

Dodd-Frank Act v. EMIR
Confirmation, reconciliation, compression and documentation rules
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Introduction

The Dodd-Frank Act and EMIR will both impose requirements on derivatives counterparties with respect to confirmations, portfolio reconciliation and compression and client documentation

This paper summarises and compares:

- **CFTC rules:** the final rules adopted by the U.S. Commodity Futures Trading Commission (CFTC) in August 2012 under section 4s(i) of the Commodity Exchange Act (CEA) (added by section 731 of the Dodd-Frank Act) prescribing standards for swap dealers (SDs) and major swap participants (MSPs) related to the timely and accurate confirmation, reconciliation, compression and documentation of swaps (17 CFR §23.500 through §23.505); and
- **Draft EU rules:** the corresponding provisions of the draft regulatory technical standards (RTS) specifying the requirements of Article 11(1) of the EU Regulation on OTC derivatives, central counterparties and trade repositories (EMIR) requiring financial counterparties (FCs) and non-financial counterparties (NFCs) to have appropriate procedures and arrangements to measure, monitor and mitigate operation risk and counterparty credit risk. The draft RTS were adopted by the European Securities and Markets Authority (ESMA) and submitted to the European Commission for endorsement in September 2012

This paper is not intended to be comprehensive or to provide legal advice.

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There are many similarities in the requirements, but some notable differences including:

- **Timing:** The CFTC rules come into effect on November 13, 2012, although the rules will not apply to SDs until they are registered and SDs are not required to register until December 31, 2012. This timing is ahead of the EU rules which have yet to be adopted. The EU rules on confirmations would take effect when the RTS come into force (i.e. 20 days after publication of the RTS in the Official Journal, which could be in January 2013), but the impact of both the CFTC and EU rules on confirmations is partially mitigated by a compliance schedule which phases-in the requirements over a common time frame in 2013/2014. The EU rules on portfolio reconciliation and compression and dispute resolution would only apply from 6 months after the RTS come into force.
- **Scope – parties:** The CFTC rules only apply to SDs and MSPs, whereas the draft EU rules would apply to a much broader range of counterparties authorised or established in the EU, as they generally apply to both FCs and all NFCs, although there are generally stricter requirements where the transaction involves an NFC over the clearing threshold (NFC+).
- **Scope – transactions:** There are differences between the scope of application of the CFTC and EU rules because of different definitions of swaps and derivatives under the DFA and EMIR (in particular, in relation to foreign exchange transactions).
- **Affiliate exemption:** The CFTC rules do not have exemptions for transactions with affiliates whereas EMIR includes exemptions for intra-group transactions.
- **Cross-border application:** The CFTC rules apply to transactions between an SD/MSP and any U.S. or non-U.S. counterparty and have a potentially broad application because of the potential requirements for non-U.S. entities to be treated as SDs/MSPs (although the CFTC's proposed cross-border guidance would give some relief for transactions between non-U.S. entities). The EU requirements apply to transactions by counterparties authorised or established in the EU (FCs/NFCs) and some requirements appear not to apply to transactions between FCs/NFCs and non-EU entities (e.g. the rules on confirmations and dispute resolution and aspects of the rules on portfolio reconciliation). Subsequent Level 2 measures may apply the EU rules to some transactions between non-EU entities.
- **Confirmations:** The CFTC rules require an SD/MSP to send out an acknowledgement in a transaction with a counterparty other than another SD/MSP and require the SD/MSP to have policies for execution of a confirmation within a specified time. The draft EU rules would require a confirmation to be agreed by both parties in all cases of transactions between FCs/NFCs (but allow more time for this where the transaction is with an NFC that is not an NFC+).
- **Portfolio reconciliation:** The CFTC rules require exchange of valuations in all cases, where the EU rules may limit this to cases where valuations are required by EMIR. The CFTC rules are more demanding on the timing of resolution of discrepancies between SDs/MSPs.
- **Portfolio compression:** The draft EU rules would require regular analysis of compression opportunities with all counterparties, while the CFTC rules only require SDs/MSPs to do this on request if they transact with non-SDs/MSPs (but the CFTC rules do impose obligations on SDs/MSPs to have procedures for terminating offset transactions with other SDs/MSPs).
- **Client documentation:** The CFTC rules include detailed requirements for client relationship documentation, including agreement on valuation methods, whereas the draft EU rules would only impose more limited documentation requirements with respect to dispute resolution.
- **Record keeping and reporting:** The CFTC rules include specific record-keeping requirements while the draft EU rules do not. Conversely, the draft EU rules require FCs to report to their regulator on unconfirmed transactions while the CFTC rules do not.

