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# THE IMPACT OF EMIR ON NON-FINANCIAL COUNTERPARTIES

To Our Clients and Friends:

On **16 August 2012**, The European Market Infrastructure Regulation ("**EMIR**")[1] came into force with immediate and wide-ranging consequences for firms dealing in derivatives related to or affecting the European Economic Area ("**EEA**").[2] A wide range of entities and derivatives fall within the scope of EMIR, as discussed further below.

This note summarises the effects of EMIR on **non-financial counterparties**[3] and contains suggested immediate next steps for ensuring EMIR-compliance. Gibson Dunn has a separate client briefing note in relation to the impact of EMIR on financial counterparties.

## WHAT IS EMIR?

EMIR is the European Union's ("**EU**") answer to Title VII of the US Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.[4] These laws share the same origins in the 2009 G20 post-crisis reform agenda, and introduce requirements aimed at reducing counterparty risk and improving transparency within over-the-counter ("**OTC**") derivative markets. In EU terms (or EEA terms given the text has EEA relevance), this translates into extensive clearing, risk mitigation and reporting obligations for counterparties that will enter into force on a phased basis over the next couple of years.

### *Scope - Type of derivative*

EMIR applies to all derivatives identified in Annex 1 Section C (4) to (10) of The Markets in Financial Instruments Directive ("**MiFID**").[5] This is an expansive list that includes:

- most options, futures and swaps on interest rates, securities, credit (including CFDs) and indices;
- commodity derivatives if cash settled or traded on a regulated market or MTF; and
- derivatives on underlyings such as inflation rates, freight rates, emission allowances, climatic variables, subject to certain conditions set out in MiFID.[6]

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[1] EMIR is legally binding on and directly applicable in the courts of all EEA member states, and needs no transposition into national law.
[2] This comprises of the countries within the European Union, plus Iceland, Liechtenstein and Norway.
[3] This note covers non-financial counterparties both above and below the clearing threshold.
[4] Please contact Michael Bopp and Jeffrey Steiner at Gibson Dunn for further information on Title VII of the Dodd-Frank Act.
[5] Article 2(5) EMIR.

However, commodity derivatives that are strictly OTC (*i.e.*, not settled in cash, traded on a regulated market or MTF) are unlikely to fall within the scope of EMIR. Spot FX is also excluded.[7]

We refer in this note to contracts that fall within the scope of EMIR as **EMIR Derivatives**.

***Scope - Type of entity***

EMIR applies to a wide range of firms and it categorizes such firms as follows:

- A financial counterparty ("**FC**"),[8] which is an investment firm, bank, insurer, registered UCITS fund, pension fund or an alternative investment fund managed by an alternative investment manager (as defined by the applicable EU legislation authorising or regulating those entities).
- A non-financial counterparty ("**NFC**"), which is an entity established in the EEA, other than a FC, that is party to an OTC EMIR Derivative.
- A third-country equivalent, which is an entity established outside the EEA that would have been subject to certain obligations under EMIR if established in the EEA, and that is party to an OTC EMIR Derivative.

EMIR treats NFCs differently depending on whether their positions in respect of OTC EMIR Derivatives (other than those relating to hedging) exceed or fall below a certain clearing threshold.

- A NFC that exceeds the threshold attracts similar treatment to an FC under EMIR. We refer to this type of entity as an **NFC+**.

- A NFC that does not exceed the threshold attracts more lenient treatment than an NFC+ or FC. We refer to this type of entity as a **NFC−**.

