EMIR: Risk mitigation

July 2013

This document provides information for clients established in the European Economic Area (EEA) that execute OTC derivative products with BNP Paribas.

Summary of obligations & deadlines:

EMIR introduced a number of risk mitigation obligations with respect to non-cleared OTC derivatives contracts. These obligations are being phased in during the course of 2013 (as set out below) and from 2015 with respect to bilateral margining.

The first "early stage" risk mitigation obligations came into force on 15 March 2013:

a) The obligation on all financial and non-financial counterparties to obtain timely confirmation of new OTC derivatives transactions. There are no exceptions to this requirement for EU established financial and non-financial counterparties within the scope of EMIR;

b) The obligation that all financial counterparties and non-financial counterparties (which have crossed the clearing threshold) must begin, if they are not already doing so, conducting daily mark-to-market valuations of non-cleared OTC derivative transactions that are outstanding on or after 15 March 2013.

On 15 September 2013, the second group of risk mitigation obligations come into force, namely portfolio reconciliation, dispute resolution and portfolio compression. These obligations are the immediate focus of this communication.

Portfolio Reconciliation and Dispute Resolution

What are our obligations?

a) The basic requirements are that:

   a. Counterparties must agree processes, either directly with each other or through a qualified third party (such as TriOptima), for portfolio reconciliation (PR) of non-cleared (collateralised or non-collateralised) OTC derivatives; and

   b. Counterparties must also agree on monitoring and dispute resolution (DR) in a timely manner, with a specific escalation process for those disputes that are not resolved within five business days. BNP Paribas will have to report to its Competent Authority any disputes that are outstanding for more than 15 business days where the amount in dispute is over 15 Million EUR.

b) These obligations are imposed directly on all EU established financial counterparties (FC), non-financial counterparties (NFC) and non-financial counterparties which exceed the clearing threshold (NFC+) and who enter into OTC derivative contracts which are not cleared.

c) From 15 September 2013, PR and DR processes should be agreed between counterparties before trading.

19 July 2013

Regulation | **EMIR**

Timelines

15 March 2013
The first "early stage" risk mitigation obligations came into force

15 September 2013
The second group of risk mitigation obligations come into force, namely portfolio reconciliation, dispute resolution and portfolio compression

Further information

If you wish to discuss further, please contact the BNP Paribas European Regulatory Reforms team (Regreform.eu@uk.bnpparibas.com) or your BNP Paribas Relationship Manager or Sales Representative.

The frequency with which PR needs to be undertaken depends upon the classification of the counterparty as an FC/NFC+ or an NFC and the number of trades outstanding between the relevant counterparties:

Counterparty type	Portfolio size	Frequency
Financial or NFC +	▪ Portfolio ⇒500 swaps ▪ 50 swaps >portfolio > 500 swaps ▪ Portfolio = <50 swaps	▪ Daily ▪ Weekly ▪ Quarterly
NFC	▪ Portfolio > 100 swaps ▪ Portfolio = < 100 swaps	▪ Quarterly ▪ Annually

What is portfolio reconciliation?

A portfolio reconciliation process enables two counterparties to undertake a comprehensive review of a portfolio of transactions with a view to identifying any discrepancies of material trade terms.

What reconciliation options are available?

BNP Paribas is proposing three options to facilitate compliance with the portfolio reconciliation obligation:

- One-way delivery (or circularisation):
  - BNP Paribas provides portfolio data to its counterparty
    - BNP Paribas' counterparty reviews the portfolio data and identifies discrepancies. In order to facilitate the process, and subject to the relevant regulatory approvals, BNPP will propose a "negative affirmation" approach (i.e. that the portfolio data is deemed accepted unless discrepancies are identified in a pre-defined timeframe)
  - Both BNP Paribas and its counterparty resolve portfolio breaks in a timely fashion.
- TriOptima adherent reconciliation:
  - Each Party provides portfolio data to TriOptima
  - TriOptima performs a reconciliation of such portfolio data
  - Each party reviews the portfolio data in accordance with the relevant notice dates or the applicable frequency as set out above
  - Portfolio breaks to be resolved in a timely fashion.
- Bilaterally agreed process:
  - Each Party provides portfolio data to the other Party in accordance with the notice procedures agreed bilaterally
  - Either Party performs a reconciliation of such portfolio data (as agreed bilaterally in the documentation between them)
  - Portfolio breaks to be resolved in a timely fashion.

What documentation will need to be put in place between BNP Paribas and its counterparties in relation to portfolio reconciliation and dispute resolution?

ISDA has released a protocol (ISDA Protocol) which is designed to allow parties to meet the relevant requirements under EMIR. The ISDA Protocol is broad enough to cover relationships in relation to non-cleared OTC Derivatives which are not governed by an ISDA Master Agreement. We encourage parties to adhere to this protocol as this avoids the need for bilateral negotiation of separate agreements with each of your counterparties (including BNP Paribas), as long as they too have adhered to this protocol. We also note that other industry bodies have either issued or are contemplating documentation in this regard for other local law governed OTC documentation.

Portfolio compression

What are our obligations?

a) EMIR imposes an obligation on all FC, NFC and NFC+ counterparties established in the EU, who have 500 or more non-cleared OTC derivative contracts outstanding with a counterparty, to have in place procedures to regularly analyse the possibility to compress their portfolio in order to reduce their counterparty credit risk.

   a. This portfolio compression analysis must be performed at least twice a year.

b) If an FC, NFC or NFC+ concludes that portfolio compression is not appropriate, it must be able to provide a reasonable and valid explanation to its relevant competent authority for such conclusion. Examples include: the portfolio is purely directional and does not allow any offsetting transactions, multilateral compression services are not available in the relevant markets or products, and bilateral compression is not feasible.

c) Portfolio compression does not prevent an offsetting transaction from being concluded with a counterparty that is different from the counterparty in the initial transaction.

What is a compression?

Portfolio compression is an exercise by which two (bilateral compression) or several (multilateral compression) entities attempt to reduce the total gross notional and the number of outstanding non-cleared OTC derivatives trades without changing the risk exposure and present value of the portfolio. This is achieved by the termination of existing trades and their replacement by a smaller number of new trades (potentially with a different counterparty when undertaken on a multilateral basis).

What is BNP Paribas doing?

BNP Paribas is currently conducting an internal analysis to identify impacted counterparties. To comply with its EMIR obligations, BNP Paribas will conduct regular analysis of the portfolios of outstanding non-cleared OTC derivatives with its counterparties. The purpose of this exercise is to identify the potential compression opportunities prior to contacting their counterparty to organise it. Do not hesitate to contact us should you have any question relating to this process.

What documentation will need to be put in place between BNP Paribas and its counterparties?

The industry bodies have not produced any protocol or specific documentation to address portfolio compression concerns. Should you choose to go through entities such as Trioptima to perform your compression, we expect them to provide you with their own standard terms and conditions to which you will have to sign up.

Where clients do not have the facility or systems to interface with Trioptima (and others) directly, bilateral compression with BNP Paribas will be required. BNP Paribas will assist in processing your compression on a bilateral basis. Terms and conditions will be agreed at the time of the portfolio analysis based on the population of trades you have with us.