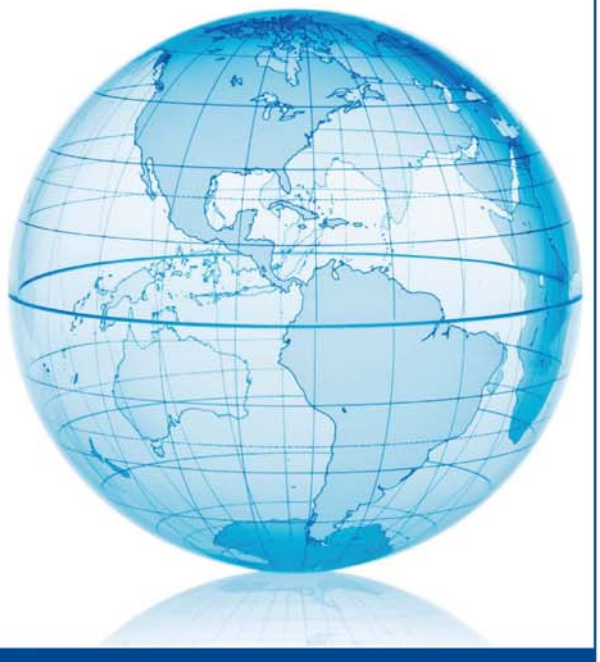
Alternative Investment Management Association

AIMA Note
on the progress of the European Commission's draft proposal for a Regulation on OTC derivatives, central counterparties and trade repositories (EMIR)



July 2011

Alternative Investment Management Association

Executive summary

- A version of the EMIR proposal was approved by the European Parliament's ECON Committee on 24 May 2011.
- A vote is scheduled in the European Parliament plenary on the same set of amendments and certain other new plenary amendments which have been submitted. We expect ECON and European Parliament plenary texts to be substantially the same.
- The Council continues to debate the issues ahead of reaching an agreement on a common text, which is expected to be approved at the October ECOFIN committee meeting.
- Both the European Parliament's and Council's texts make improvements over the Commission's original proposal, certain of which are expected to benefit buyside firms.
- The main areas of debate continue to be:
  - the powers of ESMA;
  - whether the scope of EMIR should be extended to include exchange traded derivatives;
  - the ability of Central Counterparties (CCPs) to access central bank liquidity;
  - recognition of third country CCPs;
  - exemptions for intragroup transactions and pension schemes.
- AIMA and its member working group continue to engage with the European Parliament, Council and Commission on the issues of most importance to hedge fund managers, including:
  - segregation and portability of assets and positions;
  - recognition of third country CCPs, permitting them to provide clearing services to EU entities; and
  - a role for the buyside on CCP governing boards and risk committees.
- The obligations applicable to AIMA members are not expected to apply until 1 January 2013.

AIMA believes it is too early in the legislative process for members to take any actions or to begin planning for compliance with EMIR, however, we will continue to update members on any new developments.

1. Introduction

On 15 September 2010, the European Commission (the Commission) published its draft proposal for a Regulation on OTC derivatives, central counterparties and trade repositories (the Draft Proposal). Collectively, the various amended versions of the Draft Proposal are commonly referred to as the European Market Infrastructure Regulation or 'EMIR'.

This note examines:

- what point have we reached in the legislative process and what are the outstanding issues;
- what were AIMA's concerns with the Draft Proposal;

- to what extent have these concerns been addressed in:
  - the amended text which is expected to be adopted by the European Parliament (EP) on 5 July; and
  - the latest compromise text prepared by the Hungarian Presidency of the Council of the European Union (the Council) (see below);
- what are the next steps in the legislative process; and
- the details of the European Parliament's ECON Committee's agreed text of EMIR.

2. What is the current position and what are the outstanding issues?

European Parliament

On 24 May 2011, the Economic and Monetary Affairs Committee (ECON) of the EP passed a compromise text (the ECON Text), which made a number of amendments to the Draft Proposal. These amendments are examined in detail in Annex 1 below. The ECON Text is expected to receive formal approval by the EP at its plenary session on 5 July 2011.

European Council

On 8 June 2011, the Council attachés held their last meeting to consider an amended version of the Draft Proposal, prepared by the Hungarian Presidency of the Council. Following this meeting, the Hungarian Presidency attaché prepared a further version of the Draft Proposal, dated 14 June 2011 (the Council Text).

The Committee of Permanent Representatives (COREPER) met on 17 June 2011 in order to consider the Council Text and seek agreement on a number of outstanding issues (see below) before submitting the Council Text to a meeting of the Member States' Finance Ministers (ECOFIN).

However, COREPER at its meeting of 17 June 2011 (and, as a consequence, ECOFIN at its meeting on 20 June 2011) failed to reach agreement on the remaining issues. The Council attachés will, therefore, continue working on a new Council Text, which will be referred back to COREPER only once the majority of the outstanding issues are resolved.

Once COREPER is able to resolve any remaining areas where there is still dispute, an agreed text will be passed to ECOFIN, who will vote on, and approve, a Council version of EMIR amendments. This is now unlikely to occur before the October ECOFIN meeting.

Outstanding issues within the Council

The Council remains divided on a number of key topics. At a high level, (section 3 below looks at the issues as currently set out in the Council Text in greater detail), these include:

(a) the powers of ESMA

two main camps exist, whereby some Member States (MS) – including the UK and Germany - wish to see national authorities, such as the FSA, retain responsibility for both registration and authorisation of central counterparties (CCPs) and trade repositories (TRs), while others – such as France and Italy - would like to see the European Securities and Markets Authority (ESMA) have a significant role in this regard;

(b) scope

a significant group of MS, large enough to form a blocking minority, opposes the extension of the clearing obligation to include all derivatives (as opposed to OTC derivatives only) as proposed in the Council Text. In addition, there are conflicting views in Council as to whether or not the Regulation should contain provisions regarding the right of access of CCPs to the trade flow of any execution venue;

(c) access of CCPs to central bank liquidity

Access to central bank liquidity is one of the most highly divisive issues in EMIR. Article 10 of the Draft Proposal states that a CCP's liquidity can be obtained from a central bank or a commercial bank. Some MS are concerned with the competitive impact of allowing such access in normal situations (as opposed to in times of stress), while others are pushing for mandatory access to central bank liquidity as this is seen as a more reliable guarantee of liquidity than relying on commercial bank liquidity. However, to have such access, a CCP would have to be licensed as a credit institution and, in many MS, CCPs are unable to be licensed as such an institution.

MS are also concerned that, at its most extreme, central bank liquidity could be taken to mean bailout support during a crisis - something which many authorities oppose on the grounds it might encourage a CCP to cut corners on margin charges and other costly risk management safeguards in the knowledge it would be rescued by a central bank in a worst-case scenario.