***The Clearing Threshold Calculation***

Under EMIR, an NFC is deemed to be an NFC+ where the gross notional value[9] of its OTC derivatives contracts, during any 30 working day rolling average position, exceeds any of the asset-class thresholds below:[10]

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[6] See Annex 1 Section C (10) of MiFID.
[7] There is ongoing debate as to whether FX forwards are excluded. Unless and until ESMA provides definitive guidance on this matter, an NFC should assume that they are included.
[8] Article 2(8) EMIR.
[9] The calculation of notional values of derivative contracts follows the finance industry standard convention.

| *OTC derivative type* | *Gross notional value (EUR billions)* |
|---|---|
| Credit derivatives | 1 |
| Equity derivatives | 1 |
| Interest rate derivatives | 3 |
| Foreign exchange | 3 |
| Commodity derivatives and other OTC derivatives | 3 |

*"Hedging" exception*

As mentioned above, when conducting the threshold calculations, an NFC may disregard OTC derivative contracts related to hedging,[11] *i.e.* those which are objectively measurable as reducing risks directly related to its commercial activity or treasury financing activity or that of other non-financial entities in its group.

The relevant technical standard ("**Technical Standard**"),[12] published in the Official Journal of the EU, sets out the precise definition for derivatives contracts falling within this "hedging" exception. In summary, this includes activity which:

- covers risks incurred in the normal course of business; or
- covers risks arising from fluctuations in interest rates, inflation rates, foreign exchange rates, credit risk. *etc.*; or
- qualifies as a "hedging contract" pursuant to International Financial Reporting Standards.

Although hedging contracts are excluded, all non-hedging related OTC EMIR Derivatives entered into by the NFC or by other non-financial entities of the group[13] (irrespective of whether those entities are located within or outside the EEA) are to be included in the threshold

[10] These thresholds are set out in Article 11 of Technical Standard (No. 149/2013).

[11] Note that it is necessary to take into account the hedging positions of the NFC itself and those of other non-financial entities in its group.

[12] Commission Delegated Regulation (EU) No 149/2013 of 19 December 2012 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on indirect clearing arrangements, the clearing obligation, the public register, access to a trading venue, non-financial counterparties, and risk mitigation techniques for OTC derivatives contracts not cleared by a CCP.

[13] Article 2(16) EMIR defines 'group' very broadly as: "the group of undertakings consisting of a parent undertaking and its subsidiaries within the meaning of Articles 1 and 2 of Directive 83/349/EEC or the group of undertakings referred to in Article 3(1) and Article 80(7) and (8) of Directive 2006/48/EC".

calculation. Furthermore, transactions subject to an intragroup exemption must also be included in the calculation (see the *Intragroup Exemption* section below).

**EMIR OBLIGATIONS FOR NFCs**

In this section, we provide details of the obligations introduced by EMIR and corresponding subordinate legislation that specifically apply to an NFC+ or an NFC−. The table below provides an overview of these obligations.

| *Obligation* | *Expected entry into force* | *NFC+* | *NFC−* |
|---|---|---|---|
| Record keeping obligation | 16 August 2012 | ✓ | ✓ |
| Risk mitigation techniques | 16 August 2012 / 15 March 2013 / 15 September 2013 | ✓ | ✓ |
| Notification obligation | 15 March 2013 | ✓ | × |
| Reporting obligation | Some apply from 1 July 2013 | ✓ | ✓ |
| Clearing obligation | Early-mid 2014 | ✓ | ✓ |

There is an exception to some of the obligations, which is referred to as the *Intragroup Exemption*. This is discussed in detail at the end of this section.

**Obligation 1 - Record-keeping**

From 16 August 2012, NFCs have been required to keep a record of any derivative contract they have concluded, and of any modification thereto, for a period of at least five years following the termination of the contract.[14]

As a matter of prudence, and due to the 'backloading' reporting obligation (see below), all counterparties may wish to confirm that they currently hold records sufficient to complete the minimum standards required under the reporting obligation.

**Obligation 2 - Risk mitigation techniques**

All NFCs are required to put in place certain procedures and arrangements to mitigate the risks associated with OTC derivative contracts (which are referred to as **risk mitigation techniques**).[15] The risk mitigation techniques must be observed in respect of all OTC EMIR Derivatives that are not centrally cleared. As discussed above, a contract may not need to be

[14] Article 9(2) EMIR.
[15] Article 11 EMIR and Chapter VIII Technical Standard.

cleared either because it is with an NFC− or because the clearing obligation does not apply to that type of contract.

