



Hogan  
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# Brexit

## The impact on Market Infrastructure

3 August 2016

# Introduction

# Introduction

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- Where are we now?
- What happens next?
- What is at stake for market infrastructure?
- What regulations will apply until Brexit?
- What is the current relevant Market Infrastructure Law?
- What might the UK regime look like post-Brexit?
- Potential impact of Brexit on market infrastructure
  - Trading venues
  - CCPs  
CSDs
  - Other market infrastructure
- Migration of CCP operations
- Closing thoughts

Where are we now?

# Where are we now?

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- Six weeks on from the vote to Leave on 23 June:
  - Exit process has not been triggered so vote still has no legal effect
  - Initial market and political response can now be assessed, in UK, the EU and around the world
  - New Prime Minister Theresa May, new Cabinet, new Cabinet Departments
  - "Brexit will mean Brexit" but not yet clear what that means
  - UK has relinquished its EU Presidency, due to be held July-December 2017
  - UK's EU Commissioner, Lord Hill has resigned but successor, Latvia's former PM, Dombrovskis, plans to continue the same agenda for CMU and financial services
  - FCA's Andrew Bailey has said there will be "no bonfire of regulations"

# What happens next?

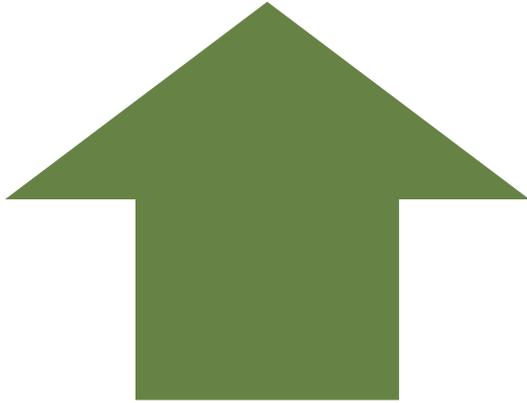
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- Process
  - Exit process is triggered by the UK serving Article 50 notice, at its discretion
  - Prime Minister has stated that Article 50 notice will not be served until the "UK approach" to negotiating is clear – unlikely to be before beginning 2017
  - Prime Minister could trigger Article 50 by using prerogative powers
  - Role of Parliament not yet clear – may vote on service of Article 50 or only on deal
  - Once Article 50 served, there is a notice period of two years to negotiate withdrawal terms
  - Rights under EU Treaties automatically lapse, including Free Trade Agreements with rest of world, on expiry of notice
  - Any extension requires unanimous approval by EU27
  - May be possible to unilaterally withdraw Article 50 prior to exit

What is at stake for market infrastructure?

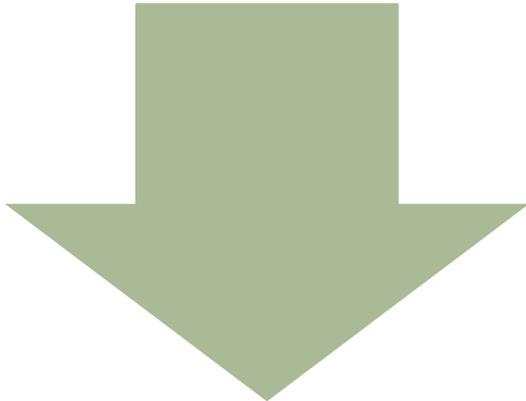
# What is at stake for market infrastructure?

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## The Prize

- Access for UK market infrastructure to EU participants
- Access by EU market participants to UK market infrastructure
- 40% of the world's currency trades (US\$5tn/day notional) traded and booked in London
- Half of the US\$600tn OTC derivatives market
- Three-quarters of Europe's share trading volume
- Loss of clearing could result in 100,000 fewer jobs in London



## The Threat

- ***"The City, which, thanks to the EU, was able to handle clearing operations for the eurozone, will not be able to do them. It can serve as an example for those who seek the end of Europe"*** – Francois Hollande, 24 June 2016
- ***"I am convinced that, in the medium term, euro clearing cannot take place to the existing extent in London – Frankfurt would be the more appropriate alternative"*** – Andreas Dombret, Executive Board Member, Deutsche Bundesbank, 13 July 2016

What regulations will apply until Brexit?

# What regulations will apply until Brexit?

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Continued  
Compliance  
with existing  
EU measures

Implementation  
of new EU  
measures

Reduced UK  
influence over  
EU  
policy

Uncertainty  
over the future  
regulatory  
structure



July 2016  
Market Abuse  
Regulation

Q1/2 2017 EMIR  
Margin  
requirements  
expected to  
come into force

January 2018  
MiFID II /  
MiFIR

January 2018  
PSD II

What is the current relevant Market Infrastructure Law?

