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Brexit

Impact of Brexit on Derivatives Transactions

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Introduction

Introduction

- What does Brexit mean for derivatives generally?
- EU regulation relating to derivatives
- EMIR and MiFID II
- Impact on derivatives documentation
- Bank resolution and other insolvency issues
- Taking collateral
- Closing thoughts

EU regulation relating to derivatives transactions

What regulations will apply until Brexit?

Continued
Compliance
with existing
EU measures

Implementation
of new EU
measures

Reduced UK
influence over
EU policy

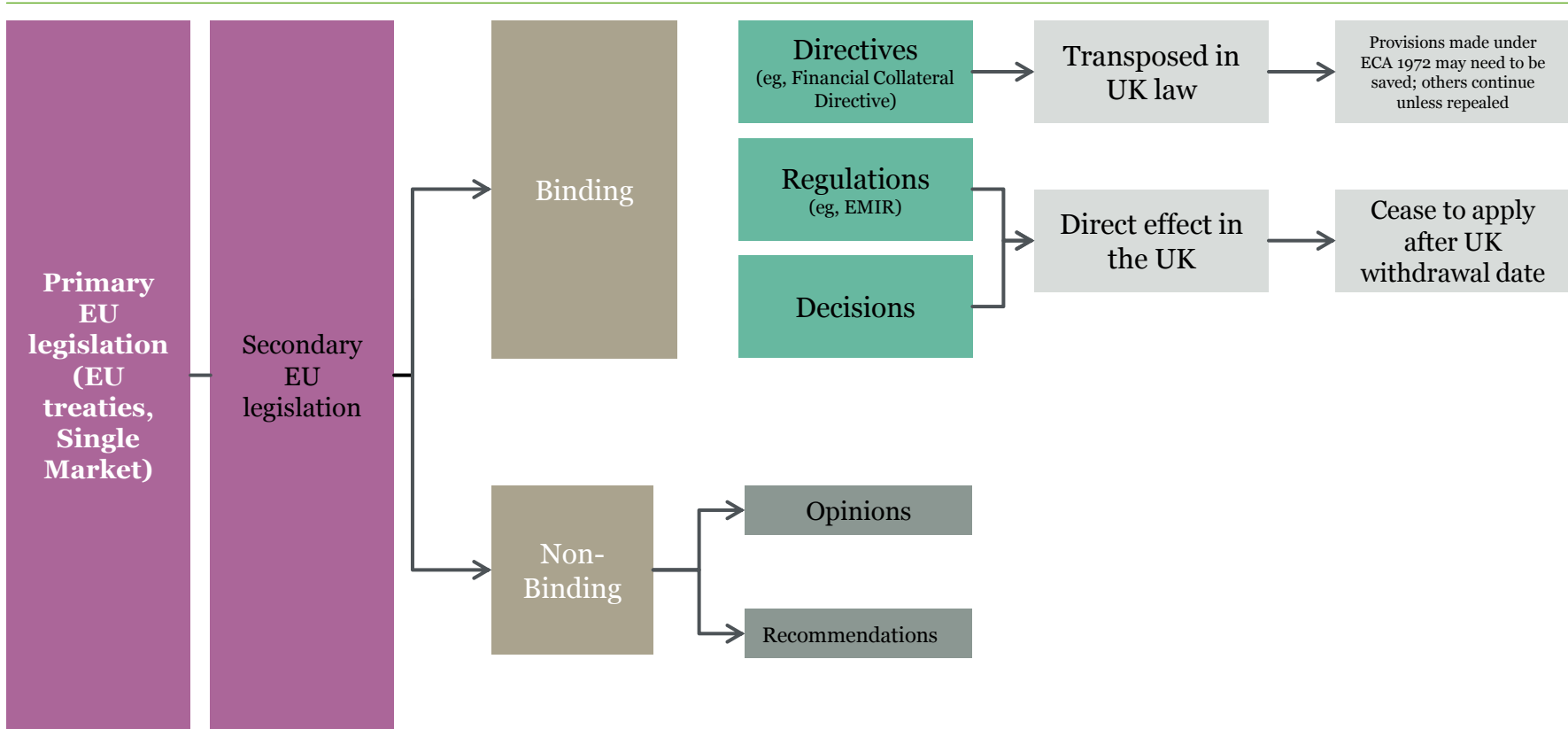
A chance for the
UK to establish
equivalence