In terms of geographical scope, although the Technical Standard that contains the principal obligations in relation to risk mitigation techniques only purports to place obligations on NFCs and FCs (*i.e.* entities established in the EEA), EMIR states that, as with the clearing obligation, the obligations in respect of risk mitigation techniques also apply to contracts entered into between third country entities that would be subject to those obligations if they were EEA entities, "*provided that those contracts have a direct, substantial and foreseeable effect within the Union or the obligation is necessary or appropriate to prevent the evasion of any provisions of [EMIR]*".[16] Additional legislation will be introduced to provide further guidance on the extraterritorial effect of certain aspects of EMIR, including the risk mitigation techniques.

The table in Annex A of this note sets out, in detail, the risk mitigation techniques that NFCs must observe. FCs are subject to the most stringent risk mitigation requirements but, as you will see from the table, an NFC+ is subject to additional and more onerous obligations than an NFC− in places. NFCs may wish to enter into dialogue with their counterparties and consider signing up to the relevant ISDA protocol[17] (which includes a mechanism for an NFC, and third country equivalent, to represent their status as NFCs in respect of the clearing threshold) to avoid being subject to a higher standard of risk mitigation techniques than strictly necessary.

**Obligation 3 - Notification**

On 15 March 2013, NFCs+ will become subject to the notification obligation under Article 10(1)(a) EMIR. This requires an NFC+ to make a notification to ESMA[18], as well as to its relevant local regulator (*e.g.* the FSA in the UK), to declare that it exceeds the clearing threshold.

Financial regulators across the EU are in the process of adopting their notification procedures. For NFCs+ established in England and Wales, notifications will need to be made to the FSA. Details of the notification process as well as the notification form are available on its notification webpage.[19] For the purposes of notifying ESMA, forms are now available on its webpage.[20]

**Obligation 4 - Reporting**

Under EMIR, all counterparties and central counterparties ("**CCPs**") must ensure that details of any derivative contract are reported to a registered trade repository[21] ("**TR**") within one working

[16] Article 11(12) EMIR.
[17] ISDA 2013 EMIR NFC Representation Protocol.
[18] This is the independent EU authority that is primarily responsible for the implementation of EMIR.
[19] http://www.fsa.gov.uk/about/what/international/emir/emir-notifications-and-exemptions.
[20] http://www.esma.europa.eu/page/European-Market-Infrastructure-Regulation-EMIR.
[21] Where no relevant TR is in place a report should be made to ESMA. A counterparty will need to choose a Trade Repository that is authorised or recognised by ESMA and that accepts the type of contract that the counterparty needs to report. These TRs, as well as the type of contracts they accept, will be available on ESMA's website.

day of its conclusion, modification or termination. The purpose of reporting is to ensure that information on the risks inherent in OTC derivatives markets will be centrally stored and easily accessible to ESMA, regulators and relevant central banks.

***Scope of reporting obligation***

- ***Derivatives***: The reporting obligation applies to all EMIR Derivatives contracts whether cleared or non-cleared, OTC or exchange-traded (including, for the avoidance of doubt, intragroup transactions).
- ***Counterparties***: "Counterparty" is not a defined term in EMIR, so it is not clear which entities will be required to comply with this obligation. This may refer to all market participants, or more narrowly, to only FCs and NFCs. Further guidance is expected.
- ***Backloading***: There is an obligation to backload data onto a TR from date of entry into force of EMIR. Trades outstanding on 16 August 2012 and still outstanding on the reporting start date have to be reported within 90 days of the reporting start date. Trades outstanding on 16 August 2012 or entered into thereafter but not outstanding on the reporting start date have to be reported within 3 years of the reporting start date.

