

***ISDA Commentary on ESMA RTS on Confirmations (in European Commission Delegated Regulation C(2012) 9593 final (19 December 2012))***

*29 January 2013*

**A Introduction**

We welcome the opportunity to comment on the final Regulatory Technical Standards (RTS) on EMIR, covering OTC derivatives, CCPs and Trade Repositories, endorsed by the European Commission on 19 December 2012. In this note we comment specifically on the RTS on trade confirmations. In light of the short time allowed for market participants to ready themselves for implementation, industry is working quickly to prepare, in particular through various ISDA committees.

Since 1985, ISDA has worked to make the global over-the-counter (OTC) derivatives markets safer and more efficient. Today, ISDA has over 800 member institutions from 60 countries. These members include a broad range of OTC derivatives market participants including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure including exchanges, clearinghouses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's web site: [www.isda.org](http://www.isda.org).

ISDA recognizes the importance of the RTS addressing the issue of timely confirmation of OTC derivatives and strongly supports initiatives that enhance market efficiency and soundness. We further underline that the views addressed in this document should be seen in the context of our ongoing desire and commitment to enhanced operational infrastructure and safe and efficient post-trade processes, as shown by the industry's efforts and achievements under the 'Fed letter' process.<sup>1</sup> Indeed, we welcome the majority of the RTS, as a means of reducing risk in derivatives business and recognise the tireless work of the EC and ESMA towards delivery of G20 objectives and deadlines.

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<sup>1</sup> Commencing in 2005, market participants (including major dealers and buy-side firms) have, through active dialogue with members of the Global Regulatory community (through the OTC Derivatives Supervisors' Group ("ODSG")) regularly set and updated goals and commitments to bring infrastructure, market design and risk management improvements to all OTC derivatives asset classes. It is undisputable that documentation standards in derivatives business have improved considerably due to these efforts. In the case of the majority of the targets set via this process, the industry is meeting or exceeding expectations.

Nevertheless, this paper addresses points where we would welcome helpful, non-exhaustive guidance (in keeping with recital 26 of the RTS) on the meaning of the RTS. Such clarity is key to compliance efforts, and would be particularly appreciated as, despite the initial appearance of alignment, the RTS addressing confirmations go further than the requirements under the CFTC regime, differing significantly in product scope (particularly regarding coverage of CDS and equity derivatives) and in the extent to which burdens of compliance fall on different counterparties (particularly the case for dealer-client trades, where compliance is not fully within either market participant's control under the RTS).

## **B Detailed Concerns**

### **1. Interpretation of the practical effects and requirements of the RTS on confirmations**

Below please find our understanding of how the confirmations requirements in the RTS should be interpreted:

- ***What constitutes a confirmation?*** A 'confirmation' is defined as the documentation of the agreement of the counterparties to all the terms of an OTC derivative contract. Recital 26 of Annex II of the RTS states that the confirmation may take the form of an electronically executed contract or a document signed by both counterparties. We understand that a confirmation may also take another form, provided it meets the definition of a 'confirmation'. Below please find some thoughts on the types of arrangement which we believe would meet this description:
  - Negative/passive affirmation has not been specifically addressed in the technical standards. We believe that this common and efficient practice (ISDA can provide examples in this regard) should be viewed as an acceptable and compliant form of confirmation, where combined with an appropriate legal framework (e.g. a 'Master Confirmation Agreement') between the parties providing for confirmations to be issued and take effect in this way, and within the timeframe prescribed by the RTS. Under this arrangement, one counterparty (normally the bank) typically issues a confirmation to the other party and the recipient will be bound by the terms of the confirmation unless it objects by a specified deadline.
  - Further to this point, certain trading relationships are not electronically confirmed, with firms typically exchanging confirms and ensuring that the economic terms are the same. We believe that this would meet the definition of confirmation under Article 1(c) of the RTS if this confirmation of materially matching terms is provided within the timeframe set out in the RTS.
  - We also consider that a confirmation would meet the definition under the RTS where the confirmation is delivered through an internet site operated by one of the counterparties. For example, a financial counterparty may post an electronic version of a confirmation on a password-protected internet website of the financial counterparty combined with notification to the client of that posting (including by e-mail or by agreeing to the timings for such posting in advance), provided this process has been agreed with the client. The counterparty may then accept the confirmation either through negative affirmation (as described above), or a form of positive

affirmation (e.g. enabling the counterparty to agree the confirmation by clicking on a link on the website).