# What is the relevant Market Infrastructure Law?

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- The following slides identify the key regulatory measures supporting the main types of market infrastructure that apply in:
  - The EU
  - The UK
- EU Regulations have direct applicability in the UK, and therefore do not need implementing measures in the UK
- EU Directives have been implemented through domestic legislation
- Measures applying in the UK deriving from EU law may need to be amended/replaced

# Trading venues

## Issue

Authorization, Operations  
and Access

Classification of  
Derivatives Transactions

Insolvency Protection

Benchmarks  
Administration

Market Abuse

## EU

MiFID II

EMIR

X

Benchmarks Regulation

Market Abuse Regulation

## UK

RAO / Recognition  
Requirements

X

Part VII Companies Act  
1989

X

X

# Central Counterparties

## Issue

Authorization, Operations and Access

Additional Recovery Requirements

Settlement Finality Protection

Insolvency Protection

Clearing Access

Financial Collateral

## EU

EMIR

X

Settlement Finality Directive

X

MiFID II

Financial Collateral Directive

## UK

X

Recognition Requirements

Settlement Finality Regulations

Part VII Companies Act 1989

X

Financial Collateral Arrangements (No. 2) Regulations

# Central securities depositories

## Issue

Authorisation, Operations and Access

Additional Recovery Requirements

Settlement Finality Protection

Insolvency Protection

Financial Collateral

## EU

CSDR

X

Settlement Finality Directive

X

Financial Collateral Directive

## UK

X  
(Currently USRs)

Recognition Requirements

Settlement Finality Regulations

Part VII Companies Act 1989

Financial Collateral Arrangements  
(No. 2) Regulations

What might the UK regime look like post-Brexit?

# What might the UK regime look like post-Brexit?

Post-Brexit, the UK will implement its own regulatory regime and policies

UK's flexibility to make changes to its regulatory regime to benefit UK firms will be constrained by:

- If passporting retained (e.g. through EEA), the UK will need to adopt on-going "EU laws"
- If third country regime being relied on, the UK will need to secure /maintain "equivalence" status
- Obligations to meet international law commitments and framework for global standards accepted through G20, per the Financial Stability Board, Basel Committee on Banking Supervision and IOSCO

Subject to that, there may be flexibility to innovate where regulatory policy permits e.g.:

- Blockchain?

# Potential impact of Brexit on Market Infrastructure

## Implications under EU legislation if UK is not in the EEA

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In the absence of a formal cross-border deal between the UK and the EU governing market infrastructure

UK will be a "third country" for the purposes of various EU measures

This will have implications for each type of market infrastructure operator

# Implications under EU legislation if UK is not in the EEA

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## Trading venues

# Impact on trading venues if the UK is outside the EEA

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## Offering trading platform access to EU participants:

### Prior to Brexit:

- Operators of UK regulated markets, MTFs and OTFs are able passport into other EU jurisdictions in order to provide services in those jurisdictions (e.g. to facilitate remote access by users based in those jurisdictions) – MiFID / MiFID II

### Post-Brexit:

- Operators of trading platforms would need to assess whether they will need to comply with any local regulatory requirements before offering or allowing access to users in EU jurisdictions.
- This could potentially involve obtaining some form of local authorization in those jurisdictions (similar to how the UK FCA requires certain overseas investment exchanges to be recognized in the UK in order to obtain exemption from regulation under the UK regime)

# Impact on trading venues if the UK is outside the EEA

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## Offering trading platform access to EU participants:

- There is a third country regime under MiFID II for firms seeking to provide investment services or perform investment activities to eligible counterparties or professional clients on a cross-border basis (without an EU branch)
- However:
  - Where the Commission has adopted a decision that the third country supervisory regime is equivalent to MiFID II requirements, and has established co-operation requirements with the local regulators, the firm will need to be registered with ESMA (which could take six months)
  - Where the Commission has not adopted an equivalence decision, access is subject to the discretion of the Member State in accordance with its national regime
- Whilst the application of the third country seems to be possible for operators of MTFs and OTFs, it is less clear for regulated markets

## Offering trading platform services to EU CCPs

- MiFID II facilitates this for third country trading venues, subject again to equivalence assessments and reciprocal access rights

# Impact on trading venues if the UK is outside the EEA

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## Treatment of trades in the absence of equivalence assessments - derivatives:

### Under EMIR:

- Derivatives traded on UK trading venues would be considered “OTC derivatives” (even if they are traded on UK regulated markets)
- They would therefore need to be counted by non-financial counterparties when determining the clearing thresholds – which require such contracts to be cleared by a CCP that is either an EU-based and authorized CCP or a recognized third country CCP

### Under MiFID II:

- Will introduce a new "trading obligation" for trades in specified derivatives to be traded only on regulated markets, MTFs, OTFs or third country trading venues from jurisdictions which the Commission has deemed offer equivalent standards
- In the absence of an equivalence assessment, counterparties subject to the MiFID II trading obligation would not be able to execute their trades on UK trading venues