***Details to be reported***

A Technical Standard setting out the minimum details of data required to be reported to TRs contains a table setting out data to be provided in respect of each counterparty, and a separate table setting out 'common data' to be provided in respect of the derivative contract itself.[22]

***Cooperation and delegation encouraged to avoid duplication***

EMIR encourages counterparties to cooperate in the reporting process and agree upon the 'common data' table to avoid inconsistencies. EMIR specifically states that reports should be made without duplication and permits one counterparty, or a CCP, to report on behalf of both counterparties to the trade, or indeed for the reporting duty to be delegated to a third party. In all cases, however, the original counterparty or CCP subject to the reporting obligation remains legally responsible for ensuring the reporting obligation is met.

***Timetable for reporting obligation***

The reporting obligation is expected to come into effect on 1 July 2013 for credit and interest rate derivatives, provided a TR has been registered for that particular derivative before 1 April 2013, or 90 days after registration of the TR.

[22] It will not be necessary to send copies of each derivative contract entered into to authorised/recognised TRs.

For other types of derivative, the reporting obligation would come into effect on 1 January 2014 if the relevant TR has been registered by 1 October 2013. If no TR has been registered for that particular derivative before 1 October 2013, the obligation will come into effect 90 days after the registration of any such TR.

In both cases, there is a long stop date of 1 July 2015 for reporting directly to ESMA derivatives for which a TR is still not available.

**Obligation 5 - Clearing**

The clearing obligation will enter into force on a phased basis from 2014 for NFCs+[23] and will require NFCs+ (as well as FCs[24]) to clear all[25] OTC EMIR Derivatives that are identified by the European Commission as "eligible" for clearing through central clearing counterparties. The concept of an "eligible" EMIR Derivative is discussed below.

***Rationale of reducing risk***

CCPs are regulated financial institutions, and will be subject to stringent prudential and risk management requirements under EMIR. [26] By interposing CCPs in bilateral trades, counterparties will be 'insulated' from one another with the CCP alone bearing the counterparty risk. This regime is intended to reduce systemic risk and contagion in OTC derivatives markets generally, and to improve oversight and transparency for financial authorities. CCPs can also assist in reducing counterparties' credit exposure through the use of multilateral netting. [27]

***Scope of clearing obligation***

The clearing obligation applies to "eligible" OTC EMIR Derivatives entered into between:

- two FCs;
- an FC and an NFC+;
- two NFCs+;

[23] On 8 February 2013, following the approval by the EU Parliament of the draft technical standards, the EU Commission published a declaration regarding the implications of those draft standards. The Commission noted the Parliament's concerns and stated that the obligation for non-financial firms to clear will be phased in over "an appropriate period of time", the suggestion being that this period will be similar to the one proposed in the technical standards for bank guarantees (*i.e.* over a period of 3 years).

[24] The obligation for FCs to clear will bite earlier. Please refer to our note on FCs.

[25] In respect of NFC+s, once the threshold has been exceeded in respect of any asset class, all eligible OTC derivative contracts, regardless of asset class, will need to be cleared.

[26] Including capital and margin requirements and liquidity risk controls. CCPs are dealt with at Article 14-54 EMIR.

[27] Multilateral netting does not itself remove credit risk, but reduces credit exposure between participants to the extent that it reduces the number and size of each party's transactions.

- an FC or an NFC+ (or third-country equivalent of an FC or NFC+); or
- two entities established in one or more third countries that would be subject to mandatory clearing obligations if they were EEA entities, provided that the EMIR Derivative that they have entered into has "*a direct, substantial and foreseeable effect within the Union*", or the obligation is necessary or appropriate to prevent the evasion of any provisions of EMIR. [28]

It follows from above that an NFC− is not required to clear its OTC EMIR Derivatives, even where its counterparty is an FC or an NFC+.

***"Eligible" EMIR Derivatives traded OTC***

The clearing obligation will only apply to those classes of EMIR Derivatives that a CCP has been authorised or recognised to clear and that ESMA has determined should be cleared. ESMA can also identify derivatives for clearing in circumstances where no CCP currently clears them.