- We suggest that where trades are fully settled, with no further obligations remaining to be met - within the time limits set out for confirmations in different asset classes and market participants in the RTS - there should be no requirement to seek evidence of agreement to the terms thereafter. In this case it is clear that the parties have accepted the terms by performance.
- We suggest that trades recorded on internal systems may be recognised as confirmations in relation to discretionary investment management business whereby the discretionary investment manager acts in different capacities i.e. as counterparty and as discretionary investment manager acting for the client. Some FX hedging trades, for example, are not confirmed by an exchange of documents because the discretionary investment manager is effectively acting on both sides of the trade in this way. A document advising the client as to the terms of the transaction can be generated on request, containing the terms of the trade, however.
- Meaning of '**where available**' in relation to electronic confirmation: What qualifies as 'available' to different types of counterparty? We understand that the requirement to confirm 'where available via electronic means' should be interpreted to the effect that counterparties are required to confirm via electronic means where electronic means are available to the counterparties at the time of entry into the transaction. It does not imply an obligation for counterparties to ensure that they are able to confirm via electronic means in relation to *all* types of transaction they may enter into where electronic means of confirmation may be *possible*. We suggest that electronic confirmation should not be required where there are practical commercial (e.g. low volume of trades vs high cost of gaining access), legal or security-related concerns with confirming a trade electronically. Where a market participant has not signed up to an electronic confirmation platform, a paper/non-electronic confirmation should comply with the requirement as electronic means would not be 'available'. We note that in some jurisdictions there may be issues with respect to the ability of an entity to confirm a trade electronically (with respect to capacity or otherwise), even if electronic confirmation may be, strictly speaking, 'available' in the market. We further observe that there are currently no EU trading venues that qualify as 'electronic execution' and the impact of electronic execution on confirmation timeliness is therefore not fully understood. Equally, although a matching platform may become 'available' on the market or a new product may become available for matching, it can take several months for market participants to adapt products in line with these processes, and we would hope for some regulatory flexibility and appreciation of efforts made to comply in this regard. Some market participants will have further to go than others in adapting their systems to achieve compliance, and this will take some time. We recognise that over time, however, electronic means of confirmations will facilitate timely confirmation on an efficient basis by an ever-greater proportion of market participants, and, as such, large sell-side firms will continue to encourage its use by clients.
- It is not clear to whom **Article 12(2)** of the RTS applies. However, as Article 11(1) of EMIR states that financial counterparties and non-financial counterparties are required to comply

with this obligation, we understand that Article 12(2) is limited to cases where either a financial counterparty or non-financial counterparty (over the clearing threshold) concludes a transaction with an NFC whose derivatives activity is below the *clearing threshold* set out in EMIR.

- Meaning of **extended deadlines**: The RTS provide - in Article 12(3) - for an extended deadline in some circumstances. We believe that there are two situations where an extended deadline may be necessary: (1) where the trade is concluded after 4pm local time in the time zone of either of the (trading or operations units of either of the) counterparties or (2) where a (trading or operations unit of a) counterparty is located in a different time zone (to the trading or operating unit of its counterparty) which doesn't allow for confirmation by the set deadline (the set deadline is not *practicable* whether due to translation requirements, daylight overlap, impracticability of efficiently and safely executing confirmation very late in the day etc).
- Meaning of **business day**: There is no definition in the RTS of 'business day', a term used in Article 12 of the RTS, and there is also no consistent definition of this term in other EU financial services legislation. When dealing with different jurisdictions, it is essential to be able to determine which jurisdiction determines whether something is a business day and which time zone determines the end of a business day. We would welcome a discussion of this point with ESMA.
- Meaning of Article 12(4) regarding **reporting of outstanding unconfirmed transactions**: Article 12(4) does not specify when you begin counting the five business days referred to. On the face of it, it requires reporting when the transaction has been outstanding for five business days following the conclusion of the contract, even if the maximum period allowed for confirmation is longer than five business days e.g. under Article 12(2)(d). We understand that firms are considering proceeding on the basis of compilation of a regular monthly 'snapshot' report showing all trades not confirmed within 5 business days at that point, even if, in some instances, this may result in a higher standard (for timely confirmation) than set out in the RTS e.g. in Article 12 (2)(d), and firms would provide this report if requested by their regulator. Clarification that this approach would be acceptable would be welcome.