Application and scope

	U.S.: CFTC rules §§23.500 – 23.505	EU: Article 11(1) EMIR	Comment
Effective date	60 days after publication of the rule in the Federal Register, i.e. November 13, 2012 (subject to the specific compliance dates referred to below delaying the full application of the confirmation requirements) but will only apply to SDs/MSDs and SDs need not register before December 31, 2012	The Commission has three months in which to decide whether to endorse the draft RTS adopted by ESMA. If it does, the RTS will come into effect 20 days after publication in the Official Journal, subject to the specific compliance dates delaying the full application of the confirmation requirements, as mentioned below. In addition, the rules on portfolio reconciliation and compression and dispute resolution would only apply from 6 months after the RTS come into force. Article 11(1) may be self-executing from 16 August 2012, but should only impose limited requirements on counterparties in advance of the RTS being adopted and coming into force	The detailed EU requirements will come into effect later than the CFTC requirements
Retroactivity	Rules (including swap trading relationship documentation rules) will only apply prospectively to new swaps entered into after effective date	The RTS rules on confirmations and documentation probably only apply prospectively to derivatives entered into after they come into effect (but e.g. the requirements to analyse compression opportunities may affect existing transactions)	
Legal certainty	CFTC states that it does not intend to make swaps voidable because of failure to comply with documentation requirements but that it cannot provide immunity from private rights of action	Article 12(3) EMIR provides protection from invalidity and private rights of action for contraventions of Article 11(1)	

Application and scope (2)

	U.S.: CFTC rules §§23.500 – 23.505	EU: Article 11(1) EMIR	Comment
Scope: parties	The CFTC rules apply to transactions between an SD/MSP and any U.S. or non-U.S. counterparty and have a potentially broad application because of the potential requirements for non-U.S. entities to be treated as SDs/MSPs (although the CFTC's proposed cross-border guidance would give some relief for transactions between non-U.S. entities)	Requirements of Article 11(1) EMIR apply to derivatives entered into by all FCs and NFCs with any counterparty, according to ESMA's interpretation (but some rules may not apply to transactions with non-EU parties – see below) Also apply to transactions between third country entities that would have been subject to these obligations if established in the EU where contracts have a direct, substantial and foreseeable effect in the EU or where such application is necessary to prevent evasion (this will be specified through subsequent Level 2 measures)	EU requirements have broader scope but their cross-border application may be more limited
Scope: transactions	Some requirements apply to swaps cleared by a designated clearing organization (DCO) Definition of swap transaction includes any event that results in new swap or change to terms of a swap, including terminations, assignments, etc. Some of the requirements will not apply to FX forwards and FX swaps if the Treasury adopts the proposed exemption under the Dodd-Frank Act	Requirements of Article 11(1) EMIR only apply to OTC derivatives contracts not cleared by a CCP Requirements do not explicitly address amendments, etc. to swaps The Commission and ESMA have not yet clarified the scope of the application of EMIR to FX transactions	Some of the CFTC requirements apply to cleared derivatives There will be other differences between the scope of application of the US and EU rules due to the differing definitions of swaps and derivatives
Affiliate exemptions	None	Article 11 EMIR contains exemptions for intra-group transactions	
Record-keeping	Each rule is accompanied by specific recordkeeping requirements	There are no specific recordkeeping requirements under Article 11 EMIR Article 9(2) EMIR requires a counterparty to keep a record of each swap concluded and any modification for 5 years	