Regarding the possibility and preconditions for access to central bank money by CCPs there is currently a review clause included in the Council Text, which links the topic to further work on exploring the need for a banking license. France is a strong promoter of that inclusion, while the UK, Bulgaria, Czech Republic, Germany, Italy, Poland and Sweden (and, to a lesser extent, Spain, Luxembourg and Romania) are opposed;

(d) third countries

MS are divided on the question of whether or not to strengthen third country provisions in a number of areas of the Draft Proposal, beyond the issues of authorisation and registration referred to under 'the powers of ESMA' above.

The Commission has recently identified the need to improve the Draft Proposal by making changes to the existing provisions in respect of international coordination, the exemption for central banks, the clearing obligation and risk mitigation techniques for bilateral contracts, the recognition of third country CCPs and TRs, regulatory access to TRs' data by foreign authorities and indemnification requirements.

However, there are mixed views within Council as to whether this is the time to amend the Draft Proposal, without prejudice to negotiations in the G20 context aimed at ensuring a level playing field for CCPs, TRs and their users;

(e) intragroup transactions

The Council is split on the question of whether intragroup transactions should be excluded from the clearing obligation.

Furthermore, some MS would also wish to see an exemption from requirements in respect of bilaterally cleared transactions, since these do not involve exposure to a counterparty outside the group, while others would wish to see further clarification and resolution of outstanding technical issues, in particular:

- the definition of the group, which some MS feel is too restrictive;
- more precision, possibly through a cross-reference to existing legislation, on capital requirements;
- the geographical scope of the exemption in Article 6a(1aa) (i.e., whether the concerned intragroup counterparties would have to be located in the same Member State, as is the case in CRD, or in the EU, or could be located anywhere in the world);
- the possible need to put in place equivalence requirements vis-à-vis third country regimes, and clarification of the authority responsible for assessing these;
- whether to refer, as a precondition, to the absence of "current or foreseen practical or legal impediments to the prompt transfer of own funds or repayment of liabilities" between the concerned counterparties;

(f) pension schemes

Since CCPs currently request cash as collateral for variation margin purposes from their counterparties and since pension schemes typically have little cash but, instead, potentially highly liquid collateral, subjecting such schemes to the clearing obligation immediately would significantly raise costs (and so diminish returns for retail savers).

Some MS, therefore, wish to see an exemption for "pension funds" which would be inclusive of the different forms which the pension industry takes across the EU. However, there is the fear on the part of some that excluding such schemes may create distortions in decisions taken by investors. The issue comes down to a matter of definition as to which schemes would be exempt, with some MS having strong reservations either against an exemption *per se* or with overextending the scope of any exemption by means of an overly broad definition.

3. Next steps – second reading process and tactics

Once the Council has agreed a general approach, the next stage of the legislative process would ordinarily be for the Commission, ECON and the Presidency of the Council to enter into a three-way process of negotiations, or 'trilogues', until agreement can be reached on a final text. This final text would then be voted through at first reading at a plenary session of the EP and be formally adopted by the Council at a later date before entering into force upon its publication in the Official Journal of the European Union.

However, in the case of EMIR, it seems very likely that the EP's rapporteur will seek to proceed by the unusual (although perfectly legitimate) route of a second reading passage (see below).

However the Regulation is eventually passed, further work will follow in order to determine technical ('Level 2') standards on a number of issues, and the intention remains for EMIR to be effective across the EEA as from 1 January 2013.

Second reading - process

The vast majority of European financial services legislative proposals to date have been passed by way of first reading. Under this process, the Commission publishes a proposal for legislation. The EP and Council then develop their own preferred version of the proposal and, through trilogues, reach agreement on a compromise text. This is then approved at first reading in a plenary session of the EP and later formally adopted by the Council.

However, Werner Langen, the EP's rapporteur on EMIR, has stated (and appears to be set on delivering on his statement) that he will not be entering into trilogue negotiations but will instead be seeking approval of the text at a second reading. In the context of EMIR, this means that the EP plenary would hold a formal vote on 5 July 2011 on the ECON Text as it stands and then forward this (as the Parliamentary Text) to the Council.

The Council would then have to either accept the Parliamentary Text as passed or propose its own amendments to the Draft Proposal. Given that Council would choose the latter route, it would then develop its own preferred text (a "common position") and deliver that, along with a statement of reasons behind its amendments, to the EP.

Once the EP receives the Council's common position, the EP would have three months (which it may extend by one month) in which either to accept the Council's position (in which case the Regulation would be voted through) or to produce a further set of amendments to the Council's document. In the latter case, the EP amendments would be sent to the Council, which would then have three months (again, extendable by one month) in which either to agree the new changes or not to agree them.

If agreement can be reached, the text would be passed by the EP in plenary session at second reading and formally adopted later by the Council. If, however, no agreement can be reached between the institutions at this stage, the President of the Council would convene, within six weeks (extendable to eight) a special Conciliation

Committee to seek to negotiate a joint text. The Committee would have six weeks (extendable to eight) in which to do so, starting from the date of its first meeting.

The second reading procedure, however, carries the risk that, if no jointly acceptable position can be found between the EP and Council, the Proposal as a whole falls.

Second reading – impact on timing

The fact that the EP is not willing to enter into a first reading agreement with the Council may have significant implications for the Draft Proposal. We can, at this stage, only speculate on the reasons for the rapporteur's tactics.

Whatever the reasons for the EP's decision, history seems to show that it is, in fact, unlikely that the process would be accelerated since second reading agreements typically tend to take on average up to twice as long to conclude (24 to 31 months) as first reading agreements (15 months) from the moment the Commission proposal is introduced. The EP's plenary vote is scheduled for 5 July 2011. If the rapporteur does, indeed, push for a second reading, we might, then, expect the common Council position to be agreed in October or November 2011.

If the Council common position is still substantially away from the EP position, there could be significant delay in reaching the final agreement. However, many expect that the Council and the EP will negotiate intensively following the first reading vote in the EP so that the Council common position will represent a near final text. Under such 'quick second reading' scenario, political agreement could be reached before the end of the year. Otherwise we could see a prolongation of negotiations into 2012. Given that a number of secondary rules need to be developed by ESMA, a process which could require six months or more, and given that industry could expect to have a period of time in which to implement the final rules, the final and full implementation of EMIR could slip into 2013.

4. Conclusion

AIMA welcomed the Commission's Draft Proposal when published, as we believed that it reflected the G20 commitments on clearing and reporting on OTC derivatives and provided comprehensive rules, which would reduce risk and enhance transparency in OTC derivative markets.

We consider that the majority of amendments put forward in the Council Text and by the Parliament's ECON committee, are largely either neutral or positive. The amendments contain much which would improve on the Draft Proposal and alleviate many of our concerns. For example, we are pleased with the strengthened protections provided by the ECON Text for clients' margin provided as collateral under Article 37 (Segregation and portability).

