

## **EMIR Portfolio Reconciliation Operational Guidance Note**

Version - 10 September 2013

The below are answers compiled by the ISDA EMIR Portfolio Reconciliations Working Group to some frequently asked questions to help understand the portfolio reconciliation and dispute resolution obligations imposed by EMIR which come into effect on 15<sup>th</sup> September 2013. This material has been prepared and published for informational purposes only and should not be construed as legal, accounting, tax or other professional advice. You should consult with professional advisors before taking any action on the basis of this information. Parties are not bound by this market guidance and should consider its application to their Transactions. Nothing herein is contractually binding on any parties or amends any Transaction or Confirmation.

### **Who is subject to the portfolio resolution and dispute resolution obligations and how frequently are they required to reconcile?**

This depends on two things:

i) Counterparty location:

If you are established in the EU, then EMIR regulations require you to reconcile portfolios with all of your counterparties (both EU and non-EU).

If you are established outside the EU but you trade with an EU counterparty, that counterparty will be required to reconcile portfolios and will require you to take certain actions to facilitate their compliance.

The current industry view pending formal cross-border guidance from ESMA is that branches of an EU counterparty will also be in scope.

ii) Counterparty Classification:

The frequency of reconciliation with a counterparty depends on your classification as a Financial Counterparty (FC), Non Financial Counterparty above the Clearing Threshold (NFC+) or Non Financial Counterparty (NFC<sup>1</sup>) and the number of OTC Derivative contracts facing that counterparty.

NB. If you have not adhered to the ISDA NFC Representation Protocol (<http://www2.isda.org/functional-areas/protocol-management/protocol/11>) or otherwise provided a representation of your classification, certain firms may treat you as an FC/ NFC+ as this will provide for the most conservative treatment under EMIR

### **What needs to be reconciled?**

All OTC Derivative Contracts (as defined in Article 2 of EMIR) whether they are collateralised or uncollateralised need to be reconciled post September 15<sup>th</sup> 2013.

### **When do I need to reconcile?**

When and how often portfolio reconciliation should take place depends on your classification and the number of OTC derivative trades with a counterparty. See below the regulatory frequencies:

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<sup>1</sup> Also referred to as NFC- being a non-financial counterparty which is below the clearing thresholds specified by ESMA

<b>EMIR Port Rec Rules</b>	
<b>OTC Derivatives with FC and NFC+</b>	<b>OTC Derivatives with NFC</b>
Daily for portfolio 500+ trades Weekly for 51-499 trades Quarterly for 1-50 trades	Quarterly for portfolio > 100 trades Annual 1-100 trades

Per the ESMA FAQ, trade count and therefore portfolio reconciliation frequency should apply at the fund level or sub fund level and not the level of the fund manager.

NB. If you are a Fund Administrator or Investment Advisor, you may wish to reconcile at a consistent frequency across all of your funds to make this process easier to manage. If you wish to reconcile on a more frequent basis than the regulatory thresholds then please ensure you have agreed this in writing with your Counterparties prior to the Compliance date.

### **How do I agree terms of reconciliation?**

The regulations state that counterparties need to agree in writing the arrangements under which portfolios will be reconciled. ISDA has published the ISDA 2013 EMIR Portfolio Reconciliation, Dispute Resolution and Disclosure Protocol which is a tool which allows counterparties to efficiently comply with this obligation across multiple counterparties. The Protocol can be accessed via the ISDA website where counterparties make certain elections as to the terms of reconciliation with each other. There may be other operational points of reference that need to be agreed with each other in addition to this. See below for further details:

i) Protocol adherence:

ISDA have published the [ISDA 2013 EMIR Portfolio Reconciliation, Dispute Resolution and Disclosure Protocol](#).

Under the Protocol you will make elections as to your: (i) decision to be a Portfolio Data Receiving or Sending Entity; (ii) Local Business Day; and (iii) ability to reconcile through a third party service provider. By adhering, you will also agree to a procedure to identify and resolve disputes as well as apply a specific process to disputes that remain unresolved for more than 5 business days.