Confirmation requirements

	U.S.: CFTC rule §23.501	EU: Article 11 draft RTS	Comment
Timing of confirmation	<p>Transactions between SDs/MSPs and other SDs/MSPs: SD/MSP must execute confirm as soon as technologically possible and by end T+1</p> <p>Transactions between SDs/MSPs and other counterparties: SD/MSP must send acknowledgement as soon as technologically possible and by end T+1</p> <p>SD/MSP must have policies/procedures designed to ensure that it executes confirm by end T+1 (with financial entities) and by end T+2 (with other counterparties)</p> <p>SD/MSP must provide counterparty with draft acknowledgement on request before execution</p>	<p>OTC derivatives shall be confirmed (where available by electronic means) as soon as possible and at latest (for transactions between FCs/NFC+s) by end T+1 or (for transactions with other NFCs) by end T+2</p> <p>Additional business day allowed if after 16.00 local time or with a counterparty in a different time zone which does not allow same day confirmation</p> <p>Confirmation is defined to mean the documentation of the counterparties to all the terms of the contract (may take form of an electronically executed contract or document signed by both counterparties)</p>	<p>Draft EU rules mandate use of electronic means where available (CFTC rules do not)</p> <p>Draft EU rules do not address timing requirements for confirmation of transactions between an FC/NFC and non-EU entity (the CFTC rules would apply to cross-border transactions as well)</p>
Compliance schedule	<p>Transactions between SDs/MSPs:</p> <ul style="list-style-type: none"> ▪ CDS/IRS: until February 28, 2014, T+2 ▪ Other: until August 31, 2013, T+3; then until August 31, 2014, T+2 <p>Transactions with other counterparties::</p> <ul style="list-style-type: none"> ▪ CDS/IRS: until August 31, 2013, T+5; then until August 31, 2014, T+3 ▪ Other: until August 31, 2013, T+3, then until August 31, 2014, T+2 	<p>Transactions between FCs/NFC+s:</p> <ul style="list-style-type: none"> ▪ CDS/IRS: until February 28, 2014, T+2 ▪ Other: until August 31, 2013, T+3; then until August 31, 2014, T+2 <p>Transactions with other NFCs:</p> <ul style="list-style-type: none"> ▪ CDS/IRS: until August 31, 2013, by end T+5, then until August 31, 2014, T+3 ▪ Other: until August 31, 2013, T+7, then until August 31, 2014, T+5 	<p>The compliance schedules phase in the requirements by replacing the deadlines stated above during an interim period</p>

Confirmation requirements (2)

	U.S.: CFTC rule §23.501	EU: Article 11 draft RTS	Comment
Cleared and traded swaps	<p>Swaps executed on a swap execution facility (SEF)/designated contract market (DCM): deemed to satisfy the requirements if confirm takes place at same time as execution</p> <p>Swaps cleared by a DCO: deemed to satisfy the requirements if submitted for clearing by above deadlines and confirmation of all terms take place at time of acceptance for clearing (if clearing rejected, time limits apply from rejection)</p>	Requirements do not apply to transactions cleared by a CCP	<p>Draft EU rules do not address:</p> <ul style="list-style-type: none"> ▪ treatment of transactions executed anonymously on trading platforms ▪ treatment of derivatives not yet accepted for clearing (or rejected from clearing)
Reporting and record keeping	<p>No reporting requirement</p> <p>Record keeping requirement applies</p>	<p>FCs must report to competent authority on unconfirmed transactions outstanding for more than 5 business days</p> <p>No record keeping requirement</p>	