As the European institutions finalise their respective EMIR texts ahead of future trilogue negotiations (whether as part of a first reading or a second reading process), there remains much work to be done if we are to ensure that the final agreed text of EMIR addresses both the political questions associated with mandating use of services provided by new and large systemically important institutions and the technical issues of importance to market users as they begin to plan to clear and report trades in 2013. A crucial agreement will need to be found on the issue of third countries and the EU and US officials will, in particular, need to continue to engage in intense dialogue.

If members have any questions about the ECON Text, please contact Jiří Król or Daniel Measor.

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ANNEX 1

Comparison of ECON and Council Texts in respect of AIMA's main concerns

In December 2010, AIMA published a Position Paper on the Draft Proposal, in which we identified a number of key areas of concern. We set out below AIMA's key points and the positions taken by ECON and by Council to date in respect of each of these issues. Note that we set out, at Annex 2 below, a fuller summary of the ECON text, which is now in final form.

(a) Scope and definitions

AIMA's key point:

- **We support clearing of OTC derivatives and believe the requirements should be applied as broadly as appropriate.**

ECON Text	Council Text
Under the ECON Text, the clearing obligation, non-discriminatory access provision and requirements for uncleared trades will all apply to derivatives, as defined in MiFID, traded over-the-counter (OTC). Despite pressure to exclude particular classes of foreign exchange derivative contracts, this was not taken up in the ECON Text. The ECON Text does, however, state at Recital 12b that "for certain classes of derivatives, involving exchange of principal, such as foreign exchange, settlement risk may be the predominant risk, which is already addressed through existing market infrastructure. This should be taken into account when considering which classes of derivatives should be mandated for central clearing." The clearing obligation would not apply to intragroup trades where the contracts are 'justified for economic reasons', where the contract does not increase systemic risk in the financial system and where there are no legal restrictions to capital flows between the undertakings. Pension schemes, which are specifically defined in the ECON Text definitions, must comply with the clearing obligations as a financial counterparty, except in so far as the posting of liquid collateral would result in an undue burden on the investor due to asset conversion requirements. Their obligation to clear eligible contracts may also be delayed for three years follow implementation of EMIR.	In the Council, there has been significant debate about whether EMIR should apply to OTC derivatives or to all derivatives, wherever they are traded. In the Council Text, it provides that the clearing and reporting obligations and requirements for uncleared trades will apply to all derivatives, wherever traded. The non-discriminatory access provision will apply only to CCPs clearing OTC derivatives. Intragroup trades are specifically excluded from the clearing obligation, as it applies to OTC derivatives. For non-financial counterparties, an intragroup transaction is one between two counterparties established in the EU or a third country, which form part of a group, who are subject to the same risk evaluation, measurement and control procedures. For financial counterparties, an intragroup transaction is one between two counterparties established in the EU or a third country which form part of a group, who are subject to prudential requirements and who are subject to the same risk evaluation, measurement and control procedures. Pension Schemes, as defined in the IORP Directive, and other types of pension schemes must comply with the clearing obligations as a financial counterparty. However, where derivative contracts are objectively measureable as reducing risks directly related to the financial solvency of Pension Schemes, they are given five years after the entry into force of EMIR to comply with the clearing obligation. They would remain subject to the reporting obligation and other EMIR requirements.

(b) The clearing obligation

AIMA's key points:

- **Under the 'top down' approach, ESMA should consult publicly on any class of derivatives which it proposes for the clearing obligation.**
- **Those classes of contract which are eligible for clearing but for which no CCP is yet authorised or recognised to clear should not be subject to the mandatory clearing obligation.**

ECON Text	Council Text
The ECON Text provides that financial counterparties and certain non-financial counterparties[1] that conclude a contract with other financial/non-financial counterparties (including third country counterparties) shall clear their OTC derivative contracts if the contract is deemed 'eligible'. A contract will be considered eligible if: • an authorised CCP (or recognised third country CCP) is currently clearing a class of derivatives and ESMA deems the contract 'eligible' (the Bottom-up approach); or • ESMA, on its own initiative, identifies a class of derivatives which it believes should be subject to the clearing obligation (the Top-down approach). Under each approach, ESMA shall conduct a public consultation and consult the European Systemic Risk Board (ESRB) and, where relevant, competent authorities of third countries. Under the Top-down approach, if no CCP is available to clear the class of derivatives, ESMA shall publish a "call for development" of proposals to clear the class of derivatives. The ECON Text states that ESMA shall base its decision as to which contracts will be 'eligible' on (a) the reduction of systemic risk in the financial system; (b) the liquidity of contracts; (c) the availability of fair, reliable and generally accepted pricing sources; and (d) international consensus. The clearing obligation may be applicable to	The Council Text provides that contracts declared subject to the clearing obligation must be cleared if entered into by financial counterparties and certain non-financial counterparties[2]; or where one of those counterparties enters into the trade with a third country entity that would be subject to the clearing obligation if it were established in the EU. The Council Text contains a Bottom-up approach, whereby ESMA will submit draft implementing technical standards to the Commission for approval, and a Top-down approach in the same manner as the ECON Text. The clearing obligation may be applicable to different categories of counterparty at different dates. Contracts entered into before the clearing obligation takes effect may also be required to be cleared if they have greater than a minimum remaining maturity ("front loading"). The Council Text states that ESMA shall base its decision as to which contracts will be subject to the clearing obligation on: (a) the degree of standardisation of the class of derivatives (contractual terms and operational processes); (b) the volume and liquidity of the class of derivatives; and (c) the availability of fair, reliable and generally accepted pricing sources. ESMA is additionally instructed to "pay due regard to the anticipated impact on the level of systemic risk in the financial system and to the levels of counterparty credit risk between counterparties" when preparing draft technical standards that further specify the criteria. In determining which categories of counterparty shall be subject to the clearing obligation and whether the

[1] Certain non-financial counterparties will not be required to clear eligible OTC derivatives contracts if their rolling average position, objectively measurable as directly linked to the hedging of commercial or treasury financing activity, for 50 business days does not exceed a threshold that will be determined by ESMA and the Commission.

[2] The Council Text contains a similar threshold to the ECON Text but the relevant time period under which the position is maintained is 30 days over a three month period.

different counterparties or classes of counterparties at a range of dates after the clearing obligation takes effect. To achieve international consistency, the Commission may seek a mandate to negotiate with third countries regarding making EMIR and a third country's legislation consistent. Classes of contract subject to the clearing obligation shall be recorded in a public register maintained by ESMA.	contract will be front loaded, ESMA shall look at: (a) the expected volume of relevant contracts; (b) whether one or more CCPs already clear the same class of derivatives; (c) the ability of relevant CCPs to handle the expected volume; (d) the type and number (or expected number) of active counterparties in the derivative; (e) the time needed by a counterparty to put in place arrangements to clear a class of derivatives with a CCP; and (f) the risk management, legal and operational capacity of the counterparties. Classes of contract subject to the clearing obligation shall be recorded in a public register maintained by ESMA.

