The European Securities and Markets Association (ESMA)
103 Rue de Grenelle
Paris
75007
France

Attention: Rodrigo Buenaventura/Fabrizio Planta

12 March 2013

Dear Sirs,

The Alternative Investment Management Association (**AIMA**)[1] and Managed Funds Association (**MFA**[2], and together with AIMA, **we**) understand the European Securities and Markets Authority (**ESMA**) is in the process of preparing an updated list of questions and answers (**Q&As**)[3] in relation to the European Market Infrastructure Regulation (EU) No 648/2012 (**EMIR**).[4] We respectfully submit to ESMA this list of Q&As on key areas of uncertainty that our members believe warrant further clarification. We are hopeful that this list will aid ESMA in the formulation of its next set of Q&As. We believe that ESMA providing an updated list of Q&As will provide greater clarity and facilitate enhanced compliance within the regulated community.

Although this letter is confined to providing ESMA with key areas of uncertainty for our members, we note that several issues, particularly those issues raised in sections 1, 2 and 3 of the Appendix to this letter, relate to either: (1) the scope of EMIR's application to alternative investment funds (**AIFs**); or (2) impending obligations which arise immediately on the 15 March 2013 effective date of the European Commission Delegated Regulations (EU) No 148/2013 to 153/2013.[5] We, therefore, encourage ESMA to address these issues as a matter of particular urgency. Terms used but not defined in this letter and the Appendix hereto have the meanings given to such terms in EMIR and Directive 2011/61/EU (**AIFMD**).[6]

The key areas of uncertainty we raise in this letter are as follows:

1. Correct classification of AIFs under EMIR;

2. Counterparty obligations arising on 15 March 2013:

    (i) Risk mitigation requirements for daily valuation
        a. The use of the term "outstanding contracts" under Article 11(2) of EMIR;

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1 AIMA is the trade body for the hedge fund industry globally; our membership represents all constituencies within the sector – including hedge fund managers, fund of hedge fund managers, prime brokers, fund administrators, accountants and lawyers. Our membership comprises over 1,300 corporate bodies in over 40 countries.

2 Managed Funds Association represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent and fair capital markets. MFA, based in Washington, DC, is an advocacy, education and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry's contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, the Americas, Australia and all other regions where MFA members are market participants.

3 Most recent EMIR Q&As dated 8 February 2013, available at: http://ec.europa.eu/internal_market/financial-markets/docs/derivatives/emir-faqs_en.pdf.

4 Available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:201:0001:0059:EN:PDF.

5 Available at: http://eur-lex.europa.eu/JOHtml.do?uri=OJ:L:2013:052:SOM:EN:HTML.

6 Available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:174:0001:0073:EN:PDF.

b. Use of marking-to-model under Article 11(14)(b) of EMIR;

(ii) Risk-management procedures under Article 11(3) of EMIR; and
(iii) Application of Article 11 to third country entities (**TCEs**);

3. Counterparty obligations potentially arising on 1 July 2013 for credit and interest rate derivatives and 1 January 2014 for all other classes of derivatives

(i) Scope of the reporting obligation under Article 9 of EMIR; and
(ii) Obligation to avoid duplication under Article 9 of EMIR;
(iii) Risk mitigation requirements as relevant to reporting
   a. Mark-to-market or mark-to-model value reporting of OTC derivative contracts terminated prior to the reporting start date;
   b. Mark-to-market or mark-to-model value reporting of OTC derivative contracts entered into prior to the reporting start date

4. Counterparty obligations arising on 15 September 2013:

(i) Portfolio reconciliation and portfolio compression requirements under Article 11(1) of EMIR; and
(ii) Dispute resolution processes under Article 11(1) of EMIR; and

5. Implementing acts on equivalence under Article 13 of EMIR.

Our detailed Q&As are set out in the Appendix to this letter for your consideration.

We thank ESMA for the opportunity to highlight our key areas of uncertainty with respect to EMIR and the relevant level 2 measures. We hope that you find our questions and suggested answers helpful in respect of these concerns. We would welcome the opportunity to discuss the contents of this submission in greater detail. Please do not hesitate to contact Jiří Król, Adam Jacobs or Wesley Lund of AIMA at +44 (0) 20 7822 and Stuart J. Kaswell or Carlotta King of MFA at +1 (202) 730-2600 in this regard.