Portfolio reconciliation requirements

	U.S.: CFTC rule §23.502	EU: Article 12 draft RTS	Comment
Coverage	<p>SDs/MSPs must agree in writing on terms of reconciliation with counterparties (does not require reconciliation of swaps cleared by a DCO)</p> <p>Covers exchange of trade terms and valuations and reconciliation of discrepancies in material terms and valuations</p> <p>Reconciliation can be performed by a third party</p>	<p>FCs/NFCs must agree in writing (or other equivalent electronic means) on terms of reconciliation with counterparties for OTC derivatives not cleared by a CCP</p> <p>Must be agreed before entering into OTC derivatives contract</p> <p>Covers reconciliation of key trade terms and valuations attributed under Article 11(2) EMIR (which requires FCs/NFC+s to mark-to-market or model)</p> <p>Reconciliation can be performed by a third party</p> <p>Requirement only applies from 6 months following entry into force of RTS</p>	<p>CFTC rules appear to require an exchange of valuations in all cases but the draft EU rules may not require a counterparty to provide a valuation where it is not subject to valuation requirements of Article 11(2) EMIR (e.g. NFCs other than NFC+s and third country entities)</p>
Frequency	<p>Minimum required frequency by size of portfolio of outstanding swaps between counterparties:</p> <p>Transactions between SDs/MSPs:</p> <ul style="list-style-type: none"> ▪ ≥500 swaps: once every business day ▪ <500 but >50 swaps: once each week ▪ ≤50 swaps: once each quarter <p>Transactions between SDs/MSPs and other entities:</p> <ul style="list-style-type: none"> ▪ >100 swaps: once each quarter ▪ ≤100 swaps: once each year 	<p>Minimum required frequency by size of portfolio of outstanding OTC derivatives contracts between counterparties:</p> <p>For FCs/NFC+s:</p> <ul style="list-style-type: none"> ▪ ≥500 contracts: once every business day ▪ <500 but >50 contracts: once each week ▪ ≤50 contracts: once each quarter <p>For other NFCs:</p> <ul style="list-style-type: none"> ▪ >100 swaps: once each quarter ▪ ≤100 swaps: once each year 	<p>Unclear how draft EU rules apply to transactions between FCs/NFCs and non-EU entities</p>

Portfolio reconciliation requirements (2)

	U.S.: CFTC rule §23.502	EU: Article 12 draft RTS	Comment
Resolution of discrepancies	<p>Transactions between SDs/MSPs and other SDs/MSPs: Required immediately to resolve discrepancies in material terms and have policies and procedures reasonably designed to resolve discrepancies in valuation within 5 business days</p> <p>Transactions between SDs/MSPs and other entities: Required to have policies and procedures designed to resolve discrepancies in terms and valuation in a timely fashion</p> <p>Less than 10% valuation difference is not treated as a discrepancy for these purposes</p>	<p>Under Art 14 draft RTS, FCs/NFCs concluding transactions with each other must agree detailed procedures and processes covering:</p> <ul style="list-style-type: none"> ▪ identification, recording and monitoring of disputes relating to recognition or valuation of contract and exchange of collateral ▪ resolution of disputes in a timely manner, with a specific process for those disputes that are not resolved within 5 business days <p>Requirement only applies from 6 months following entry into force of RTS</p> <p>Note: draft RTS do not</p> <ul style="list-style-type: none"> ▪ explicitly provide that every discrepancy in valuation must be treated as a dispute ▪ address position where FCs/NFCs enter into transactions with non-EU counterparties 	<p>CFTC rules are more demanding in requiring SDs/MSPs to have policies for immediate resolution of discrepancies of trade terms and to resolve valuation differences within 5 business day (where transacting with other SDs/MSPs)</p> <p>Draft EU rules are not limited to disputes arising from portfolio reconciliation</p>
Reporting and record keeping	<p>SDs/MSPs required to report to CFTC (and prudential regulators/SEC where relevant) valuation disputes >\$20m (~€16m) not resolved within 3 business days (with other SDs/MSPs) or five business days (with other counterparties)</p> <p>Record keeping requirements apply</p>	<p>Under Art 14 draft RTS, FCs must report to competent authority any disputes relating to an OTC derivative contract, its valuation or exchange of collateral for an amount or value higher than €15m (~\$18.8m) and outstanding for at least 15 business days</p> <p>Requirement only applies from 6 months following entry into force of RTS</p> <p>No record keeping requirement</p>	<p>Draft EU reporting requirement applies to broader range of counterparties and is not limited to valuation disputes</p>