(c) Access to CCPs and trading venues

AIMA's key points:

- **A CCP must maintain non-discriminatory access for any class of contract for which it is authorised to clear, wherever that contact is executed.**
- **A CCP should equally have non-discriminatory access to venues of execution for the purposes of obtaining prices and closing out positions.**

ECON Text	**Council Text**
The ECON Text provides for access to CCPs for clearing on a transparent, fair and non-discriminatory basis, regardless of the venue of execution. Execution venues must comply with operational, technical, legal, access and risk management requirements established by the CCP. A trading venue which seeks CCP access but which is denied such access must be provided with a fully reasoned response to its request and, if there are disputes between competent authorities regarding access, the trading venue may apply to ESMA to settle any dispute. A CCP shall have the right to non-discriminatory access to the data feed of any particular trading venue and access to any relevant settlement system that it needs for the performance of its duties.	The Council Text contains the same non-discriminatory access provision but clarifies that this access is subject to compliance with operational and technical requirements of the CCP. A trading venue which seeks CCP access but which is denied such access must be provided with a fully reasoned response to its request. The competent authority of the trading venue and the CCP may only deny access to the CCP where it would threaten the smooth and orderly functioning of the markets. Venues of execution are required to provide trade feeds on a non-discriminatory and transparent basis to all authorised CCPs. The trading venue can only deny such access if it would threaten the smooth and orderly functioning of the markets and the trading venue shall be required to provide a fully reasoned response to the CCP in that instance.

(d) The reporting obligation

AIMA's key points:

- **All financial and non-financial market participants should be required to report the details of all cleared and uncleared derivative trades to trade repositories.**
- **Such reporting should be undertaken by the CCP where possible.**

ECON Text	Council Text
The ECON Text requires reporting of all derivative trades (whether cleared or not), when entered into or materially modified, novated or terminated, to a trade repository. ESMA is empowered to examine and conduct a public consultation on whether retrospective reporting obligations can be introduced. All reporting shall be based, where possible, on international industry open standards. The reporting obligation will be undertaken by a CCP where it is cleared by a CCP. Where it is not cleared, a counterparty may delegate the obligation to the other counterparty or a third party, ensuring that details are not reported twice. Reporting may be undertaken by a trade compression operator where the contracts are subject to trade compression. Reports shall contain at least details of the parties to the contract (and their underlying beneficiaries, where applicable), the main characteristics of the contract and a unique contract identifier. Where a trade repository is not available, counterparties shall report details of their trades to ESMA.	The Council Text requires reporting of all derivative trades (whether cleared or not) by counterparties or a CCP when they have concluded, modified or terminated a contract. Reporting shall include all derivatives entered into after the date on which EMIR takes effect and all derivatives that are outstanding as at that date. A counterparty or a CCP may delegate its reporting obligation. Counterparties and CCPs shall ensure details are reported without duplication. Reports shall contain at least the details of the parties to the contract and the main characteristics of the contract. Where a trade repository is not available, counterparties shall report details of their trades to ESMA.

(e) Contracts not cleared by CCP

AIMA's key points:

- **Counterparties to uncleared trades should be required to exchange appropriate amounts of collateral.**
- **Clients must be offered the option of segregation of their collateral with independent third party custodians.**

ECON Text	Council Text
The ECON Text provides that those financial and certain non-financial counterparties that would be subject to the clearing obligation for a contract, but for which a contract is not cleared by a CCP, shall have appropriate prudential procedures and arrangements to measure, monitor and mitigate operational, market and credit risk, including by exchange of collateral or capital backing commensurate with the risk. Parties must offer their counterparties the option of segregation of initial margin at the outset of the contract. Competent authorities and ESMA shall aim to prevent regulatory arbitrage between cleared and uncleared transactions and reflect risk transfers arising from derivative contracts. For Pension Schemes, bilateral collateralisation shall take account of counterparty creditworthiness and applicable capital requirements shall be aligned with those for centrally cleared contracts. ESMA shall monitor activities in uncleared derivatives to identify classes of contracts that may pose systemic risk and, where it does so, take action to prevent further accumulation of contracts in such class.	The Council Text provides that financial and certain non-financial counterparties shall have appropriate prudential procedures and arrangements to measure, monitor and mitigate operational, market and credit risk, including by exchange of collateral. Financial counterparties shall hold appropriate and proportionate amounts of capital to manage risk not covered by exchange of collateral. Parties must distinguish in accounts (including in their own accounts), in accordance with their agreement, the assets provided by the other party (i.e., segregation of assets). Obligations for uncleared trades shall not apply to certain intragroup transactions (see above).

(f) CCP authorisation and supervision

AIMA's key points:
- **CCPs should be subject to appropriate authorisation conditions.**
- **CCPs should be well supervised by an appropriate authority.**

ECON Text	Council Text
A CCP shall apply to the competent authority of the Member State in which it is established for authorisation, if it has adequate access to central bank or commercial bank liquidity to perform its services and activities. Authorisation is granted if the competent authority approves the application and ESMA and a college of authorities (including other competent authorities and central banks)	A CCP shall apply to the competent authority of the Member State in which it is established for authorisation. Authorisation is granted if the competent authority approves the application, after receiving a positive opinion of a college comprising ESMA, the European System of Central Banks (ESCB), other competent authorities and central banks.

deliver a positive opinion that the CCP is safe to operate in the EU. Authorisation is effective for the entire territory of the EU. CCPs shall have initial capital of at least EUR 10 million. The competent authority in the Member State of establishment shall be responsible for ongoing supervision of a CCP.	CCPs shall have initial capital of at least EUR 5 million. The competent authority in the Member State of establishment shall be responsible for ongoing supervision of a CCP.

(g) Third country CCPs

AIMA's key points:

- **It is important that the EU should be able to recognise third country CCPs such that EU counterparties have a competitive choice of available CCPs, especially where trading occurs outside of the EU.**
- **Third country CCPs should be recognised if they meet standards broadly equivalent to EMIR.**

ECON Text	Council Text
The ECON Text requires third country CCPs to gain recognition from ESMA to provide clearing services to entities established in the EU. Recognition is firstly subject to the CCP authorisation conditions laid down in Articles 10 to 16 and third country CCPs shall be subject to a review process of similar rigueur to the one EU CCPs are subject to. Secondly, the third country CCP must be subject to effective supervision and enforcement in the third country and be subject to legally binding requirements, which are equivalent to the requirements of EMIR (including risk management standards). Thirdly, third countries in which the CCPs are established must meet the FATF AML standards, have an OECD Model Tax Convention with the relevant EU Member State, have a legal framework that does not discriminate against EU legal entities, allows reciprocal access conditions for EU based CCPs and provides for mutual recognition and the conditions imposed on EU entities preserve a level playing field with third country entities. The Commission may grant an exemption from the authorisation conditions and procedures if this is done on a reciprocal basis with the third country that allows EU-established CCPs to gain access to those third countries.	The Council Text requires third country CCPs to gain recognition from ESMA to provide clearing services to clearing members and venues of execution established in the EU. Previous compromise versions of the Council Text required third country CCPs to gain recognition to provide clearing services to any entities established in the EU, including clients of clearing members. This would have had serious implications for the ability of EU investment firms to trade outside of the EU and, thus, we believe the Council Text is a vast improvement on those previous compromise versions. ESMA may make a decision to grant recognition, including a decision subject to conditions and restrictions, where appropriate. The decision on recognition shall be made by ESMA after consultation with a college comprising various competent authorities and central banks. The decision will be based on whether the CCP complies with legally binding requirements equivalent to those set out in EMIR, whether the CCP is subject to effective supervisions and enforcement and whether the third country provides effective recognition or access for CCPs authorised under EMIR.