21 June 2016
First clearing
obligations under
EMIR in force

Q1/2 2017
Margin
requirements
expected to come
into force

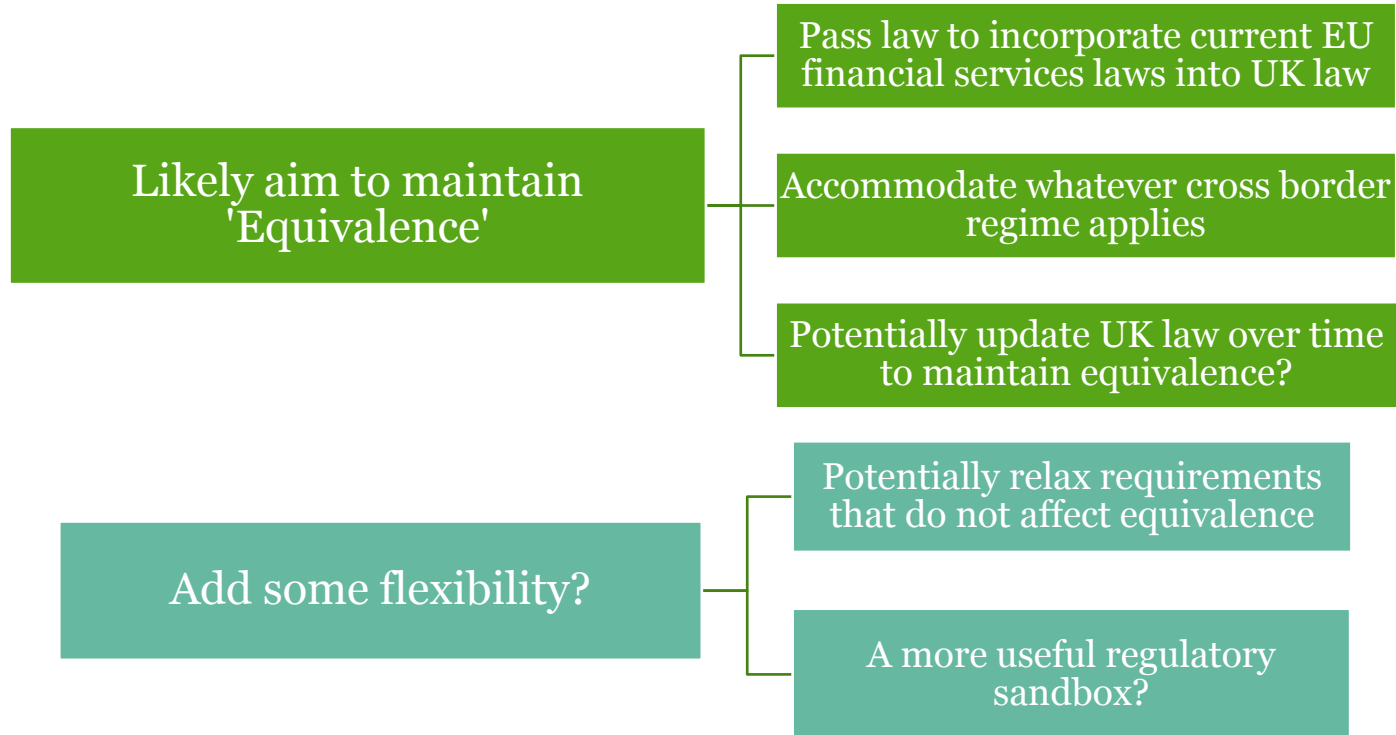
January 2018
MiFID II / MiFIR

EU regulation relating to derivative transactions



What will the UK regime look like?

UK will have a choice to maintain equivalence with EU law or to diverge.
Lack of equivalence would likely negatively affect UK access to the EU single market



Derivatives trades: Importance of passporting

- Being a counterparty to a derivative trade is in many (but not all) EU countries regarded as doing regulated business and therefore subject to the solicitation test
- EU firms transacting with UK counterparties unlikely to be affected due to availability of cross-border exemption

Potential Exit Models

- The regime governing access to EU markets will depend on what deal is proposed and negotiated with the EU.