Yours faithfully,

/s/ Jiří Król

Jiří Król

Director of Government and Regulatory Affairs,
Alternative Investment Management
Association

/s/ Stuart J. Kaswell

Stuart J. Kaswell

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Appendix – List of Q&As

1. Classification of Alternative Investment Funds

The correct classification of entities under EMIR is of importance to all parties who enter into derivative contracts, as different obligations under EMIR will apply depending on how a party is classified (*e.g.*, as a financial counterparty (**FC**), non-financial counterparty (**NFC**) or TCE. However, there is particular uncertainty that arises in respect of the classification of AIFs under EMIR that our members believe is critical to clarify as a matter of urgency, particularly in light of the imminent entry into force on 15 March 2013 of certain obligations that apply to FCs and NFCs.[7]

We note that the definition of "financial counterparty" in Article 2 of EMIR includes "an alternative investment fund managed by [alternative investment fund managers (**AIFMs**)] authorised or registered in accordance with Directive 2011/61/EU". However, no EU AIFM may become so authorised or registered until July 2013 at the earliest and, under the provisions of AIFMD, EU AIFMs shall have until July 2014 to become authorised or registered. In addition, no non-EU AIFM may become so authorised or registered until the European Commission (**Commission**) adopts the relevant delegated act referred to in Article 67 of AIFMD, which may be as late as October 2015. It is, therefore, clear that, until the relevant AIFM becomes so authorised or registered, no AIF will be an FC under EMIR.

We have set out in the proposed Q&A below our members' understanding of the correct classification of AIFs, both before and after authorisation or registration of the relevant AIFM. For these purposes, we have distinguished between four different scenarios, based on the jurisdiction of establishment of the AIF and the jurisdiction of establishment of the AIFM. We have also set out explanations of these conclusions, based on the definitions in EMIR. We ask ESMA to confirm that the proposed Q&A correctly sets out how AIFs should be classified under EMIR.

Proposed Q&A:

How should alternative investment funds be classified under EMIR?

The definition of "financial counterparty" in Article 2 of European Market Infrastructure Regulation (EU) No 648/2012 includes "an alternative investment fund managed by AIFMs authorised or registered in accordance with Directive 2011/61/EU". Therefore, as from the date when the alternative investment fund manager of an alternative investment fund is authorised or registered in accordance with Directive 2011/61/EU, the alternative investment fund will be a financial counterparty.

Prior to such authorisation or registration, alternative investment funds will be either non-financial counterparties or third country entities, depending on the jurisdiction of their establishment. Alternative investment funds that are third country entities will then be subject to a further sub-classification and will be (for purposes of Articles 4(1)(a)(iv), 4(1)(a)(v) and 11(12) of European Market Infrastructure Regulation (EU) No 648/2012) a hypothetical "financial counterparties" or hypothetical "non-financial counterparties" depending on whether, if they were established in the EU, they would be financial counterparties or non-financial counterparties.

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[7] The FC and NFC obligations in effect on 15 March 2013 include: (i) the requirement for FCs and NFCs that enter into OTC derivative contracts to have appropriate procedures and arrangements in place in order to ensure that trades are confirmed, where available by electronic means, as soon as possible and at the latest within specific timelines that range from one to seven days, depending on the derivative class and the date when the trade was concluded; (ii) All FCs and NFCs that exceed the exposure thresholds set out in Article 11 of Commission Delegated Regulation 149/2013 are required to mark to market/mark to model on a daily basis the value of outstanding contracts; and (iii) all NFCs that are above one or more of the relevant clearing thresholds (as set out in Article 11 of Commission Delegated Regulation 149/2013) are required to immediately notify ESMA as well as the NFC's competent authority.

Below is the correct classification of alternative investment funds:

(1) <u>Non-EU</u> alternative investment fund <u>with a non-EU</u> alternative investment fund manager	
Currently	A non-EU alternative investment fund with a non-EU alternative investment fund manager would be a third country entity. For purposes of Articles 4(1)(a)(iv), 4(1)(a)(v) and 11(12) of European Market Infrastructure Regulation (EU) No 648/2012, a non-EU alternative investment fund with a non-EU alternative investment fund manager would currently be treated as a hypothetical "non-financial counterparty" because it is a third country entity that would be a non-financial counterparty if it were established in the EU. A non-EU alternative investment fund with a non-EU alternative investment fund manager would not currently be a financial counterparty or a hypothetical "financial counterparty" for purposes of the provisions referred to above because its non-EU alternative investment fund manager is not (and cannot be) authorised or registered under Directive 2011/61/EU at this stage.
Following authorisation or registration of the alternative investment fund manager under Directive 2011/61/EU (c. October 2015[8])	A non-EU alternative investment fund with a non-EU alternative investment fund manager would be a financial counterparty, if the non-EU alternative investment fund manager becomes authorised or registered under Directive 2011/61/EU. Until the time of such authorisation or registration, the non-EU alternative investment fund with a non-EU alternative investment fund manager would remain a third country entity and a hypothetical "non-financial counterparty" for the purposes of Articles 4(1)(a)(iv), 4(1)(a)(v) and 11(12) of European Market Infrastructure Regulation (EU) No 648/2012.
(2) <u>Non-EU</u> alternative investment fund <u>with an EU</u> alternative investment fund manager	
Currently	A non-EU alternative investment fund with an EU alternative investment fund manager would be a third country entity. For the purposes of Articles 4(1)(a)(iv), 4(1)(a)(v) and 11(12) of European Market Infrastructure Regulation (EU) No 648/2012, a non-EU alternative investment fund with an EU alternative investment fund manager would currently be treated as a hypothetical "non-financial counterparty" because it is a third country entity that would be a non-financial counterparty if it were established in the EU. A non-EU alternative investment fund with an EU alternative investment fund manager would not currently be a financial counterparty or a hypothetical "financial counterparty" for purposes of the provisions referred to above because no EU alternative investment fund manager can become authorised or registered under Directive 2011/61/EU until July 2013 at the earliest, and potentially as late as July 2014.
Following authorisation or registration of alternative investment fund manager under Directive	A non-EU alternative investment fund with an EU alternative investment fund manager would be a financial counterparty once the EU alternative investment fund manager becomes authorised or registered under Directive 2011/61/EU (as it will be required to

[8] Being the date by which the European Commission may be required to adopt the relevant delegated act referred to in Article 67 of Directive 2011/61/EU for purposes of Articles 37 to 41 of Directive 2011/61/EU.

2011/61/EU (c. July 2013 to July 2014)[9]	do).
(3) EU alternative investment fund with an EU alternative investment fund manager	
Currently	An EU alternative investment fund with an EU alternative investment fund manager would be a non-financial counterparty. An EU alternative investment fund with an EU alternative investment fund manager would not currently be a financial counterparty or a hypothetical "financial counterparty" because its EU alternative investment fund manager is not (and cannot be) authorised or registered under Directive 2011/61/EU until July 2013 at the earliest, and potentially as late as July 2014.
Following authorisation or registration of alternative investment fund manager under Directive 2011/61/EU (c. July 2013 to July 2014)	An EU alternative investment fund with an EU alternative investment fund manager would be a financial counterparty once the EU alternative investment fund manager becomes authorised or registered under Directive 2011/61/EU (as it will be required to do).
(4) EU alternative investment fund with a non-EU alternative investment fund manager	
Currently	An EU alternative investment fund with a non-EU alternative investment fund manager would be a non-financial counterparty because the non-EU alternative investment fund manager is not (and cannot be) authorised or registered under Directive 2011/61/EU at this stage.
Following authorisation or registration of alternative investment fund manager under Directive 2011/61/EU (c. October 2015)	An EU alternative investment fund with a non-EU alternative investment fund manager would be a financial counterparty once the non-EU alternative investment fund manager becomes authorised or registered under Directive 2011/61/EU (as it may be required to do, as it is an alternative investment fund manager of an EU alternative investment fund).

2. Counterparty obligations arising on 15 March 2013

i. Risk mitigation requirements for daily valuation

a. Use of term "outstanding contracts" under Article 11(2) of EMIR

We note that Article 11(2) of EMIR does not define the term "outstanding contracts", but it is important for purposes of providing clarity with respect to Commission Delegated Regulation (EU) No 149/2013 for risk mitigation techniques.[10] The meaning of this term is important because counterparties need to know whether the requirement under to either mark-to-market or mark-to-model all outstanding OTC derivative contracts applies to: (1) all contracts regardless of when the parties entered into them, or (2) only outstanding OTC derivative contracts entered into on or after EMIR came into force.

Proposed Q&A:

Is the reference to "outstanding contracts" in Article 11(2) of the European Market Infrastructure Regulation (EU) No 648/2012 a reference to all OTC derivative contracts regardless of when entered into or a reference to such contracts entered into on or after 16

[9] Being the date by which the alternative investment fund manager is required to submit an application for authorisation under Directive 2011/61/EU, see Article 61(1) Directive 2011/61/EU.

[10] Available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:052:0011:0024:EN:PDF.

August 2012 (i.e., the date when European Market Infrastructure Regulation (EU) No 648/2012 came into force)?