(h) Risk committees and board participation

AIMA's key points:
- **Risk committees play an important role in ensuring the safe operation of the CCP.**
- **It is essential that clients are represented on the risk committee, not subject to a mere consultation mechanism.**
- **Clearing members should not have a majority position on the Risk Committee.**

ECON Text	Council Text
The ECON Text provides that CCP risk committees shall be composed of representatives from clearing members, clients of clearing members, independent experts and the competent authority of the CCP. No one group may represent a majority of the committee. The committee will be chaired by an independent expert who reports directly to the board. The risk committee's role will be to advise the board on arrangements affecting risk management of the CCP, including changes to the risk model, default procedures and accepting new clearing members or classes of financial instruments for clearing. Reasonable efforts should be made to consult the risk committee in emergency situations. CCPs shall have a board, which must include representation of the clients of clearing members.	The Council Text is little changed from the Draft Proposal. The risk committee may now invite external independent experts to attend the risk committee meetings in a non-voting capacity. CCPs shall allow clients of the clearing members to attend risk committee meetings in a non-voting capacity or, alternatively, establish an appropriate consultation mechanism to ensure clients' interests are adequately represented. The CCP's board shall comprise at least one third and no less than two, independent board members.

(i) Segregation and portability

AIMA's key points:
- **Full segregation of assets and positions should be offered to clients at reasonable cost.**
- **The final EMIR text should be very clear on what 'segregation' is.**
- **Segregation must be effective under all Member States' insolvency laws.**

ECON Text	Council Text
The ECON Text provides for identification and segregation of assets and positions by the CCP, through the use of records and accounts, between: • the CCP and a clearing member; • a clearing member and other clearing members;	The Council Text provides that the CCP shall keep records and accounts enabling it to 'distinguish in accounts' the assets (i.e., collateral or equivalent assets or proceeds of realisation of collateral) and positions of : • the CCP and a clearing member;

and • a clearing member and a third party who holds assets and funds. The clearing member shall distinguish, in separate accounts with the CCP, the positions of a clearing member from its clients. A client shall also have positions distinguished in separate accounts with the CCP ('full segregation') but shall be given the possibility to have positions recorded in omnibus accounts upon request. CCPs and clearing members must disclosure the costs and level of protection provided by each option. Records must be kept to identify the assets in relation to each account. Full segregation shall ensure that positions and collateral can be transferred to other clearing members upon a clearing member's default. Member States will ensure their national insolvency laws provide derogations sufficient to allow EMIR's segregation objectives and requirements to be met.	• a clearing member from other clearing members; and • clients of a clearing member from the clearing member. Clearing members shall offer to keep records and accounts for clients to enable clearing members to distinguish in accounts held with the CCP the asset and positions of a client from those of other clients ('individual client segregation'). The CCP shall also offer more detailed levels of segregation. For individual client segregation, excess margin beyond the client's requirements will also be distinguished and not exposed to losses in other accounts. CCPs and clearing members must disclosure the costs and level of protection provided by each option. Segregation must be offered under reasonable commercial terms. Distinguishing assets and positions is achieved if: • assets and positions are recorded in separate accounts; • netting of positions recorded on different accounts is prevented; and • assets covering recorded positions are not exposed to losses connected to positions recorded in other accounts.

(j) Participation requirements and ownership

AIMA's key points:

- **CCP participation by clearing members should be open to any type of firm as long as they meet certain risk-based criteria.**
- **Wide participation by many clearing members should be encouraged.**

ECON Text	**Council Text**
The ECON Text states that a CCP shall establish criteria for admissible clearing members that are non-discriminatory, transparency and objective, considering whether the proposed participant has sufficient financial resources and operational capacity to meet their obligations. Further, financial institutions cannot be restricted from being clearing members in uncompetitive or unreasonable ways. Clearing members will be responsible for monitoring and collecting information on their clients but are not permitted to set criteria that would be	The Council Text retains the Draft Proposal's text, except that categories of admissible clearing members and the relevant criteria shall be set according to the types of products cleared. Decisions on admitting new clearing members can only be made after seeking the advice of the established risk committee.

discriminatory. A potential clearing member may be refused, even if they meet the applicable financial resources and operational capacity criteria, if it is justified in writing and based on a comprehensive risk analysis.	

(k) Collateral requirements

AIMA's key points:

- **CCPs should be limited to accepting highly liquid collateral with minimal credit and market risk.**
- **Appropriate haircuts to value should be given to reflect potential reduction in value.**

ECON Text	**Council Text**
The ECON Text retains much of the Draft Proposal but includes a provision whereby highly liquid collateral shall include cash, gold, government and high quality corporate bonds. In the case of non-financial counterparties, CCPs may accept bank guarantees. The level and type of collateral shall be set out in draft regulatory technical standards developed by ESMA in consultation with the ESCB and EBA and approved by the Commission. These shall be regularly revised to reflect market conditions.	The Council Text retains the text of the Draft Proposal which requires that CCPs accept only highly liquid collateral with minimal credit and market risk.

Alternative Investment Management Association

ANNEX 2

AIMA's Summary of the European Parliament's ECON Committee Text of EMIR

On 15 September 2010, the European Commission (the Commission) published its proposal for a Regulation on OTC derivatives, central counterparties and trade repositories (the Draft Proposal), often referred to as the European Market Infrastructure Regulation (EMIR). Since publication, both the European Parliament's Economic and Monetary Affairs (ECON) Committee and the Council of the European Union (the Council), through Member States' financial attachés, have separately been developing their own preferred amendments to the Proposal ahead of the negotiations beginning under the European trilogue process.

On 24 May 2011, the ECON Committee voted in favour of an agreed compromise text (the ECON Text) coordinated and presented by the ECON Committee EMIR Rapporteur, Werner Langen (DE, EPP). The ECON Text will now require approval at a full plenary session of the European Parliament, scheduled to take place on 5 July.