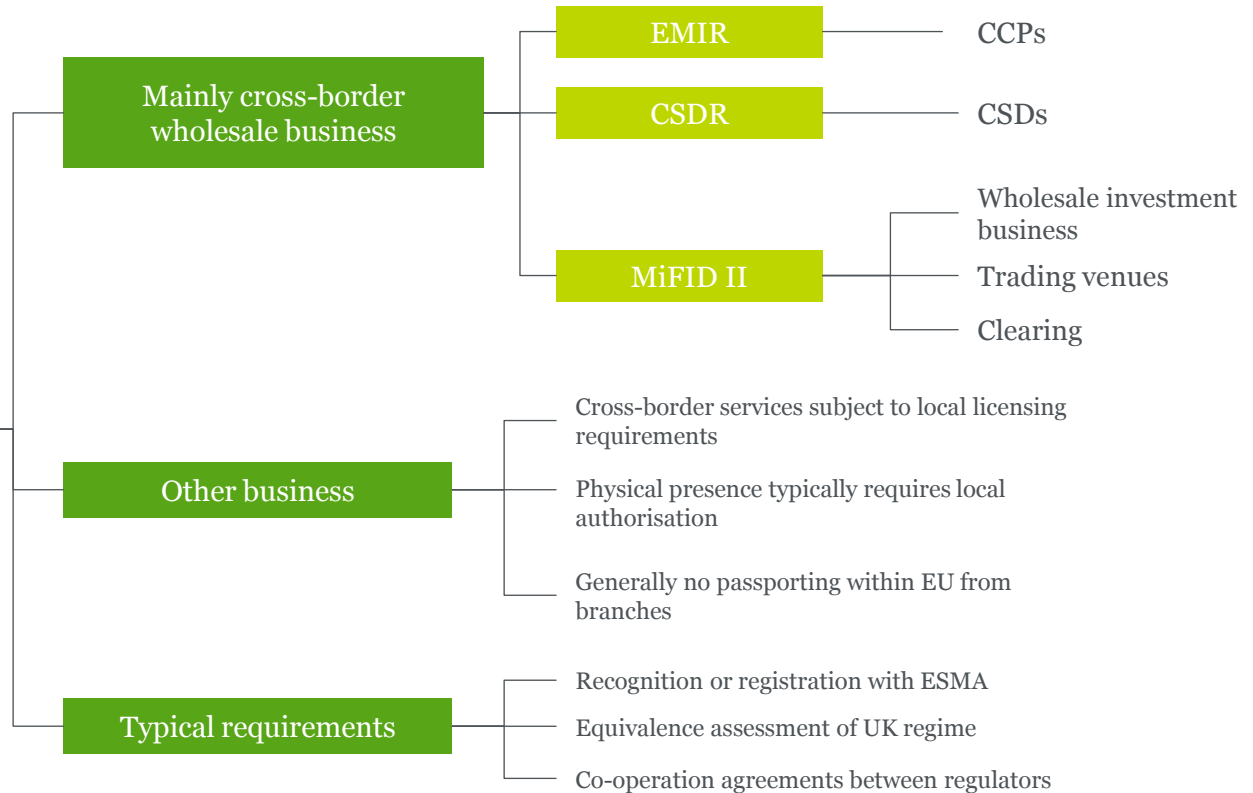
Regime	Passporting	Influence over EU measures	Comment
EEA (Norway Model)	Yes	Consultation rights – no veto	Retains access to Single Market Requires free movement of persons Potentially quickest to implement
Co-operation Agreements (Swiss Model)	Depends on what is negotiated	No	Passporting conditional on free movement of persons? EU restricting Swiss agreements
Comprehensive Free Trade Agreement	Depends on what is negotiated	No	Time consuming to negotiate Passporting conditional on free movement of persons? Such agreements typically do not cover services well
Reliance on WTO rules	No	No	Not suited to financial services

Third Country Regimes

Third country regimes facilitate non-EU firms providing services into the EU

Cross Border Access under Third Country Regimes

Not contingent on free movement of people



EMIR and MiFID II

EMIR: clearing requirements

- EMIR (and its associated delegated acts) is directly effective
- Will no longer apply post Brexit but the UK is likely to enact equivalent measures to assist with:
 - obtaining equivalence decisions; and
 - meeting its commitments as a G20 member in following IOSCO’s mandatory clearing requirements.
- UK would be a “third country” under EMIR and would need the European Commission to adopt an equivalence act
- Extraterritorial reach of EMIR clearing requirements means that many UK counterparties would still need to comply where they are transacting with an EEA counterparty

EMIR: margin requirements

- Margin requirements under EMIR are derived from the BCBS-IOSCO international framework, which UK would need to follow as a G20 member so likely UK would implement equivalent measures
- UK would seek equivalence although no equivalence decisions on margin have been adopted to date
- Extraterritorial reach of EMIR margin requirements means that many UK counterparties would still need to comply where they are transacting with an EEA counterparty