[FAQ on the Protocol can be found on the ISDA webpage.](#)

The Protocol will satisfy EMIR compliance relating to ISDA Master Agreements, as well as other OTC derivative trading documentation.

ii) Operational set up

Depending on how you adhere to the Protocol, there may be some additional operational points to setup. For example, if your reconciliation frequency is less often than daily, you may need to confirm the close of business you will use as the reconciliation date. If you want to reconcile on a more frequent basis than the regulatory thresholds you will need to agree this. You will also need to provide contact details if not provided in the Protocol.

### **Should I adhere as a Sender or Receiver?**

If a firm is adhering as a SENDER and the other party has also adhered as a SENDER, then typically an exchange of data takes place and both parties are obligated to undertake portfolio reconciliation independently. Parties may consider the use of a 3<sup>rd</sup> party reconciliation vendor to perform this service (See below).

If the portfolio is small and infrequent reconciliations are required, or you are just getting the portfolio reconciliation process underway, then you can elect to be a RECEIVER of data. This allows you to receive portfolios from firms for you to review in house. If you choose this option, you can review the data that is sent to you in house. However, you must advise the other party should you find any discrepancy within 5 days otherwise you will be deemed to have affirmed the data.

This may be a lighter touch approach to portfolio reconciliation that is more appealing to you as you will have the control over raising breaks and disputes.

NB. Under the Protocol, there is a mechanism provided for a change of its status from RECEIVER to SENDER or vice versa, but this is available only by bi-lateral written agreement between the parties (consent not to be unreasonably withheld or delayed). We understand that this might require that you change the platform / vendor of choice as your portfolio reconciliation process evolves.

### **Should I use a 3rd party vendor to reconcile my trades?**

This depends on what elections are made in the Protocol adherence process. If you choose to be a SENDER of data the decision to use a 3<sup>rd</sup> party vendor should be based on factors such as the size of your portfolio, the level of service you require and the frequency of the portfolio reconciliation that you require.

### **What are key terms?**

The ESMA Q&A published 5<sup>th</sup> August 2013 provides guidance on the key terms and the fields that might be used to identify trades in a portfolio. See below:

**“OTC Question 14** [last update 5 August 2013]

*(b) What are the “key trade terms that identify each particular OTC derivative contract” for the purpose of the portfolio reconciliation requirements?*

### **OTC Answer 14**

(b) As provided for in Article 13 of RTS on OTC derivatives, **such terms shall include the valuation attributed to each contract** in accordance with Article 11(2) of EMIR. They should also include **other relevant details to identify each particular OTC derivative contract**, such as the effective date, the scheduled maturity date, any payment or settlement dates, the notional value of the contract and currency of the transaction, the underlying instrument, the position of the counterparties, the business day convention and any relevant fixed or floating rates of the OTC derivative contract.”

The “**valuation attributed to each contract**” as referenced in bold above can be split into 3. We consider these to be the key terms that should be used at a minimum to identify breaks:

- 1. MTM valuation**
- 2. Legal Entity Name (leading to MTM valuation break)**
- 3. Unmatched Trades details (leading to MTM valuation break)**

### **What should we reconcile?**

The “**other relevant details to identify each particular OTC derivative contract**” as also referenced in bold above in the ESMA Q&A provides some examples of some fields that might be used to identify and match trades in the portfolio. We consider the list of fields below to be the most useful minimum set of fields that should be used for this purpose. This is based on the industry agreed Minimum Market Standards “MMS”.

These are NOT key terms but should provide a standardised best practice template for the industry to adopt and use for trade identification and matching purposes.

Your Trade ID  
Your Legal Entity Name  
Counterparty Legal Entity Name  
Current Notional/Quantity  
Trade Currency  
2nd Notional/Quantity (if applicable)  
2nd Notional CCY (if applicable)  
Underlier/ Product ID  
Trade Date  
End Date  
MTM  
MTM Currency  
MTM Date  
Buy/ Sell indicator

### **What is the difference between a discrepancy vs. a dispute?**

There are no industry standards that provide guidelines for what constitutes a material difference or discrepancy. Not all discrepancies will give rise to a written Dispute Notice being delivered in accordance with the terms of the Protocol. There is also no material threshold specified under EMIR for this purpose. Thresholds will be set internally based on firms' own business risk tolerances, and may shift over time. Each firm's approach to determining what will constitute a Dispute requiring a Dispute Notice to be delivered under the Protocol will be documented in their internal policies - the required follow up in the Protocol is for appropriate internal management escalation to take place and for both parties to agree on how to resolve the difference.