Scope (Article 1)

Scope may be important to AIMA members as:

- **it determines whether they, as clients, will be required to clear and report all derivatives (wherever traded) or just those traded over-the-counter.**

The ECON Text contains three main parts dealing respectively with:

- the primary obligations applicable to central counterparties (CCPs), clearing members and their clients, including the clearing and reporting obligations. These obligations will apply only to OTC derivatives. The ECON Text, within this first part, will also ensure that CCPs clear OTC derivatives traded on multiple venues or with different counterparties on a non-discriminatory basis (see Access to CCPs, below). The ECON Text imposes requirements on financial counterparties regulated under European Union (EU) legislation (including MiFID and AIFMD), on certain non-financial counterparties and on 'third-country clearing counterparties' that trade with EU financial and certain non-financial counterparties;

- authorisation and operating requirements applicable to all EU-established CCPs clearing contracts traded "within one or more financial markets" and which are presumed, therefore, to include CCPs clearing derivatives, equities, bonds, loans and other clearable products, wherever and however they are traded. Recital 27 of the ECON Text, which remains unchanged from the Draft Proposal, additionally states that the "stringent organisational, conduct of business and prudential requirements established by this Regulation" should "apply to the clearing of all financial instruments CCPs deal with, in order to ensure a uniform application". The obligations applicable to CCPs include authorisation requirements, recognition requirements for third country CCPs, organisational requirements (board and risk committee membership, etc.) and conduct of business requirements (participation, segregation and portability, margin requirements, default funds, etc.); and

- obligations applicable to trade repositories (TRs) apply to: (a) those TRs which must be authorised under EMIR; and (b) third country TRs which may be recognised under EMIR, that collect and maintain records of derivatives, wherever and however they are traded.

Definitions (Article 2)

Definitions may be important to AIMA members as they:
- **help set the scope for the clearing and reporting obligations and which clients they will apply to;**
- **provide clarity on which types of product must be cleared; and**
- **define what it means to 'segregate' initial margin provided by clients.**

Article 2 of the ECON Text contains a list of the definitions used within the text. Of particular interest are the following:

- **'clearing'** – in a change from the Draft Proposal, the ECON Text would define clearing as a process by which a third party interposes itself, directly or indirectly, between the transactions counterparties in order to assume their rights and obligations. References to the establishment of settlement positions, the calculation of net positions and checking that financial instruments are available to secure exposures have been removed;

- **'class of derivative'** – it is important that only narrowly defined classes of derivatives, which are suitable for clearing, are subject to the clearing obligation. The ECON Text has amended this definition to include example of the 'essential characteristics' of a class of derivative by inclusion of: the relationship with the underlying asset; the type of underlying asset; the pay-off profile; and the currency of the notional. It notes that derivatives which belong to the same class may have different maturities;

- **'over the counter (OTC) derivatives'** - defined as derivatives whose execution does not take place on a Regulated Market (as defined in MiFID), a third-country market considered as equivalent to a Regulated Market or any other organised trading venue established under the EU Transparency Directive that clears such contracts through a CCP;

- **'financial counterparty'** – the definition lists a range of entities established in the EU which are authorised under EU legislation, including 'investment firms' as defined in MiFID and 'authorised alternative investment funds' as defined in the AIFMD;

- **'client'** – financial and non-financial entities which are counterparties to cleared trades but which are not clearing members of the CCP will be defined as clients. A client is an undertaking with a direct or indirect contractual relationship with a clearing member or one of its affiliates which enables the undertaking to clear transactions through the clearing member's use of a CCP;

- **'third-country clearing counterparties'** – as EMIR will also apply to OTC derivative contracts traded between EU entities and non-EU entities, this definition includes an undertaking that is considered equivalent to and were it established in the EU would be a financial or non-financial counterparty;

- **'segregation'** – for the purposes of Articles 8 and 37, segregation means "at least that the assets and positions of one person shall not be used to discharge the liabilities of or claims against any other person from whom it is intended that he is segregated, and shall not be available for such purposes, especially in the event of the clearing member's insolvency".

Clearing obligation (Articles 3 and 4)

The clearing obligation may be important to AIMA members as:
- **they may be classified as financial counterparties and be required to clear eligible OTC derivative contracts from 1 January 2013; and**
- **the provisions set out how ESMA will decide which contracts must be cleared and from which date.**

Financial counterparties and non-financial counterparties[3] that enter into 'eligible' OTC derivative contracts with other financial or non-financial counterparties (including third-country clearing counterparties) must clear those contracts on a CCP listed on a public register maintained by the European Securities and Markets Authority (ESMA). The clearing obligation will only apply to those eligible contracts that are entered into after the date at which it is determined that the clearing obligation will take effect, following the publication of a decision in the public register maintained by ESMA.

The clearing obligation shall not apply: (a) to financial counterparties, non-financial counterparties or third-country clearing counterparties that enter into OTC derivative contracts between subsidiary undertakings of the same parent company; or (b) between a parent company and a subsidiary undertaking (the intragroup exemptions). The intragroup exemptions shall only apply to contracts that are 'justified for economic reasons', where the contract does not increase systemic risk in the financial system and where there are no legal restrictions to capital flows between the undertakings.

When a competent authority authorises a CCP to clear a class of derivatives, that competent authority shall notify ESMA of the classes of derivatives that are authorised to be cleared so that ESMA may determine whether those contracts should be considered 'eligible' for the clearing obligation (the bottom-up approach). ESMA will then conduct a public consultation, consult with the European Systemic Risk Board (ESRB) and relevant competent authorities (including third country competent authorities, where appropriate) and within six months make a decision on:

- whether a class of derivatives will be subject to the clearing obligation;
- the date from which the clearing obligation shall take effect; and
- any conditions to the clearing obligation that may be applied to transactions with persons in third countries.

ESMA, on its own initiative, may also conduct a public consultation and consult with the ESRB and competent authorities on whether a class of derivatives for which no CCP has been yet granted authorisation, should be subject to the clearing obligation (the top-down approach). If such a decision is made, ESMA shall publish a call for development of a proposal to clear that class of derivatives.

In deciding which classes of OTC derivative should be subject to the clearing obligation, under the bottom-up and top-down approaches, ESMA shall base its decision on the following criteria:

- the reduction of systemic risk, including potential failures of highly interconnected counterparties to meet their payment obligations and a lack of transparency concerning positions;
- the liquidity of contracts; and
- the availability of fair, reliable and generally accepted pricing sources.

[3] Certain non-financial counterparties will not be required to clear eligible OTC derivatives contracts if their rolling average position, objectively measurable as directly linked to the hedging of commercial or treasury financing activity, for 50 business days does not exceed a threshold that will be determined by ESMA and the Commission.

ESMA shall also take account of international decisions on contracts eligible for clearing (e.g., the decisions of the US authorities) and the Commission would be able to request authority of the Council to negotiate with third countries in this regard.

All decisions on a contract's eligibility for clearing will be recorded on a public register, maintained by ESMA and available on the ESMA website.