Once the clearing obligation is declared to apply to a particular class of EMIR Derivatives traded OTC, it will apply to each transaction within that class entered into either (i) on or after the date which ESMA has established as the effective date for the obligation to clear that class; or (ii) on or after the (earlier) date on which ESMA receives notification from a national regulator that a CCP has become authorised to clear that derivatives class.

In accordance with Article 6 of EMIR, ESMA must establish and maintain a public register (which it shall publish on its website) identifying those classes of OTC derivatives subject to clearing. Identification of "eligible" EMIR Derivatives traded OTC will follow a two-fold approach:

- ***Top down***: ESMA can identify certain derivatives contracts to be cleared by an authorised CCP. Relevant factors include standardization of contracts, liquidity and reliability of available pricing. The effective date from which clearing is mandatory will be determined by the expected volume and the ability for CCPs to manage the volume.
- ***Bottom up***: Competent authorities of each member state must notify ESMA of contracts authorized for clearing in their member state. ESMA will then determine whether to require mandatory clearing of such contracts in all member states.

[28] The technical standards specifying the contracts that have a direct, substantial and foreseeable effect within the EU and the cases where it is necessary or appropriate to prevent evasion of EMIR are still under review and have not yet been published.

***Notification and clearing for NFCs+***

In accordance with Article 10(1) of EMIR, an NFC must immediately notify ESMA and the relevant competent authority (see *Notification* above) when it exceeds the clearing threshold, and must clear all future OTC derivative contracts through a CCP, regardless of asset class and whether they fall within the "hedging" exception or not, within a four month grace period of becoming subject to the clearing obligation.

Should the NFC+'s OTC derivatives positions fall below the clearing threshold at a later date (even during the four month grace period), it becomes a NFC– and the clearing obligation ends immediately.[29] Upon this occurrence, the NFC– should immediately notify ESMA and the relevant competent authority of this change. NFC–s based in England and Wales can find the relevant notification form on the FSA's notification webpage here.

NFCs will therefore need to put procedures and technology in place to permit them to continuously monitor their OTC derivatives positions (and that of their group) on a rolling 30 working day average basis.

***Indirect clearing***

In order to ensure that all types of market participants which are subject to the clearing requirement are able to access a CCP, EMIR provides for indirect CCP access through the services of an existing clearing member. For details on this please refer to our briefing note on FCs here.

***Timetable for NFC+ clearing***

Before the clearing obligation procedure can begin, CCPs must first be authorised (or recognised in case of a CCP from a third country) to clear under the new EMIR regime, and the list of "eligible" derivatives defined.

The European Parliament has recently voiced concern that NFCs+ should have sufficient time to adapt to the new regime, and the European Commission has agreed that clearing for NFCs+ should be phased in over "an appropriate period of time". This is suggested to be over a period of 3 years from the entry into force of the Regulation, although further precision here is awaited.

[29] Article 10(2) EMIR.

**Intragroup Exemption**

EMIR permits intragroup transactions (described in Article 3 of EMIR) to qualify for exemptions from the clearing obligation[30] and specific risk mitigation techniques[31] when certain conditions are met. In particular:

- An NFC wishing to use the ***clearing exemption*** for transactions with ***an affiliate established in the EEA*** must notify its relevant local regulator;
- an NFC wishing to use the ***clearing exemption*** for transactions with ***an affiliate established outside of the EEA*** must first apply to its relevant local regulator;
- an NFC wishing to use the exemption from ***margin requirements*** for transactions with ***an affiliate established in the same country*** may do so, provided that there is no legal impediment to the prompt transfer of own funds or repayment of liabilities between counterparties;
- in all other instances, ***an NFC wishing to use the exemption from margin requirements*** for transactions ***with an affiliate (either established in the EEA or a third country)*** will need to notify, or seek the prior approval of its local relevant regulator.[32]

The relevant criteria is essentially that:

- the risk management procedures of the counterparties are adequately sound, robust, and consistent with the level of complexity of the transactions; and
- there is no current or foreseeable practical or legal impediment to the prompt transfer of own funds and or repayment of liabilities between counterparties.