MiFID II: trade execution and transaction reporting requirements

- Under MiFID II, sufficiently liquid derivatives trades that are subject to the clearing obligation under EMIR need to be traded on a regulated market, multilateral trading venue (MTF) or a third country trading venue
- Also introduces more comprehensive transaction reporting requirements
- Scheduled to come into force on 2 January 2018

CCPs and Trading Venues without equivalence post Brexit

UK Trading venues

- Derivatives traded on UK trading venues would be considered “OTC derivatives” under EMIR and need to be counted by non-financial counterparties when determining the clearing thresholds
- Counterparties subject to the trading obligation would not be able to execute their trades on UK trading venues

UK CCPs

- No longer able to provide clearing services under EMIR
- Would not benefit from the qualifying CCPs (**QCCP**) status under the Capital Requirements Regulation. EU banks’ exposures to QCCPs are subject to a lower risk weighting in calculating their regulatory capital

CCPs and Trading Venues: Third Country Regimes

Type of firm	Would a third country regime facilitate cross-border services without an EU branch or entity?	Requirements	Relevant EU Measure
UK MiFID wholesale trading firm	Yes. Allows cross-border services to eligible counterparties and per se professional clients	<ul style="list-style-type: none"> - Registration of firm with ESMA - Firm authorised in jurisdiction of head office - UK assessed as equivalent, reciprocal access for EU firms - Co-operation agreement between ESMA and UK regulators 	MiFID II
UK CCP	Yes. Allows EU-recognised CCPs to clear for EU clearing members	<ul style="list-style-type: none"> - Recognition by ESMA - ESMA consultation with various regulators - UK assessed as equivalent (including reciprocal access) - UK has equivalent anti-money laundering systems - Co-operation agreement between ESMA and UK regulators 	EMIR
UK CCP	Yes. UK CCP could request access to EU trading venue	<ul style="list-style-type: none"> - CCP recognised under EMIR - Reciprocal access for EU firms 	MiFID II
UK Trading Venue	Yes. UK trading venue could request access to EU CCP	<ul style="list-style-type: none"> - Assessment of equivalence of UK regime for trading venues - Reciprocal access for EU firms 	MiFID II

Impact on derivatives documentation

Derivatives documentation

- No immediate impact on standard ISDA documentation
- Review existing documentation, including:
 - termination events
 - events of default
 - references to specific EU regulations or EU territory
 - tax provisions
- Standard ISDA Master Agreement representations may require amendments post Brexit

Contractual choice of law and jurisdiction

- Section 13(a) (Governing law): EU Rome I & II Regulations broadly require courts to recognise parties' choice of law
- Section 13(b) (Jurisdiction): Broadly, if the UK acceded to the the 2005 Hague Convention on Choice of Court Agreements as an independent contracting state, should continue to be recognized, provided clause is exclusive and not one-sided

Bank resolution and other related insolvency issues

Bank recovery and resolution

- Bank Recovery and Resolution Directive (Directive 2014/59/EU) (the **BRRD**) was implemented in the UK by means of amendments to the Banking Act 2009 and secondary legislation under it
- The UK would need to ensure that the Credit Institutions (Reorganisation and Winding-up) Regulations 2004 continues as it ensures the cross-border recognition of resolution actions
- Article 55 clauses (contractual recognition of bail-in) and clauses dealing with contractual recognition of stays would need to be included by in-scope credit institutions as English law would be non-EEA law

Insolvency proceedings

- EU Insolvency Regulations may cease to apply
- The UK has implemented the Model Law of the United Nations Commission on International Trade (UNCITRAL) on cross-border insolvency
- Only a limited number of EU Member States have implemented UNCITRAL so would only created limited mutuality

Taking collateral

Taking collateral

- Financial Collateral Arrangements (No. 2) Regulations 2003 implement the Financial Collateral Directive
- Enacted as secondary legislation under the ECA 1972 so if the ECA 1972 is repealed these Regulations would fall away
- Given the benefits, likely to be re-enacted
- Decline in creditworthiness of counterparties could lead to increase collateral requirements

Closing Thoughts

What you can do now

- No immediate change in law or regulation
- Continue with clearing and margin implementation plans
- Review existing documentation

Coming soon

Coming soon

Events on Brexit's application across the sector:

- Securitization Webinar – Wednesday 27 July, 2pm (BST)
- Market Infrastructure Webinar – Wednesday 3 August, 2pm (BST)

Contact Us

- If you have any questions, you can email us on:
FISBrexit@hoganlovells.com
- Access our latest thinking on our Brexit hub at:
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