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Legal update ——— March 2014

Banking and Finance
European Market Infrastructure Regulation

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EMIR – Is your standalone hedging compliant?

As part of an international effort to stabilise the "over-the-counter" or "OTC" derivative markets, a piece of European legislation known as the European Market Infrastructure Regulation or EMIR has come into force.

If your organisation has entered into any freestanding derivatives (typically documented by way of an ISDA Master Agreement) then you will need to ensure that you are compliant with the requirements of EMIR. For most RPs/RSLs this is likely to be limited to complying with reporting and risk management requirements.

EMIR has a particularly wide-reaching effect. Not only does it affect banks, insurance companies and clearing systems (known as financial counterparties), but it also affects any entity which is classed as a non-financial counterparty or NFC. In essence, this concept is wide enough to cover any organisation which is not a financial counterparty, assuming that they are established in the EU. Any RP or RSL using standalone derivatives as part of its treasury management strategy, whether on a regular or occasional basis, is therefore likely to need to be aware of its obligations under EMIR.

Reporting requirements – already in force

The obligation to report details of derivatives contracts that have been concluded, modified or terminated applies to both counterparties. It relates to contracts and trades which take place after 12 February 2014 and retrospectively on more historic trades (depending on certain criteria and where they were entered into or were outstanding after 16 August 2012). Details must be reported no later than the working day after the conclusion, modification or termination of new contracts and various other rules apply to historic contracts.

If you are affected by these requirements and you have not heard from your counterparties with a proposal as to how they suggest you both deal with the EMIR reporting requirements, then you should make contact as the obligation remains with the RP/RSL. This is especially important if you propose to enter into new contracts or if you are proposing to trade under existing contracts.

From a practical perspective, for an affected NFC to make a report it must first obtain a Legal Entity Identifier through making an application to the London Stock Exchange. This is a unique code identifying the body making the report. The actual reports relating to the contracts or trades are then made to a trade repository or the European Securities and Markets Authority.

Counterparties may agree that one of them will report on behalf of both. Practically speaking it probably makes sense for this responsibility to lie with the financial counterparty. However, the responsibility for complying with EMIR remains with the delegating entity (in this case the RP or RSL). If you delegate this responsibility you are required to conduct reasonable checks to ensure accurate and timely reports are submitted on your behalf.

Other requirements

There are other obligations in relation to clearing which only apply to NFCs at the point where their use of derivatives exceeds the "clearing threshold". We suspect that these requirements are unlikely to apply to affected housing associations because contracts which have been entered into hedge treasury risk are excluded from this calculation.

Finally, even where there is no clearing requirement, RPs and RSLs are required to ensure that appropriate procedures and arrangements are in place to measure, monitor and mitigate operational and credit risk. Such risk mitigation techniques can include prompt confirmation of trades and daily marking-to-market and will require portfolio reconciliation at least once a year. You may already be taking steps to manage these risks as part of your existing risk and treasury management strategy.

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