# Impact on trading venues if the UK is outside the EEA

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## Treatment of trades in the absence of equivalence assessments - Shares and other instruments:

### Under MiFID II:

- Will maintain a requirement for investment firms to conduct appropriateness assessments when executing client orders in financial instruments, except (in some cases) where the instruments are shares, bonds or securitized debt admitted to trading on an EU regulated market or MTF, or a third country market that is assessed as equivalent by ESMA under the Prospectus Directive. In the absence of equivalence, a firm must assess appropriateness
- Investment firms are required to execute trades in shares that are admitted to a regulated market or traded on a trading venue on a regulated market, MTF, systematic internaliser or on a third country trading venue assessed as equivalent by ESMA under the Prospectus Directive (unless certain requirements apply)

# Implications under EU legislation if UK is not in the EEA

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CCPs

# Impact on CCPs if the UK is outside the EEA

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## Offering clearing services to EU clearing members

- EMIR prohibits third country CCPs from providing clearing services to EU clearing members or trading venues, unless the CCP is recognized by ESMA under EMIR's third country regime
- Would require:
  - an equivalence assessment between the UK and EU regimes
  - co-operation arrangements between the Bank of England and ESMA
  - UK CCPs to be registered with ESMA (could take six months)
- Under MiFID II, UK CCPs could also offer their services to EU trading venues, subject to equivalence assessment and reciprocal access rights

# Impact on CCPs if the UK is outside the EEA

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## Impact on clearing in the absence of equivalence assessment for UK CCPs:

- UK CCPs unable to provide clearing services to EU clearing members or trading venues under EMIR
- UK CCPs will not have qualifying CCPs (**QCCP**) status under the Capital Requirements Regulation
- EU banks with trade exposures to CCPs that are not QCCPs will be subject to much higher risk weightings, when calculating their regulatory capital requirements

# Impact on CCPs if the UK is outside the EEA

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## Clearing of Euro-denominated instruments

- An area of significant political pressure
- It is possible that the EU could change the law to empower the European Central Bank to require the use of a Eurozone based CCP
- This could have a significant impact on UK trading and clearing activity

## Other jurisdictions

- EU has made equivalency assessments and established co-operation arrangements, for CCPs, with Australia, Hong Kong, Mexico, the Republic of Korea, Singapore, South Africa, Switzerland and the USA
- The establishment of a common approach between the CFTC and ESMA regarding requirements for CCPs involved a tortuous and protracted negotiation. Outside the EU, the UK would need to establish its own arrangement with the CFTC to obtain equivalent benefits for UK CCPs

# Implications under EU legislation if UK is not in the EEA

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CSDs

# Impact on CSD if the UK is outside the EEA

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## Offering CSD services

- CSDR provides that third country CSDs (which will include Euroclear UK & Ireland following Brexit), may provide CSD services in the EU
- However, if a UK CSD were to:
  - provide the "core services" of the initial recording of securities in a book-entry system (notary service) or providing and maintaining securities accounts at the top tier level (central maintenance service) in relation to financial instruments constituted under the corporate law of an EU Member State; or
  - set up a branch in a Member State,
- it would require:
  - an equivalence assessment between the UK and EU regimes
  - co-operation arrangements between the Bank of England and ESMA
  - The UK CSDs to be registered with ESMA (could take six months)

## CSDR does also contemplate the establishment of links between EU CSDs and third-country CSDs

- but substantial due diligence requirements are imposed on the requesting CSD, and the link would require authorization by the EU CSD's regulator

# Implications under EU legislation if UK is not in the EEA

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Other market infrastructure

# Other market infrastructure

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## UK trade repositories

- EMIR requires counterparties to derivative contracts and CCPs to report such trades to trade repositories that are either (i) EU-based and regulated or (ii) third country based and recognized by ESMA
- A third country trade repository can only offer its services in the UK if it is recognized by ESMA, following an equivalence assessment of the third country regime, and the establishment of co-operation arrangements

## UK benchmark administrators

- An EU supervised entity will not be able to use a financial benchmark from a non-EU benchmark administrator unless the benchmark and the administrator is registered with ESMA (or recognized in the interim)
- Requires equivalence assessment
- Will affect UK trading venues that set benchmark prices for financial instruments

## UK credit rating agencies

- Under the EU Credit Rating Agencies Regulation, EU financial institutions could not use a credit rating from a third country CRA for regulatory purposes unless the rating is either endorsed by an EU registered CRA, or the third country CRA has been certified by ESMA (following an equivalency decision and a co-operation agreement)

# Migration of CCP operations

## Migration of CCP operations

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Worst case scenario – UK CCPs are unable to clear euro-denominated instruments

