International Derivatives Training

Derivatives Regulatory Overview – impact of EMIR, MiFID2, CRR & Brexit

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19 September 2019
Overview

- MiFID – the fundamentals
- Overview of EMIR - European Market Infrastructure Regulation
  - Counterparties in scope
  - Summary of key obligations
- Key MiFID2 and MiFIR obligations
- Capital rules
- Brexit
1. MiFID2 Fundamentals
MiFID and EMIR – meaning of a derivative contract

- Derivatives including options, futures, swaps, forwards and financial contracts for differences

- EMIR definition of derivatives cross refers to MiFID (C(4) to C(10))

- OTC v ETD distinction – ETD means on a regulated market. OTC means everything else including trades on OTFs and MTFs when often people mean bilaterally negotiated when they say OTC.
MiFID Financial Instruments - Derivatives

- C(4): Options, futures, swaps, forward rate agreements and any other derivative contracts relating to securities, currencies, interest rates or yields, emission allowances or other derivatives instruments, financial indices or financial measures which may be settled physically or in cash

- C(5): Options, futures, swaps, forwards and any other derivative contracts relating to commodities that must be settled in cash or may be settled in cash at the option of one of the parties other than by reason of default or other termination event

- C(6): Options, futures, swaps, and any other derivative contract relating to commodities that can be physically settled provided that they are traded on a regulated market, a MTF, or an OTF, except for wholesale energy products traded on an OTF that must be physically settled

- C(7): Options, futures, swaps, forwards and any other derivative contracts relating to commodities, that can be physically settled not otherwise mentioned and not being for commercial purposes, which have the characteristics of other derivative financial instruments

- C(8): Derivative instruments for the transfer of credit risk

- C(9): Financial contracts for differences.

- C(10): Options, futures, swaps, forward rate agreements and any other derivative contracts relating to climatic variables, freight rates or inflation rates or other official economic statistics that must be settled in cash or may be settled in cash at the option of one of the parties other than by reason of default or other termination event, as well as any other derivative contracts relating to assets, rights, obligations, indices and measures not otherwise mentioned, which have the characteristics of other derivative financial instruments, having regard to whether, inter alia, they are traded on a regulated market, OTF, or an MTF
Spot FX carve out – Art. 10(2) ‘Org Reg’

2. A spot contract for the purposes of paragraph 1 shall be a contract for the exchange of one currency against another currency, under the terms of which delivery is scheduled to be made within the longer of the following periods:

(a) 2 trading days in respect of any pair of the major currencies set out in paragraph 3;

(b) for any pair of currencies where at least one currency is not a major currency, the longer of 2 trading days or the period generally accepted in the market for that currency pair as the standard delivery period;

(c) where the contract for the exchange of those currencies is used for the main purpose of the sale or purchase of a transferable security or a unit in a collective investment undertaking, the period generally accepted in the market for the settlement of that transferable security or a unit in a collective investment undertaking as the standard delivery period or 5 trading days, whichever is shorter.

A contract shall not be considered a spot contract where, irrespective of its explicit terms, there is an understanding between the parties to the contract that delivery of the currency is to be postponed and not to be performed within the period set out in the first subparagraph.

3. The major currencies for the purposes of paragraph 2 shall only include the US dollar, Euro, Japanese yen, Pound sterling, Australian dollar, Swiss franc, Canadian dollar, Hong Kong dollar, Swedish krona, New Zealand dollar, Singapore dollar, Norwegian krone, Mexican peso, Croatian kuna, Bulgarian lev, Czech koruna, Danish krone, Hungarian forint, Polish zloty and Romanian leu.

4. For the purposes of paragraph 2, a trading day shall mean any day of normal trading in the jurisdiction of both the currencies that are exchanged pursuant to the contract for the exchange of those currencies and in the jurisdiction of a third currency where any of the following conditions are met:

(a) the exchange of those currencies involves converting them through that third currency for the purposes of liquidity;

(b) the standard delivery period for the exchange of those currencies references the jurisdiction of that third currency.
Spot FX carve out – Art. 10 of the ‘Org Reg’

- Intention to physically settle currency exchange by:
  - T+2 (major currency pair) or market convention for Spot (non major currencies); or
  - the shorter of T+5 / market convention if the main purpose is to settle a securities transaction (referred to as securities conversion or sec con)

- Rolled spot FX seen as no intention to physically settle in the timeframe prescribed and therefore a MiFID financial instrument

- Spot FX still regulated separately in a number of jurisdictions but not all

- One of the instruments listed at the back of CRDIV

- Note also MiFID ancillary service of “Foreign exchange services where these are connected to the provision of investment services”

- Recital 7 – the exchange needs to be unconditional (so options are not possible)
FX for payments carve out – Art. 10(1)(b) ‘Org Reg’

Characteristics of other derivative contracts relating to currencies

1. For the purposes of Section C(4) of Annex I to Directive 2014/65/EU, other derivative contracts relating to a currency shall not be a financial instrument where the contract is one of the following:

(a) a spot contract within the meaning of paragraph 2 of this Article,
(b) a means of payment that:
(i) must be settled physically otherwise than by reason of a default or other termination event;
(ii) is entered into by at least a person which is not a financial counterparty within the meaning of Article 2(8) of Regulation (EU) No 648/2012 of the European Parliament and of the Council (6);
(iii) is entered into in order to facilitate payment for identifiable goods, services or direct investment; and
(iv) is not traded on a trading venue.
FX carve outs – UK implementation

- RAO carve outs

- PERG 13.4 very useful, including examples of FX payments that are in or out of scope

- Issues with how firms get comfortable about the main purpose. Rules not prescriptive but PERG has examples of good practice. For example for small counterparties it may not be appropriate to rely on their representation.