*While we would welcome guidance as to whether the views expressed in Section 1 above are accurate, we would hope that such guidance as to what constitutes a confirmation would not be exhaustive, in keeping with recital 26 of the final RTS.*

*This seems all the more important, given that the confirmations requirements – however flexibly they are interpreted – in the EMIR RTS appear significantly more stringent than those in evidence in the CFTC rules, despite the initial appearance of alignment between the two sets of rules. This is due to differences in product scope and in the way that the burdens associated with the rules fall on different counterparties under different jurisdictions. We note that compliance with the confirmations RTS will not be fully within the control of any financial or non-financial firms, given the full confirmation requirement imposed on both sides of the trade. In contrast, contracts agreed between Swap Dealers (SDs) and Major Swap Participants (MSPs) on the one hand, and smaller clients on the other – in the CFTC rules – only require SDs/MSPs to send an acknowledgement to the client and for the client to have procedures in place for timely confirmation. Furthermore, while EMIR applies to all MIFID-scope OTC derivatives, including equity derivatives and single name CDS, the CFTC has no competence in regulation of single name CDS and limited competence in relation to equity derivatives (the SEC is the main regulator for a majority of forms of equity derivative).*

## 2. Global coherence

- ***Territorial scope***

Legal uncertainty continues to exist in respect of the extra-territorial application of the risk mitigation requirements, including confirmations requirements. In particular, clarity is required as to whether the requirements are intended to apply when EU counterparties enter into contracts with third country entities. The drafting of Article 12 of the RTS appears to exclude non-EU counterparties from its scope, given the use of the reference to the terms 'financial counterparties' and 'non-financial counterparties' under EMIR. The RTS expressly only address transactions concluded by financial counterparties and non-financial counterparties with each other. The definitions of 'financial counterparty' and 'non-financial counterparty' are limited to EU entities and appear, therefore, not to cover transactions between EU entities and non-EU entities.<sup>2</sup> A further complication relates to the fact that EMIR does not impose any obligation on a non-EU counterparty to co-operate in meeting the deadlines for timely confirmation.

Similar issues arise in relation to transactions between financial counterparties and non-financial counterparties on the one hand and:

- Counterparties in the EU that are not classified as financial counterparties or non-financial counterparties e.g. natural persons and sovereign entities which are not 'undertakings' and which are not subject to obligations under Article 11;
- Counterparties listed in Article 1(4) and (5) of EMIR who are exempt from obligations under Article 11.

It is essential to clarify the territorial and counterparty scope of these requirements in good time before the RTS enter into force, given that the confirmations rules apply immediately upon entry into force. This is also important, but slightly less urgent, in relation to other non-margin risk mitigation requirements, where another 6 months is allowed to prepare for compliance.

## C Conclusion

ISDA members want to be able to comply with the requirements of the RTS on confirmations. We hope that this paper will assist ESMA's understanding of our key concerns in this context, and help industry and regulators to focus discussions on interpretation of the RTS in the coming weeks. We look forward to discussing the issues addressed in this paper with ESMA, and would be happy to respond to any queries from ESMA on the views and questions set out.

*For any queries please contact [rcogan@isda.org](mailto:rcogan@isda.org)*

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<sup>2</sup> A similar lack of clarity applies to the applicability of the reporting obligation to non-EU counterparties, as the term 'counterparties' in EMIR Article 9 is not defined).