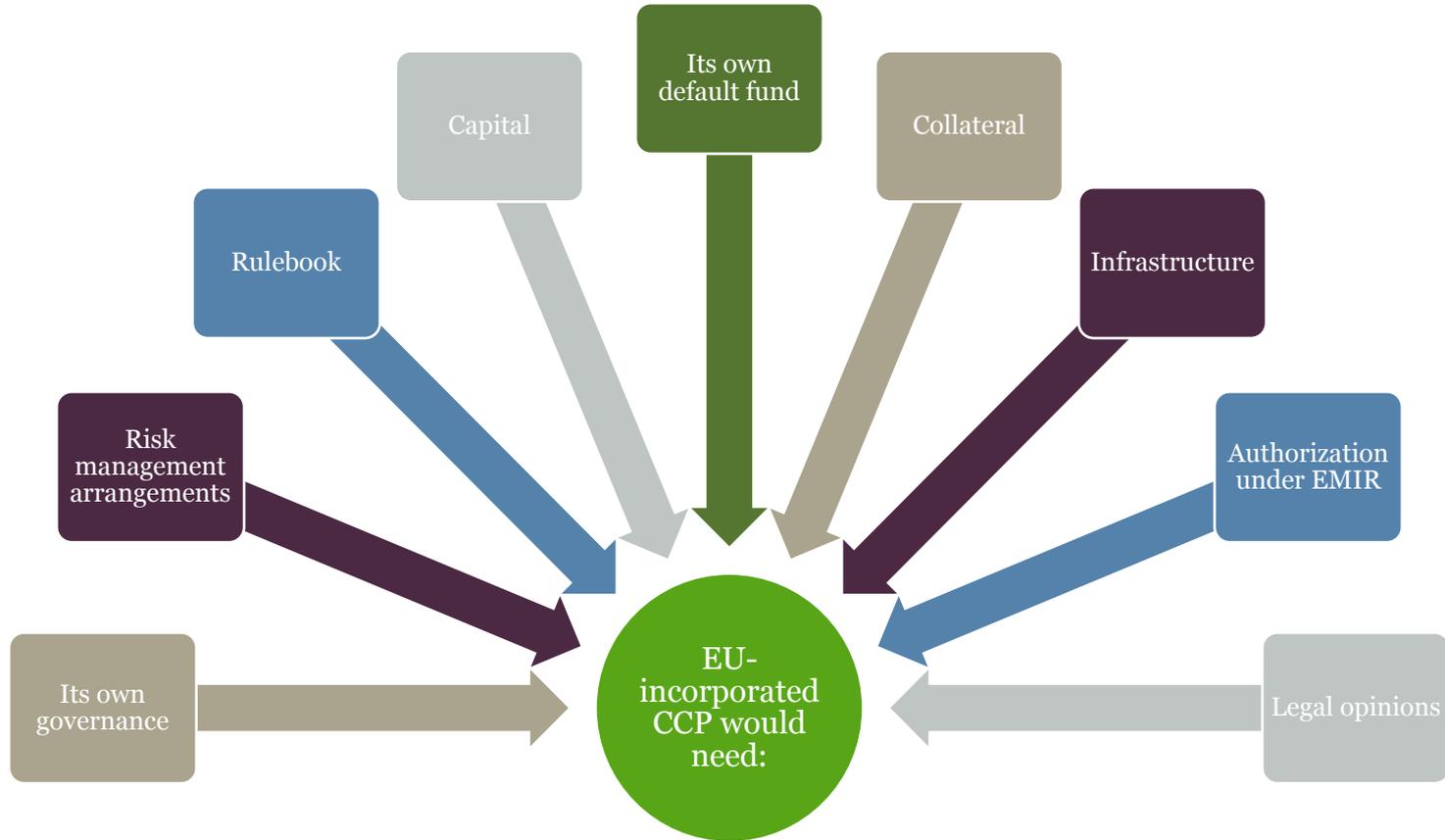
How could they establish an EU-based CCP operation?

It would not be easy

Would require the establishment of an EU-incorporated CCP

# Migration of CCP operations

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# Migration of CCP operations

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# Migration of CCP operations - acts required for transfer option

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## Migration Agreement

- Between CCPs and affected trading platforms

## Novation Agreement

- Between legacy CCP, new CCP and clearing members with migrating positions
- Including arrangements to migrate collateral

Clearing Members to update agreements with clients

## An implementation plan

- With a robust "Go"/"No Go" process and arrangements for a wind-back if necessary

Ensuring that the open positions remain effectively cleared and risk managed at all times will be critical

# Closing thoughts

# Contact us

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- If you have any questions, you can email us on:  
[FISBrexit@hoganlovells.com](mailto:FISBrexit@hoganlovells.com)
- Access our latest thinking on our Brexit Hub at:  
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