Article 11(2) captures all uncleared OTC derivative contracts that are "outstanding" on 15 March 2013, regardless of the date when the parties entered into the contract, because Commission Delegated Regulation (EU) No 149/2013 enters into force on that date. The approach of using 15 March 2013 as the relevant date is consistent with Commission Implementing Regulation (EU) No 1247/2012,[11] which requires market participants to report mark-to-market or mark-to-model valuations daily, and with European Market Infrastructure Regulation (EU) No 648/2012, which requires market participants to report OTC derivative contracts outstanding on 16 August 2012 regardless of whether market participants had entered into such OTC derivative contracts prior to this time.

b. Use of marking-to-model under Article 11(14)(b) of EMIR

Article 11(2) of EMIR provides that FCs and NFCs exceeding the prescribed clearing threshold should mark-to-market the value of outstanding OTC derivative contracts on a daily basis. Where market conditions prevent marking-to-market, FCs and NFCs shall use "reliable and prudent marking-to-model". Article 17(e) of Commission Delegated Regulation (EU) No 149/2013 specifies that the board of directors of FCs and NFCs must duly document and approve as frequently as necessary, following any material change and at least annually any model used by such FCs and NFCs when marking-to-model. Article 17(e) also specifies that the board may delegate its approval to a committee.

Market participants are uncertain as to the level of detail required with respect to models that are approved by an FC's or NFC's board of directors (or the relevant delegated committee of such board), in particular because market participants consider that they may only be able to determine certain issues relating to the operation of the model at the time when they use the model. Market participants are also uncertain as to the basis on which a board may delegate its approval for any models. Recital (34) of Commission Delegated Regulation (EU) No 149/2013 states that, although FCs and NFCs may develop the design of the model internally or externally, accountability rests with either "the board of directors or the delegated committee of such board". It is not clear, for instance, whether such delegated committee may be: (1) an externally appointed investment manager, (2) an internal appointment - which is challenging in the case of AIFs because they usually have no employees - that reports to the board of directors, or (3) both.

A further question arises where the entity in question does not have a "board of directors" (*e.g.*, a partnership or some other form of organisation that does not have a board of directors). Any market participant comprising such an entity requires guidance on this issue in order to make sure that the model is approved by it in accordance with EMIR.

Proposed Q&A:

With respect to Article 17(e) of Commission Delegated Regulation (EU) No 149/2013: (1) what level of detail is required with respect to models which a financial counterparty or non-financial counterparty's board of directors have approved; (2) what level of delegation is permitted by the board of directors; and (3) where an entity does not have a board of directors who should perform the relevant function for these purposes?

Given that it is difficult to assume the precise conditions that might exist at the time that a financial counterparty or non-financial counterparty might need to mark-to-model, ESMA understands that financial counterparties and non-financial counterparties will need to determine certain issues in relation to the operation of the model (such as how to most accurately price a particular asset) at the time that they use the model. When developing and using a model, financial counterparties and non-financial counterparties should bear in mind the overriding objective in Article 11(2) of European Market Infrastructure Regulation (EU) No 648/2012 is that they should use "reliable and prudent marking-to-model". If the board of directors of the financial counterparty or

[11] Available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:352:0020:0029:EN:PDF.

non-financial counterparty is satisfied that the financial counterparty or non-financial counterparty can only determine certain issues in a reliable and prudent manner based upon market conditions that exist at the time when the financial counterparty or non-financial counterparty uses the model, then ESMA considers that it is acceptable for the financial counterparty or non-financial counterparty to determine such issues at such later time.

ESMA understands the need for a board of directors to ensure that those persons with the relevant level of expertise be permitted to assess the merits of the model and the model's compliance with the criteria specified in European Market Infrastructure Regulation (EU) No 648/2012 and Commission Delegated Regulation (EU) No 149/2013. Consequently, ESMA recognises the need for such experts ultimately to approve the model based on their expert assessment. The board of directors of a financial counterparty or non-financial counterparty may, therefore, delegate approval of the model to: (1) externally appointed investment professional(s), acting on behalf of a financial counterparty or non-financial counterparty; (2) an internally appointed committee of the board of directors, or (3) a committee comprising a combination of (1) and (2); provided that, accountability for the model rests always with the board of directors of the financial counterparty or non-financial counterparty.