As mentioned above, although qualifying intragroup transactions may no longer be subject to clearing and certain risk mitigation techniques if the intragroup exemption applies, they will still be subject to the reporting obligation.

**PENALTIES**

EMIR provides that Member States must lay down penalties applicable to infringements of EMIR. The penalties must be effective, proportionate and dissuasive and include at least administrative fines. An infringement of EMIR will not affect the validity or enforceability of an OTC derivative contract, nor will it give rise to any right of compensation from a counterparty. We await details of such penalties from local relevant regulators, including the FSA.

[30] Article 4(2) EMIR.
[31] Articles 11(4) to (10) EMIR.
[32] We await additional guidance on the notification process.

| ***RISK MITIGATION TECHNIQUES*** | | | |
|---|---|---|---|
| ***Who?***<br>***(NFC-? NFC+?)***[33] | ***What?*** | ***When?*** | ***How?*** |
| ***Timely confirmation***[34] ***- Implementation date: 15 March 2013***[35] | | | |
| All NFCs | All EMIR Derivatives to be confirmed by set deadlines. Confirmation is defined as the documentation of the agreement of the counterparties to all the terms of the OTC derivative contract.[36] | As soon as possible and at the latest:<br>-for CDS/IRS with an NFC-: T+5 until 31 August 2013, then T+3 until 31 August 2014, then T+2<br>-for other types of contracts with a NFC−: T+7 until 31 August 2014, then T+4 until 31 August 2014, then T+2<br>- for CDS/IRS between FCs/NFCs+: T+2 until 28 February 2014, then T+1<br>-for other types of contracts between FCs/NFCs+: T+3 until 31 August 2013, then T+2 until 31 August 2014, then T+1<br>(*n.b.* If a transaction is concluded | Confirmation should be by electronic means, where available.<br>In terms of documenting the requirements, ISDA has released standard form wording.[37] |

33 The risk mitigation techniques that apply to FCs are discussed in another note.
34 Article 12 Technical Standard.
35 Article 21 Technical Standard.
36 Article 1(c) Technical Standard.
37 See http://www2.isda.org/functional-areas/protocol-management/protocol/11.

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| *RISK MITIGATION TECHNIQUES* | | | |
|---|---|---|---|
| ***Who?*** ***(NFC-? NFC+?)[33]*** | ***What?*** | ***When?*** | ***How?*** |
| | | after 16.00 local time, or with a counterparty located in a different time zone which does not allow confirmation by the set deadline, the counterparties may enjoy a one business day extension.) | |
| ***Portfolio reconciliation[38] - Implementation date: 15 September 2013[39]*** | | | |
| All NFCs | Agree in writing or other electronic means with each of its other counterparties the arrangements under which portfolios shall be reconciled (*Requirement 1*); and<br><br>Perform portfolio reconciliation on the key trade terms that identify each particular OTC derivative contract (including the mark-to-market / mark-to-model valuation[40]) (*Requirement 2*).<br><br>It should be noted that portfolio reconciliation is not defined in EMIR or the Technical Standard. | *Requirement 1*: Before entering into the OTC derivative contract<br><br>*Requirement 2*: For an FC or NFC+, portfolio reconciliation must be performed at least:<br><br>-daily if the counterparties have 500+ OTC derivative contracts outstanding with one another;<br><br>-weekly if the number of outstanding contracts is between 51 and 499; or<br><br>-quarterly if the number of | *Requirement 1*: ISDA is set to release guidance/standard wording in relation to this risk mitigation technique.<br><br>*Requirement 2*: This process can be outsourced to a duly qualified third party. |