Portfolio compression requirements

	U.S.: CFTC rule §23.503	EU: Article 13 draft RTS	Comment
Scope	SDs/MSPs must have policies and procedures for portfolio compression Does not require portfolio compression for swaps cleared by a DCO	FCs and NFCs with portfolio of ≥500 outstanding OTC derivatives not cleared by a CCP must have procedures to analyse possibility of conducting portfolio compression exercises and engage in such exercises	Draft EU requirements apply to broader scope of counterparties
Frequency	Transactions between SDs/MSPs and other SDs/MSPs: SD/MSP must have policies and procedures for (where appropriate): <ul style="list-style-type: none"> ▪ Terminating full offsetting transactions in timely fashion ▪ Periodic bilateral compression exercises, when appropriate ▪ Periodic multilateral compression exercises, when appropriate (at least when required by CFTC and to evaluate those initiated, etc. by third parties) Transactions between SDs/MSPs and other counterparties: SD/MSP must have policies and procedures for periodically terminating fully offsetting swaps and engaging in portfolio compression exercises when requested	Must regularly (at least twice a year) analyse possibility of conducting portfolio compression exercises (and be able to provide explanation to competent authority if concluded that exercise not appropriate) Requirement only applies from 6 months following entry into force of RTS	CFTC requirements are more demanding in requiring policies and procedures for timely termination of fully offset transactions between SDs/MSPs (without waiting for a compression exercise) but less demanding in only requiring compression of transactions between SDs/MSPs and other counterparties on request
Record keeping	Record keeping requirements apply	No record keeping requirement	

Client documentation requirements

	U.S.: CFTC rule §23.504	EU: draft RTS	Comment
General requirement	<p>SDs/MSPs must have policies and procedures designed to ensure that it executes written swap trading relationship document with its counterparties including all terms governing relationship.</p> <p>Does not apply to swaps executed on a DCM or to swaps executed anonymously on a SEF provided that swaps are cleared by a DCO (and does not apply to swaps cleared by a DCO)</p>	No equivalent general requirement with respect to swap trading relationship documentation (but authorized investment firms are under some client documentation requirements under MiFID, although mainly for retail clients)	
Valuation process	<p>Documentation between SDs/MSPs and other SDs/MSPs or financial entities and, if requested, other counterparties must include agreed process for determining the value of swaps (based on objective criteria to maximum extent practicable).</p> <p>This may include agreement to use one party's confidential proprietary model (but not necessarily the precise model or all inputs). SDs/MSPs are not required to disclose confidential model information.</p>	No equivalent requirement	
Dispute resolution	<p>The documentation must address dispute resolution procedures although specific details are not required</p> <p>See above for policies and procedures relating to resolution of discrepancies arising from portfolio reconciliation</p>	<p>Under Art 14 draft RTS, FCs/NFCs concluding transactions with each other must agree detailed procedures and processes covering:</p> <ul style="list-style-type: none"> ▪ identification, recording and monitoring of disputes relating to recognition or valuation of contract and exchange of collateral ▪ resolution of disputes in a timely manner, with a specific process for those disputes that are not resolved within 5 business days 	<p>Note: draft EU rules do not address position where FCs/NFCs enter into transactions with non-EU counterparties</p> <p>EU requirement only applies from 6 months following entry into force of RTS</p>

Client documentation requirements (2)

	U.S.: CFTC rule §23.504	EU: draft RTS	Comment
Other requirements	<p>Documentation must include:</p> <ul style="list-style-type: none"> ▪ status disclosure on SD/MSP (e.g. whether insured depository institution) ▪ notice about effect of acceptance of a swap for clearing by a DCO <p>Policies and procures must be approved in writing by senior management</p> <p>SDs/MSPs must have periodic internal or external audits of documentation policies</p> <p>Record keeping requirements apply</p>	No equivalent requirement	
End user exception requirement	<p>Under CFTC rule §23.505, SDs/MSPs must obtain documentation sufficient to provide a reasonable basis for belief that a counterparty meets statutory conditions required for exemption from clearing requirement</p> <p>Record keeping requirements apply</p>	<p>No equivalent requirement under Article 11(1) EMIR.</p> <p>However, FCs/NFC+s are likely to require representations from counterparties with respect to their status under the clearing obligation (and the risk mitigation rules under Article 11 to the extent that they are dependent on counterparty status) and may require other documentation to demonstrate status in some cases</p>	