ESMA further understands that not all entities subject to Article 11(2) of European Market Infrastructure Regulation (EU) No 648/2012 will have a board of directors. In these circumstances, references to the board of directors should be construed by the entity to be a reference to the decision making body that undertakes functions similar to those undertaken by a board of directors.

ii. Risk-management procedures under Article 11(3) of EMIR

With respect to uncleared OTC derivative contracts, Article 11(3) of EMIR requires FCs and NFCs that exceed the clearing threshold to have in place "risk-management procedures that require the timely, accurate and appropriately segregated exchange of collateral with respect to OTC derivative contracts that are entered into on or after" 16 August 2012 or when the clearing threshold is exceeded. Item I.6 of the Commission's "EMIR: Frequently Asked Questions" document,[12] which relates to Article 11(3) of EMIR, states that the requirements of Article 11(3) will apply to relevant OTC derivative contracts "concluded as of the date that" that the relevant Commission Delegated Regulation enters into force.

We understand the Commission's reference to "concluded" to refer to OTC derivative contracts entered into on or after the date on which the relevant Commission Delegated Regulation comes into force. This approach reflects the fact that retroactive requirements in respect of collateral exchange might contradict the terms of existing contracts, whilst also invalidating their pricing assumptions. We ask ESMA to confirm that this reading is the correct reading of the Commission's response, which would also prevent unnecessary market uncertainty about whether obligations will apply to market participants retroactively.

Proposed Q&A:

Item I.6 of the Commission's "EMIR: Frequently Asked Questions" document, which relates to Article 11(3) of European Market Infrastructure Regulation (EU) No 648/2012, confirms that the requirements of Article 11(3) will apply to relevant OTC derivative contracts "concluded as of the date that" the related Commission Delegated Regulation enters into force. What does "concluded as of the date that" mean in this context?

"Concluded as of the date that" means that the requirements of Article 11(3) will apply to OTC derivative contracts entered into on or after the date on which the relevant Commission Delegated Regulation comes into force.

[12] Available at: http://ec.europa.eu/internal_market/financial-markets/docs/derivatives/emir-faqs_en.pdf.

iii. Application of EMIR to TCEs

Articles 13 and 14 of Commission Delegated Regulation (EU) No 149/2013 refer to portfolio reconciliation and compression taking place with each "counterparty" of a FC or NFC, which implies that these Articles may apply to TCEs as counterparties to FCs and NFCs. In contrast, Articles 12 and 15 of the Delegated Regulation appear to envisage timely confirmation and dispute resolution procedures being put in place only where contracts are concluded between FCs and NFCs, which suggests that these Articles do not apply to TCEs because TCEs would not be FCs or NFCs. The differing wording in EMIR could create uncertainty in respect of the scope of the application of EMIR to TCEs.

We believe that the Commission's intention was to apply EMIR to TCEs where, as set out in: (1) Article 4(1)(a)(iv), the TCE's counterparty is an FC or NFC meeting the prescribed conditions; and (2) Articles 4(1)(a)(v) and 11(12), the TCE's counterparty is another TCE and the circumstances set out in such Articles apply. This approach is also consistent with Recital (23) of EMIR. Therefore, we encourage ESMA to clarify that our understanding is correct as to which provisions of EMIR apply to TCEs.

Proposed Q&A:

What provisions of European Market Infrastructure Regulation (EU) No 648/2012 apply to third country entities?

A third country entity is required to comply with European Market Infrastructure Regulation (EU) No 648/2012 in the circumstances set out in Articles 4(1)(a)(iv) (where its counterparty is a financial counterparty or non-financial counterparty meeting the prescribed conditions), 4(1)(a)(v) (where its counterparty is another third country entity) and 11(12) (where its counterparty is another third country entity) thereof. This application is consistent with Recital (23) of European Market Infrastructure Regulation (EU) No 648/2012, which states that "to foster financial stability within the Union, it might be necessary also to subject transactions entered into by third country entities to the clearing and risk mitigation techniques obligations provided that the transactions concerned have a direct, substantial and foreseeable effect within the EU or where such obligations are necessary or appropriate to prevent the evasion of any provisions of" European Market Infrastructure Regulation (EU) No 648/2012. These foregoing provisions of European Market Infrastructure Regulation (EU) No 648/2012 are the only provisions that bind third country entities and Commission Delegated Regulation (EU) No 149/2013 should be construed accordingly.