However, for Financial Counterparties, all disputes related to an OTC derivative contract, it's valuation or the exchange of collateral for an amount or a value over EUR 15mm and outstanding for at least 15 days must be reported to its competent authority.

### **How does EMIR fit in with the CFTC regulations?**

The following table compares various points of both regulations directly with each other:

<i>EMIR/ CFTC Comparison</i>	<i>CFTC Port Rec Rules</i>		<i>EMIR Port Rec Rules</i>	
<i>Client Classification</i>	Swaps with SDs and MSPs	Swaps with other entities	OTC Derivatives with FC and NFC+	OTC Derivatives with NFC -
<i>Rule applicable to</i>	Swap Dealers (SDs) and Major Swap Participants (MSPs)		Financial counterparts (FC's), Non Financial Counterparties above the clearing threshold (NFC+) and Non Financial Counterparties below the threshold (NFC).	
<i>Compliance date</i>	23rd August 2013		15th September 2013	
<i>Terms</i>	Agree in writing with each counterparty on terms governing portfolio reconciliation		Agree in writing or by other electronic means with each of their Counterparties the terms on which the portfolio will be reconciled	
<i>Reconciliation venue</i>	Bi lateral or qualified 3rd party vendor subject to agreement of the parties			
<i>Reconciliation frequency</i>	Daily for portfolio 500+ trades Weekly for 51-499 trades Quarterly for 1 - 50 trades	Quarterly for portfolio >100 trades Annual 1-100 trades	Daily for portfolio 500+ trades Weekly for 51-499 trades Quarterly for 1-50 trades	Quarterly for portfolio > 100 trades Annual 1-100 trades
<i>Material Terms Definition</i>	Material Terms terms (subset of SDR reportable fields)		Key trade terms, including at least valuation attributed to each contract	
<i>Resolution of parameter discrepancies</i>	Immediate resolution of any discrepancy in material terms	Resolution of any discrepancies in a material term in a timely fashion	No specific guideline for resolving key trade term discrepancies, talks specifically about the "dispute relating to the recognition of valuation of collateral and exchange of collateral"	
<i>Valuation discrepancy definition</i>	Difference between the lower and the higher valuation of more than 10% of the higher valuation (per the rule)		Defined by each firm's internal risk tolerances and documented within their policies.	
<i>Resolution of valuation discrepancies</i>	Establish policies and procedures reasonably designed to ensure the swap valuation discrepancies are resolved as soon as possible but in any event within 5 business days	Establish policies and procedures reasonably designed to resolve swap valuation discrepancies in a timely fashion	When concluding derivatives contracts with each other, FC and NFC shall have agreed detailed procedures and processes in relation to the resolution of disputes in a timely manner with a specific procedure for those disputes that are not resolved within 5 business days	
<i>Reporting of valuation disputes</i>	Valuation disputes > 3 business days Exceeding USD 20mm Reported to CFTC	Valuation disputes > 5 business days Exceeding USD 20mm Reported to the CFTC	Any disputes relation to OTC Derivatives contract, its valuation or exchange of collateral. >15 business days, exceeding EUR 15mm Reportable to competent authority	
<i>Record keeping</i>	SDs and MSPs - Make and keep a record of each swap portfolio reconciliation Including number of portfolio reconciliation discrepancies Including number of swap valuation disputes (including time to resolution of each dispute, age of outstanding valuation disputes, categorized by transaction and counterparty) For 5 years after termination, maturity, expiration, transfer, assignment or novation date of the swap. Records to be made available promptly on request to CFTC and other US regulators (if applicable)		At the conclusion of the derivative contract with each other, FC and NFC shall have detailed procedures and processes for the recording of disputes. Key elements: i) length of time which the dispute remains outstanding, ii) counterparty, iii) amount disputed	