-cleared' trades.

2.3 Trade Repository

One of the key requirements introduced by EMIR is the obligation for organizations to report all derivative contracts to a Trade Repository. This is a mandatory requirement regardless of whether the derivatives are traded on a regulated market or over-the-counter, and whether these derivatives came under the central or bilateral clearing obligations. EMIR requirements follow a 'No-Exemption' policy for all counterparty, whether it is a financial institution or a non-financial institution. Both counterparties to a derivative contract are obligated to report the details of the agreement and subsequent change or termination, separately, to a trade repository of their choice.

IT Focus Areas

This will require banks to provide data at multiple times during the lifecycle of the OTC trade. Thus the challenge for the technology department is to provide these different transaction and static data elements for a typical trade. Various challenges will impact the organization in terms of the new data elements which are required to be reported like UTI (Unique Trade Identifier) which will help the regulators to understand the trade, LEI (Legal entity Identifiers) a common counterparty identifier. Another big challenge for firms will be to backload the data into regulatory system for existing trades and their identification. This will require a solution which will be auditing all historical trades, generating, mapping and matching a UTI to these trades and then report back to the regulators.

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ITC Infotech Solutions and Capabilities in Treasury and Capital Markets (TCM)

ITC Infotech has been working with Global Financial Services companies across US, Europe and APAC for over 10 years. We have a business unit that caters to Treasury and Capital Markets (TCM) with focus on offering Regulatory Compliance Solutions. We also have a strategic partnership with a prominent player in the financial services software industry.

ITC Infotech Treasury and Capital Markets Capabilities Snapshot

Over 100+ pool of certified consultants trained in the area of Treasury Management and Capital Markets. Projects delivered globally for 65+ Clients	Established Product implementation, Support & Testing Methodology having successfully executed projects with third-party product vendors	Bespoke Development and Product implementation experience in the areas of Investment Banking, Asset Management and Private Banking/ Wealth management with Global Clients.

	Regulatory Reporting and Compliance	How ITC Infotech can help?
Service Offerings		■ Pre-defined solution for Kondor+users ■ Data Extraction & Organization ■ While you organise your EMIR response strategy and implementation plans generally, you can begin your plans in respect of the EMIR reporting obligation ■ Data mitigation and planning ■ Identification of data sets required ■ Data Sets classification ■ Data Sourcing - across multiple internal systems ■ Data reporting and entities to report to ■ Data Sets that can be used for multiple regimes (eg. MiFID, etc)
Key Enablers	■ Strong TCM Domain Knowledge and Skills ■ Strong understanding of requlatory reporting and compliance requirements such as EMIR, BASEL II, Dodd Frank, etc ■ Dedicated Technology CoE focused on BI & DW, Data Analytics and Reporting (Dashboards) ■ Tools Usage - Informatica, Cognos, BO, Tableau, etc	

Our expertise on leading trading platforms has helped us map relevant information from Swap Deals to the EMIR reporting requirements. ITC Infotech provides extensive consulting on Market Data Feed Consolidation and Data Architecture including Data Mapping, Data Cleansing, Data Definition and Data Standardization. So, partner with ITC Infotech and complying with the stringent EMIR requirements on OTC derivatives is still within your reach.

Authors

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