3. Reporting start date of 1 July 2013 and 1 January 2014 for credit and interest rate derivatives and for all other classes, respectively (assuming a trade repository (TR) is registered under EMIR by the relevant deadline).

i. Scope of reporting obligation under Article 9 of EMIR

We note that Article 9 of EMIR places the reporting obligation on "counterparties"; however, none of EMIR, the draft delegated regulations or the implementing regulations define that term. Table 1 of the Annex to the Commission Delegated Regulation (EU) No 148/2013[13] sets out a data field under which a reporting counterparty is requested to specify the "[f]inancial or non-financial nature of the counterparty". It further requires the reporting counterparty to "[i]ndicate if the reporting counterparty is a financial ***or*** non-financial counterparty in accordance with points 8 and 9 of Article 2 of Regulation (EU) No 648/2012." (emphasis added). Therefore, this phrase would suggest that the reporting obligation applies only to an FC or an NFC, and that ESMA intends the term "counterparties" to refer to an FC or NFC for purposes of the reporting obligation under Article 9 of EMIR. We ask ESMA to confirm this intention as set out below in a suggested Q&A.

[13] Commission Delegated Regulation (EU) No 148/2013, available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:052:0001:0010:EN:PDF.

Proposed Q&A:

Who is subject to the reporting obligation in Article 9 of European Market Infrastructure Regulation (EU) No 648/2012?

The reporting obligation in Article 9 of European Market Infrastructure Regulation (EU) No 648/2012 applies to "counterparties" and central counterparties. For purposes of that reporting obligation, any references to "counterparties" in European Market Infrastructure Regulation (EU) No 648/2012 and the relevant delegated and implementing regulations shall mean "financial counterparties" and "non-financial counterparties", as defined in Articles 2(8) and 2(9) of European Market Infrastructure Regulation (EU) No 648/2012[14] (including in this context the entities listed in Article 1(5) of European Market Infrastructure Regulation (EU) No 648/2012).[15]

ii. Obligation to avoid duplication under Article 9 of EMIR

Article 9(1) of EMIR permits delegation of the reporting requirement and places an obligation on counterparties to ensure that they report contracts "without duplication". We understand that ESMA is in favour of centralised reporting (*i.e.*, receiving a single report in respect of a single derivative contract, rather than multiple reports in respect of a single derivative contract).

Our members are also strongly in support of centralised reporting by their counterparties (who are highly likely to be FCs) or the relevant CCP. Our members believe that a single report in respect of a single derivative contract would be beneficial to all parties because it would eliminate the duplicative reporting problem for trade repositories and would alleviate the large administrative and operational burden on our members if they were unable to delegate their obligation to report.[16]

We ask ESMA to confirm that counterparties to a derivatives contract are under an obligation to consider delegation of the reporting obligation to a single party, wherever possible. We propose below a suggested Q&A.

Proposed Q&A:

What does the Article 9(1) obligation to ensure reporting "without duplication" mean?

The obligation to report derivative contracts pursuant to Article 9 of European Market Infrastructure Regulation (EU) No 648/2012 applies to "counterparties" and central counterparties. Article 9(1) requires counterparties and central counterparties to ensure that the details of their derivative contracts are reported without duplication and expressly permits a counterparty or central counterparty to delegate its reporting obligation.

ESMA is in favour of centralised reporting and encourages counterparties and central counterparties to seek to ensure that a single report is submitted in respect of a single derivative contract, rather than multiple reports in respect of a single derivative contract. However, the precise terms of the delegation are a matter of agreement between the counterparties and central counterparties.

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[14] (8) "financial counterparty" means an investment firm authorised in accordance with Directive 2004/39/EC, a credit institution authorised in accordance with Directive 2006/48/EC, an insurance undertaking authorised in accordance with Directive 73/239/EEC, an assurance undertaking authorised in accordance with Directive 2002/83/EC, a reinsurance undertaking authorised in accordance with Directive 2005/68/EC, a UCITS and, where relevant, its management company, authorised in accordance with Directive 2009/65/EC, an institution for occupational retirement provision within the meaning of Article 6(a) of Directive 2003/41/EC and an alternative investment fund managed by AIFMs authorised or registered in accordance with Directive 2011/61/EU; (9) "non-financial counterparty" means an undertaking established in the Union other than the entities referred to in points (1) and (8).

[15] Excluding the following entities from the Article 9 reporting obligation: (a) multilateral development banks, as listed under Section 4.2 of Part 1 of Annex VI to Directive 2006/48/EC; (b) public sector entities within the meaning of point (18) of Article 4 of Directive 2006/48/EC where they are owned by central governments and have explicit guarantee arrangements provided by central governments; (c) the European Financial Stability Facility and the European Stability Mechanism.