38 Article 13 Technical Standard.
39 Article 21 Technical Standard.
40 See *Mark-to-Market (or Model)* section below.

| *RISK MITIGATION TECHNIQUES* | | | |
|---|---|---|---|
| ***Who?*** ***(NFC-? NFC+?)***[33] | ***What?*** | ***When?*** | ***How?*** |
| | | outstanding contracts is 50 or less.<br><br>For an NFC−, portfolio reconciliation must be performed at least:<br><br>-<u>quarterly</u> if the counterparties have more than 100 OTC derivative contracts outstanding with one another; or<br><br>-<u>annually</u> if the number of outstanding contracts is 100 or less. | |
| ***Portfolio compression***[41] ***- Implementation date: 15 September 2013***[42] | | | |
| All NFCs with 500 or more OTC derivative contracts outstanding with a single counterparty | Implement and maintain procedures to analyse the possibility of conducting a portfolio compression exercise in order to reduce their counterparty credit risk and engage in such portfolio compression exercise if warranted (*Requirement 1*).<br><br>Ensure that they are able to provide a reasonable and valid explanation to their | *Requirement 1*: At least bi-annually<br><br>*Requirement 2*: Ongoing | ISDA is set to release guidance/standard wording in relation to this risk mitigation technique. |

[41] Article 14 Technical Standard.
[42] Article 21 Technical Standard.

| *RISK MITIGATION TECHNIQUES* | | | |
|---|---|---|---|
| ***Who?*** ***(NFC-? NFC+?)***[33] | ***What?*** | ***When?*** | ***How?*** |
| | relevant local regulator for concluding that a portfolio compression exercise is not appropriate (*Requirement 2*). | | |
| ***Dispute Resolution***[43] ***– Implementation date: 15 September 2013***[44] | | | |
| All NFCs | Agree with counterparties and maintain detailed procedures and processes in relation to:<br><br>-the identification, recording, and monitoring of disputes relating to the recognition or valuation of the contract and to the exchange of collateral between counterparties (the procedures must at least record the length of time for which the dispute remains outstanding, the counterparty and the amount which is disputed); and<br><br>-the resolution of disputes in a timely manner with a specific process for those disputes that are not resolved within five business days. | When concluding an OTC derivative contract with another counterparty | ISDA is set to release guidance/standard wording in relation to this risk mitigation technique. |

[43] Article 15 Technical Standard.

[44] Article 21 Technical Standard.

| ***RISK MITIGATION TECHNIQUES*** | | | |
|---|---|---|---|
| ***Who?*** ***(NFC-? NFC+?)***[33] | ***What?*** | ***When?*** | ***How?*** |
| ***Mark-to-Market (or Model)*** [45] ***– In force from 16 August 2012***[46] | | | |
| Only NFCs+ | Mark-to-market the value of outstanding contracts. Where market conditions prevent marking-to-market[47], reliable and prudent marking-to-model must be used. | Exercise to be undertaken daily on an ongoing basis | The Technical Standard sets out specific criteria in relation to models for marking-to-model.[48] |
| ***Segregated Exchange of Collateral***[49] ***– In force from 16 August 2012***[50] | | | |
| Only NFC+ | Implement and maintain procedures for the timely, accurate and appropriate segregated exchange of collateral, other than in respect of certain intragroup transactions[51] . | Ongoing requirement | The precise level and exact type of collateral to be exchanged will be specified by further subordinate legislation, which is not due to come into force until next year.<br>Until then, counterparties have the freedom to apply their own rules on collateral.[52] |

45 Article 11(2) EMIR.
46 Article 91 EMIR.
47 The circumstances in which marking to model is acceptable are set out in Article 16 of the Technical Standard.
48 Article 17 Technical Standard.
49 Article 11(2) EMIR.
50 Article 91 EMIR.
51 Article 3, Article 11(5) and Article 11(6) of EMIR. The exemption is discussed in the Intragroup Exemption section above.
52 See ESMA's EMIR: Frequently Asked Questions (Updated: 8 February 2013).