Access to CCPs (Article 5)

Access to CCPs may be important to AIMA members as:
- **non-discriminatory access of trading venues to CCPs will improve competition and the lower cost of clearing services**

The Commission and many members of ECON have been concerned with ensuring adequate competition both in the area of trading as well as clearing and wish to ensure that a regulation results in as open and transparent architecture as possible. Article 5 of the ECON Text provides that CCPs shall accept OTC derivative contracts for clearing on a "transparent, fair and non-discriminatory basis, regardless of the venue of execution". The only caveats to this requirement are that accepting trades, regardless of trading venue, may be derogated from if it would adversely affect risk mitigation or if trading venues seeking to clear trades with a given CCP do not comply with certain operational, technical, legal, access and risk management requirements established by the CCP.

In the event that a CCP rejects a request from a trade execution venue to clear contracts with the CCP, the CCP must send a fully reasoned and explained response to the trade execution venue. ESMA shall settle any disputes between Member States that exist as a result of the acceptance or rejection of a trading venues access to a CCP.

The ECON Text also provides CCPs with non-discriminatory access to the data feed of any particular trading venue and access to any relevant settlement system needed to perform the CCP's duties.

Reporting (Article 6)

The reporting obligation may be important to AIMA members as they:
- **will have to report all of their derivative trades to trade repositories;**
- **may make arrangements with their counterparty that the counterparty reports the trade; and**
- **may fulfil other reporting obligations by their fulfilment of this reporting obligation.**

The ECON Text requires the reporting of the details of derivatives trades by:

- if the trade is handled by a CCP, the CCP;
- if the trade is not handled by a CCP, one of the counterparties to the trade; or
- if the trade is one of a number of derivative contracts subject to a process of trade compression, the operator of a trade compression service.

Parties may delegate their obligation to the other counterparty or to a third party and must avoid submitting duplicative reports. The ECON Text does not make it clear as to how this is to be done in practice nor does it provide for further technical measures which would specify what steps reporting parties must take in order to avoid duplication.

Reports must be made to a TR registered under EMIR or, if no TR has been registered, ESMA. A report to a TR or ESMA shall be made no later than one business day after the execution, material modification, novation or

termination of a trade. The reporting obligation will apply to all trades executed after the implementation of EMIR; however, ESMA is empowered to examine whether a retrospective reporting obligation can be imposed, taking into consideration technical requirements, remaining times to maturity on outstanding transactions and public comments on the proposal.

All reporting must be, where possible, based on international industry open standards.

ESMA is tasked with preparing draft regulatory technical standards, in coordination with the European Banking Authority (EBA), the European System of Central Banks (ESCB) and the ESRB on the details to be contained in reports and the frequency and format of those reports that are required to be made. The Commission may then adopt draft implementing technical standards. The reports must, however, include details of:

- the parties to the contract and, where different, the beneficiary of the rights and obligations arising from it;
- the main characteristics of the contract, including the type, underlying, maturity, exercise, delivery date, price data and notional value; and
- a unique contract identifier.

The details of the report shall be "guided" by the list of requirements for reporting transactions in MiFID.

Non-eligible, uncleared trades (Article 8)

Rules on non-eligible and uncleared trades may be important to AIMA members as:

- **not all trades will be suitable for CCP clearing;**
- **counterparties to uncleared trades will be required to post collateral; and**
- **AIMA members may request that collateral is segregated with a third party who is independent of the counterparty to the trade.**

OTC derivatives contracts, entered into by financial and certain non-financial counterparties, which are not required to be cleared, shall "ensure with due diligence that appropriate prudential procedures and arrangements are in place to measure, monitor and mitigate operational, market and credit risk". Those prudential procedures and arrangements shall include adequate electronic confirmation of the terms of the contract and standardised processes to reconcile portfolios, identify disputes between parties, manage risk and monitor the value of outstanding contracts by marking-to-market on a daily basis. Risk management shall, importantly, include the timely, accurate and appropriate exchange of collateral or capital backing commensurate with the risk and applicable regulatory capital requirements. Where capital and margin are provided, the competent authorities and ESMA shall ensure that regulatory arbitrage opportunities are not available between cleared and uncleared derivative contracts. Margin standards will be reviewed by ESMA and the competent authorities to seek alignment of practices between cleared and uncleared contracts. Counterparties must be offered the option of having their initial margin segregated, at the outset of the contract, as is common market practice.

Pension schemes are given special treatment with regard to uncleared trades and may post reduced levels of margin taking into account counterparty creditworthiness, yet will not receive less favourable capital requirement than those for centrally cleared contracts.

The ECON Text contains a provision that requires ESMA to monitor activities in non-eligible derivatives to identify those contracts that may pose systemic risk and, where identified, take action to prevent further accumulation of contracts in that class.

Authorisation of CCPs and third country CCPs (Title III; Article 23)

The authorisation of CCPs may be important to AIMA members as it may:
- **limit the number of CCPs they may use to clear their contracts; and**
- **prevent AIMA members trading outside of Europe if clearing is required and third-country CCPs cannot gain recognition under EMIR.**

The ECON Text creates robust requirements for EU-established CCPs around authorisation and their capital requirements. Recognising the importance of CCPs, their authorisation must be approved by a college of relevant competent authorities and relevant central banks, which will be chaired by ESMA and which will keep under review all authorisation decisions. Day-to-day supervision of an authorised CCP will remain with the competent authority of the Member State in which the CCP is established. Authorisation is required for all CCPs regardless of the financial instrument type they propose to clear, i.e., stocks, bonds, derivatives, loans, etc.

A CCP established in a third country may only provide services to entities established in the EU after gaining recognition from ESMA. Of particular importance to Article 23 is that recognition by ESMA is required in order for a CCP to provide clearing services to EU entities, not just when they are trading on European markets but wherever, and in whatever form, they trade worldwide. For example, a UK established counterparty executing a trade on a US market with a US counterparty could not clear those trades with a US CCP unless that CCP has gained recognition from ESMA.

To gain recognition to provide clearing services to entities established in the EU, third country CCPs will be subject to the same authorisation conditions and procedures as an EU-established CCP and shall be subject to review by a process of "similar rigueur" to that to which EU CCPs are subject. In particular, Article 13 requires that the CCP must comply with all of the requirements of both EMIR and the Settlement Finality Directive. Third country CCPs may gain an exemption from some of the authorisation conditions on the proviso that the exemption is granted on a reciprocal basis for EU CCPs seeking recognition in the third country and following a decision of the Commission. The Commission must receive confirmation that EU CCPs will gain similar exemptions when providing services in that third country. Whether or not exemption from some of the authorisation conditions is granted, third country CCPs may only gain recognition where ESMA, in consultation with competent authorities of the EU, the EBA and relevant members of the ESCB, finds that:

(a) the CCP:

- is authorised in, and is subject to, effective supervision and enforcement in the third country on an ongoing basis;
- is in compliance with legally binding requirements, which are equivalent to those in EMIR;
- has risk management standards, which are assessed by ESMA as compliant with the EMIR CCP organisational standards (Title IV); and

(b) the third country of the CCP:

- has standards that meet the Financial Action Task Force requirements and are of the "same effect" as the EU Anti-Money Laundering Directive;
- has signed an agreement with the Member State where authorisation is sought that complies with the OECD Model Tax Convention and ensures effective exchange of information on tax matters, including multilateral tax agreements;
- has a legal framework that is not discriminatory vis-à-vis EU legal entities; and
- applies reciprocal access conditions for EU-established CCPs and has implemented a mutual recognition regime.