[16] We also note that, in the US, the Commodity Futures Trading Commission rules have a clear structure as to which counterparty has the obligation to report – *i.e.*, if one counterparty is a swap dealer, the swap dealer shall be the reporting counterparty, see Section 45.8, Title 17 of the Code of Federal Regulations.

iii. Risk mitigation requirements as relevant to reporting

a. Mark-to-market or mark-to-model value reporting of OTC derivative contracts entered into prior to the reporting start date

Article 2 of Commission Implementing Regulation (EU) No 1247/2012 provides that counterparties should report on a daily basis to a trade repository the mark-to-market or mark-to-model valuations of OTC derivative contracts determined pursuant to Article 11(2) of EMIR. As Article 9(1) of EMIR requires counterparties to report the details of derivative contracts entered into prior to the reporting start date,[17] market participants require clarification as to whether they are required to report the mark-to-market or mark-to-model valuations applicable to such derivative contracts on each day prior to the reporting start date. The purpose of phasing in reporting start dates is to enable participants to prepare systems and processes to operate from the reporting start date onwards. We, therefore, do not believe it is necessary to report the mark-to-market or mark-to-model value of OTC derivative contracts entered into prior to the reporting start date, and providing clarity on this point will assist market participants in preparing for the reporting start date.

Proposed Q&A:

Under Article 2 of Commission Implementing Regulation (EU) No 1247/2012, is it necessary to report the mark-to-market/mark-to-model value of OTC derivative contracts entered into prior to the reporting start date for any day prior to that date?

ESMA does not consider the reporting of mark-to-market or mark-to-model values of OTC derivatives contracts that existed prior to the reporting start date of particular relevance for regulatory purposes. The reporting party must report such values for existing OTC derivatives contracts beginning on the reporting start date and continuing each day afterwards.

b. Mark-to-market or mark-to-model value reporting of OTC derivative contracts terminated prior to the reporting start date

As noted above, Article 2 of Commission Implementing Regulation (EU) No 1247/2012 provides that counterparties should report on a daily basis to a trade repository the mark-to-market or mark-to-model valuations of OTC derivative contracts determined pursuant to Article 11(2) of EMIR. As Article 9(1) of EMIR requires counterparties to report derivative contracts that were outstanding when EMIR entered into force but that terminated prior to the reporting start date, market participants require clarification as to whether they are required to report the mark-to-market or mark-to-model valuations applicable to such terminated derivative contracts on any day prior to the reporting start date. Recital (5) of Commission Implementing Regulation (EU) No 1247/2012 states that OTC derivative contracts that terminate prior to the reporting start date "are not of major relevance for regulatory purposes". We, therefore, do not believe it is necessary to report the mark-to-market or mark-to-model values of such terminated OTC derivative contracts, and providing clarity on this point will assist market participants in preparing for the reporting start date.

Proposed Q&A:

Under Article 2 of Commission Implementing Regulation (EU) No 1247/2012, is it necessary to report the mark-to-market or mark-to-model value of OTC derivative contracts that terminate prior to the reporting start date?

ESMA does not consider the reporting of mark-to-market or mark-to-model values that existed in respect of OTC derivative contracts that have terminated prior to the reporting start date of particular relevance for regulatory purposes, and thus, counterparties do not need to report such values.

[17] Potentially arising on 1 July 2013 for credit and interest rate derivatives and 1 January 2014 for all other classes of derivatives.

4. Counterparty obligations arising on 15 September 2013

i. Portfolio reconciliation and portfolio compression requirements under Article 11(1) of EMIR

Article 11(1) of EMIR requires FCs and NFCs entering into uncleared OTC derivative contracts to ensure that "formalised processes" are in place for portfolio reconciliation and portfolio compression. However, it is unclear whether this requirement applies to contracts entered into prior to the date on which such requirements apply. In the interest of consistency with the approach to Article 11(3) of EMIR, as discussed above, we believe that Article 11(1) should not apply to such contracts, and instead should apply only in respect of OTC derivative contracts entered into on or after the date on which such requirements first apply in accordance with Article 21 of Commission Delegated Regulation (EU) No 149/2013 (*i.e.*, being 15 September 2013, which will be six months from the date on which such Commission Delegated Regulation is in force).

Proposed Q&A:

Do the portfolio reconciliation requirements and/or the portfolio compression requirements in Article 11(1) of the European Market Infrastructure Regulation (EU) No 648/2012 apply to uncleared OTC derivative contracts entered into prior to the date on which such requirements first apply?