U.S. glossary

- **CEA:** U.S. Commodities Exchange Act
- **CFTC:** U.S. Commodity Futures Trading Commission
- **DCM:** Designated contract market under the CEA
- **DCO:** Designated clearing organisation under the CEA
- **DFA:** U.S. Dodd-Frank Wall Street Reform and Consumer Protection Act
- **End user:** this term is not expressly defined under the CEA, but based on Section 2(h)(7) of the CEA would be an entity that is not a financial entity and is using swaps to hedge or mitigate commercial risk.
- **Exempt FX instruments:** foreign exchange forwards and foreign exchange swaps (under the proposed DFA exemption for FX transactions)
- **Financial entity:** defined by the DFA to include SDs, MSPs, commodity pools, private funds (as defined in the Investment Advisers Act of 1940), employee benefit plans and persons predominantly engaged in activities that are in the business of banking or in activities that are financial in nature, but excludes certain captive finance affiliates
- **Foreign exchange forward:** a transaction that solely involves the exchange of two different currencies on a specific future date at a fixed rate agreed upon at the inception of the contract
- **Foreign exchange swap:** a transaction that solely involves an exchange of two different currencies and a reverse exchange at a later date, at a fixed rate that is agreed upon at the inception of the contract
- **MSP:** major swap participant as defined under the DFA, which covers a person, other than an SD, that maintains a substantial position in swaps (excluding positions held for hedging or mitigating commercial risk), has substantial counterparty exposure that could have serious adverse effects on the financial stability of the U.S. banking system or financial markets, or is highly leveraged relative to the amount of capital it holds
- **SD:** swap dealer as defined under the DFA
- **SEC:** U.S. Securities Exchange Commission
- **SEF:** swap execution facility under the CEA
- **Swap:** the DFA defines a swap broadly to include interest rate, equity, currency, fixed income and broad-based security index swaps, forwards and options, and total return swaps referencing broad-based security indices

EU glossary

- **CCP:** central counterparty
- **Clearing threshold:** the threshold size of derivatives positions specified for the purposes of determining whether a non-financial counterparty is subject to the clearing requirement under EMIR
- **Commission:** the European Commission
- **Derivative:** as defined in EMIR, i.e. a financial instrument as set out in points (4) to (10) Section C, Annex 1, MiFID, as implemented by the MiFID implementing regulation
- **EMIR:** the EU regulation on OTC derivatives, central counterparties and trade repositories
- **ESMA:** European Securities and Markets Authority
- **EU:** European Union
- **FC:** financial counterparty as defined in EMIR, i.e. an investment firm, credit institution, insurance/reinsurance undertaking, UCITS, pension scheme and alternative investment fund managed by an alternative investment manager, in each case where authorised or registered in accordance with the relevant EU directive
- **FX:** foreign exchange
- **Level 2 measure:** delegated or implementing act (including RTS) adopted by the Commission under powers conferred by an EU regulation or directive
- **Member State:** member state of the EU
- **MiFID:** the EU Markets in Financial Instruments Directive
- **MiFID2 and MiFIR:** the proposed EU directive and regulation intended to replace MiFID
- **NFC:** non-financial counterparty as defined in EMIR, i.e. an undertaking established in the EU which is not a financial counterparty
- **NFC+:** a non-financial counterparty whose positions in OTC derivatives (excluding positions reducing risks directly relating to commercial or treasury financing activity) exceed the clearing threshold
- **OTC derivative:** over-the-counter derivative as defined in EMIR, i.e. a derivative executed outside a regulated market (as defined in MiFID) or equivalent non-EU market
- **RTS:** regulatory technical standards proposed by an ESA and adopted by the Commission under powers conferred by an EU regulation or directive

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