If a third country CCP is recognised, ESMA, the EBA, the ESCB and the competent authorities shall enter into a cooperation agreement with the third country where the CCP is established to ensure coordination of supervisory activities and a mechanism for exchange of information between competent authorities in the EU and the third country.

Organisational requirements (Title IV; Articles 25 and 26)

The CCP organisation requirements may be important to AIMA members as they may wish to:
- **take a position on the board of the CCP;**
- **influence risk decisions in the CCP risk committee; and**
- **become direct clearing members.**

Title IV of the ECON Text sets out organisational requirements for CCPs and, of particular relevance to managers, the composition of both the CCP's board and its risk committee.

The board of the CCP shall have a supervisory role in overseeing the business of the CCP and the ECON Text states that "the clients of the clearing members must be represented in the composition of the board". The extent of the clients' representation on the board is not stated, although it states that board members must be of "sufficiently good repute and have adequate expertise in financial services, risk management and clearing services".

CCPs shall establish a risk committee that will advise the board on any arrangements that may impact the risk management of the CCP, such as changes to the risk model, default procedures, accepting new members, accepting new classes of financial instruments for clearing or outsourcing of CCP functions. The CCP shall be composed of representatives from:

- the clearing members;
- clients of the clearing members;
- independent experts; and
- the competent authority of the CCP.

No one group shall be entitled to have a majority position on the risk committee. Clients not represented in the risk committee may still be consulted on relevant risk committee decisions to ensure their interests are adequately represented.

Clients may also become a direct clearing member participant of the CCP if they are within a category of admissible clearing members and meet certain non-discriminatory, transparent and objective admission criteria.

Segregation and portability (Article 37)

The segregation and portability requirements may be important to AIMA members as:
- **they will determine the level of protection of the collateral they are required to post upon the insolvency of the clearing member; and**
- **positions held with a counterparty that becomes insolvent may be transferred to a solvent counterparty reducing distributions to trading.**

The ECON Text provides for the identification and segregation of assets (provided as collateral) and positions of counterparties to ensure that assets of one counterparty are not used to discharge the liabilities of other parties,

including upon insolvency and that those assets can be returned to the counterparty or the assets and positions can be transferred to a new counterparty (in the case of a client).

Article 37 provides for the identification and segregation of assets and positions by the CCP, via keeping records and accounts, of one clearing member from the assets and positions of other clearing members and the CCP's own assets and positions. Where the CCP places assets with a third party, it shall also ensure that those assets and funds are kept separately from assets and funds belonging to the CCP and other clearing members at the third party and those assets and funds belonging to the third party itself.

The clearing member shall distinguish, in separate accounts, its own proprietary positions from those of its clients. The clearing member shall also distinguish, in separate accounts with the CCP, the positions of each individual client, described as being "full segregation". Clients will be given the possibility to 'opt-out' of full segregation, by written request, and have positions recorded in omnibus accounts which may be a cheaper segregation option and provide for distinguishing positions from those of the clearing member but not from other clients in the omnibus account. Clearing members shall provide their clients with details on the level of protection, cost, risks and information on the relevant jurisdiction's insolvency laws that are relevant to full segregation and omnibus segregation. The assets that relate to positions recording in accounts with the CCP shall also be recorded so that those assets can be identified. The result of distinguishing assets and positions in separate accounts with the CCP shall be the ability to transfer the assets and positions of a client of a defaulting clearing member to a new non-defaulting clearing member. This result will occur under EMIR irrespective of any conflicting Member State insolvency laws that would otherwise prevent this objective. Full segregation shall also mean that clients subject to the requirements of the Capital Requirements Directive can benefit from favourable capital treatment compared with a bilateral arrangement or omnibus segregation, as their exposure is seen as being only to the low-risk CCP and not to the clearing member or the other clients in the omnibus account.

Collateral requirements (Articles 39 and 43)

The collateral requirements may be important to AIMA members as:
- **they will be required to post collateral on cleared trades; and**
- **the type of collateral that may be posted has a bearing on the cost of trading.**

Where a trade is cleared with a CCP, the CCP shall accept only "highly liquid collateral" with "minimum credit and market risk to cover its initial and ongoing exposure to its clearing members". Examples of the types of collateral that may be acceptable are cash, gold, government and high quality corporate bonds. Non-financial counterparties may be able to provide bank guarantees as collateral against their exposure to a clearing member bank. CCPs may also accept the underlying of a derivative contract or the financial instrument that originates the CCP exposure as collateral to cover the margin requirements.

The value of the collateral required to be posted will be subject to adequate haircuts to asset values that reflect their potential to decrease in value over the interval between their last revaluation and the time they can reasonably be assumed to be liquidated. The CCP must also consider the liquidity risk and concentration risk of certain assets when deciding which assets may be acceptable as collateral and what haircuts are appropriate. The ECON Text requires minimum collateral standards to be calibrated to the risk level and shall be regularly revised to reflect market conditions and in response to emergency situations where amending collateral standards may mitigate systemic risk. Margin payments shall be collected on at least a daily basis and be sufficient to cover losses resulting from at least 99% of the exposure's movement over an appropriate time horizon. The CCP shall adopt models and parameters to set the required margin requirements, which must be validated by the competent authority and subject to an opinion of a college of relevant competent authorities and central banks. Margin may be calculated in respect of a portfolio of financial instruments, rather than specific instruments, only when the price correlation among the financial instruments included in the portfolio is "high and stable".

ESMA, in consultation with the ESRB and EBA, shall develop draft regulatory standards setting out the types of collateral that shall be accepted and how the haircuts to asset values should be applied. The draft regulatory standards must be submitted to the Commission by 30 June 2012.

Implementation and transitional provisions (Title VIII)

The implementation and transitional provisions may be important to AIMA members as:

- **they will need to prepare to meet their obligations under EMIR before implementation.**

The ECON Text sets out requirements for the drafting of several regulatory technical standards and implementing acts, to be prepared by ESMA, in consultation with the EBA, ESRB and the competent authorities, which must be prepared by 30 June 2012. The Commission will be required to approve these secondary legislative measures ahead of implementation of EMIR.

Financial and non-financial entities will be subject to the clearing and trading obligations and requirements for uncleared swaps six months after the Commission adopts regulatory technical standards, implementing standards and guidelines. So the expected date of implementation is end 2012/beginning 2013 (end 2012 being the agreed G20 deadline). Pension funds will be excluded from the clearing obligation for three years after entry into force of EMIR, which may be extended by the Commission if pension funds are still unduly burdened by the requirements. Those derivative contracts that are required to be reported, which have been entered into prior to the implementation of EMIR, shall be reported to a TR within 120 days of the date of registration of an applicable TR by ESMA.

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