Article 13 of Commission Delegated Regulation (EU) No 149/2013 explicitly provides that financial counterparties and non-financial counterparties should reach agreement on the terms of portfolio reconciliation "before entering into the OTC derivative contract" such that this agreement will apply to OTC derivative contracts entered into on or after the time such Article comes into force. Although there is no express requirement for prior agreement with respect to portfolio compression in Article 14 of such Commission Delegated Regulation, given that both Articles 13 and 14 apply at the same time, ESMA considers that both Articles should apply in the same manner to the same OTC derivative contracts. Therefore, the portfolio reconciliation requirements and the portfolio compression requirements need only apply in respect of OTC derivative contracts entered into on or after the date such requirements first apply in accordance with Article 21 of Commission Delegated Regulation (EU) No 149/2013 (*i.e.*, being 15 September 2013, which will be six months from the date on which such Commission Delegated Regulation is in force).

ii. Dispute resolution processes under Article 11(1) of EMIR

Article 11(1) of EMIR requires FCs and NFCs entering into uncleared OTC derivative contracts to ensure that "formalised processes" are in place to identify disputes early and resolve them. Once again, in the interests of consistency with the approach to Article 11(3) of EMIR, as discussed above, ESMA should make clear that dispute resolution requirements apply in respect of OTC derivative contracts entered into on or after the date such requirements first apply in accordance with Article 21 of Commission Delegated Regulation (EU) No 149/2013 (*i.e.*, being 15 September 2013, which is six months from the date on which such Commission Delegated Regulation is in force). Furthermore, in preparation for this requirement coming into force, it is necessary to clarify whether FCs and NFCs must produce such formalised processes in written form.

Proposed Q&A:

Do the dispute resolution requirements in Article 11(1) of European Market Infrastructure Regulation (EU) No 648/2012 apply to uncleared OTC derivative contracts entered into prior to the date on which such requirements first apply? Do the dispute resolution requirements in Article 11(1) of European Market Infrastructure Regulation (EU) No 648/2012 require financial counterparties and non-financial counterparties to produce dispute resolution processes in written form?

Article 15 of Commission Delegated Regulation (EU) No 149/2013 explicitly provides that counterparties should have an agreement on dispute resolution requirements in place when "concluding OTC derivative contracts with each other" such that this agreement will apply to OTC

derivative contracts entered into between such counterparties on or after the time such article comes into force. ESMA considers that the dispute resolution requirements apply in respect of OTC derivative contracts entered into on or after the date such requirements first apply in accordance with Article 21 of Commission Delegated Regulation (EU) No 149/2013 (*i.e.*, being 15 September 2013, which is six months from the date on which such Commission Delegated Regulation is in force).

Financial counterparties and non-financial counterparties should interpret the reference to "formalised processes" (emphasis added) in Article 11(1) of European Market Infrastructure Regulation (EU) No 648/2012 as a requirement to ensure that the counterparties' dispute resolution processes shall be in written form.

5. Implementing acts on equivalence under Article 13 of EMIR

Article 13 of EMIR permits the Commission to adopt implementing acts declaring a third country's legal, supervisory and enforcement arrangements to be (amongst other things) equivalent to the requirements of Articles 4, 9, 10 and 11 of EMIR. Where the Commission has adopted an implementing act with respect to a third country, EMIR deems counterparties entering into a derivative contract subject to EMIR to satisfy the requirements of Articles 4, 9, 10 and 11; provided that, at least one of the counterparties is established in the relevant third country. The meaning of the word "established" in Article 13 is unclear and should be interpreted so as not to result in market participants having to comply with duplicative and conflicting requirements (which Article 13(1) expressly sets out to avoid).

Proposed Q&A:

Where the Commission has adopted an implementing act pursuant to Article 13 of European Market Infrastructure Regulation (EU) No 648/2012 declaring a third country's legal, supervisory and enforcement arrangements to be (amongst other things) equivalent to the requirements of Articles 4, 9, 10 and 11 of European Market Infrastructure Regulation (EU) No 648/2012, if a financial counterparty or non-financial counterparty and a third country entity are complying with that third country's laws, but neither is established (in the sense of being organised or physically located) in that third country, may the parties to the OTC derivative contract take the benefit of Article 13?

The purpose of Article 13 is to allow the Commission to adopt implementing acts on equivalence, which would have the effect of releasing counterparties from the obligation to comply with certain aspects of European Market Infrastructure Regulation (EU) No 648/2012 where those counterparties are instead operating in compliance with a third country's legal, supervisory and enforcement arrangements in respect of which the Commission has adopted such implementing act. For purposes of Article 13, a party may be said to be "established" in the third country, if it is being regulated pursuant to or complying with that third country's regime by reason of some "nexus" to the third country. For example, an investment fund based in Third Country X may be acting in compliance with the laws of Third Country Y, where its investment manager is based. If the Commission has adopted an implementing act on equivalence in respect of Third Country Y, then in these circumstances, due to the investment manager, the investment fund is "established" in Third Country Y.