- Need to be careful with over-hedging – PERG talks about reasonable estimates

- Regulatory creep: FCA and PRA papers on algo trading to include FX Spot despite being an unregulated product in the UK:
Physically settled commodity transactions Art. 7 Org Reg

1. For the purposes of Section C(7) of Annex I to Directive 2014/65/EU, a contract which is not a spot contract in accordance with paragraph 2 and which is not for commercial purposes as laid down in paragraph 4 shall be considered as having the characteristics of other derivative financial instruments where it satisfies the following conditions:
   
   (a) it meets one of the following criteria:
       
       (i) it is traded on a third country trading venue that performs a similar function to a regulated market, an MTF or an OTF;
       
       (ii) it is expressly stated to be traded on, or is subject to the rules of, a regulated market, an MTF, an OTF or such a third country trading venue;
       
       (iii) it is equivalent to a contract traded on a regulated market, MTF, an OTF or such a third country trading venue, with regards to the price, the lot, the delivery date and other contractual terms;

   (b) it is standardised so that the price, the lot, the delivery date and other terms are determined principally by reference to regularly published prices, standard lots or standard delivery dates.

2. A spot contract for the purposes of paragraph 1 shall be a contract for the sale of a commodity, asset or right, under the terms of which delivery is scheduled to be made within the longer of the following periods:
   
   (a) 2 trading days;
   
   (b) the period generally accepted in the market for that commodity, asset or right as the standard delivery period.

A contract shall not be considered a spot contract where, irrespective of its explicit terms, there is an understanding between the parties to the contract that delivery of the underlying is to be postponed and not to be performed within the period referred to in paragraph 2.

3. For the purposes of Section C(10) of Annex I to Directive 2004/39/EC of the European Parliament and of the Council ( ¹ ), a derivative contract relating to an underlying referred to in that Section or in Article 8 of this Regulation shall be considered to have the characteristics of other derivative financial instruments where one of the following conditions is satisfied:
   
   (a) it is settled in cash or may be settled in cash at the option of one or more of the parties, otherwise than by reason of a default or other termination event;
   
   (b) it is traded on a regulated market, an MTF, an OTF, or a third country trading venue that performs a similar function to a regulated market, MTF or an OTF;
   
   (c) the conditions laid down in paragraph 1 are satisfied in relation to that contract.

4. A contract shall be considered to be for commercial purposes for the purposes of Section C(7) of Annex I to Directive 2014/65/EU, and as not having the characteristics of other derivative financial instruments for the purposes of Sections C(7) and (10) of that Annex, where the following conditions are both met:
   
   (a) it is entered into with or by an operator or administrator of an energy transmission grid, energy balancing mechanism or pipeline network,
   
   (b) it is necessary to keep in balance the supplies and uses of energy at a given time, including the case when the reserve capacity contracted by an electricity transmission system operator as defined in Article 2(4) of Directive 2009/72/EC is being transferred from one prequalified balancing service provider to another prequalified balancing service provider with the consent of the relevant transmission system operator.
Physically settled commodity transactions

- Cash settled and on-venue commodity trades are in scope with the exception of wholesale gas and power trades on an OTF.

- Physically settled commodity trades that are off venue and do not have the characteristics of other derivative financial instruments are out of scope:
  - Standardised and
  - One of the following three conditions:
    - Traded on a third country venue;
    - Expressly stated to be traded on a venue or subject to rules of them;
    - Equivalent to a trade on a venue (EU or third country venue).

- Commodity transactions for “commercial purposes” carved out irrespective of how trades. Commercial purposes defined in Art. 7(2) Org Reg is limited to balancing trades with an operator or administrator of an energy transmission grid, energy balancing mechanism or pipeline network.

- Commodity spot trades carved out from C7 definition

- Commodity spot transactions carved out from C7 but not expressly from C6 – some industry debate

- Definition in Art. 7(2) Org Reg of a commodities spot transaction
Commodity spot transactions Art. 7(2) Org Reg

- Commodity spot transactions carved out from C7 but not expressly from C6 – some industry debate as to whether commodity spot transactions on an EU venue is a MiFID financial instrument or not, e.g. LME tomorrow transactions (LME Toms)

- Definition in Art. 7(2) Org Reg of a commodities spot transaction

2. A spot contract for the purposes of paragraph 1 shall be a contract for the sale of a commodity, asset or right, under the terms of which delivery is scheduled to be made within the longer of the following periods:

(a) 2 trading days;
(b) the period generally accepted in the market for that commodity, asset or right as the standard delivery period.

A contract shall not be considered a spot contract where, irrespective of its explicit terms, there is an understanding between the parties to the contract that delivery of the underlying is to be postponed and not to be performed within the period referred to in paragraph 2.

- Oil and coal trades in scope where they meet the tests but some temporary exemptions from EMIR obligations (Art. 95 MiFID2)
2. Overview of EMIR - European Market Infrastructure Regulation
Overview of EMIR – European Market Infrastructure Regulation

G20 commitment (Pittsburgh 2009):

“all standardised OTC derivative contracts should be traded on exchanges or electronic clearing platforms, where appropriate, and cleared through central counterparties by end-2012 at the latest. OTC derivatives should be reported to trade repositories. [Non-centrally cleared contracts should be subject to higher capital requirements and minimum margining requirements should be developed].”
## Overview of EMIR – European Market Infrastructure Regulation

### Counterparties in scope

<table>
<thead>
<tr>
<th>Entity category</th>
<th>Details</th>
</tr>
</thead>
</table>
| FC              | A financial counterparty (FC) includes:  
- a MIFID investment firm  
- a credit institution  
- a UCITS (and, where relevant, its management company)  
- an alternative investment fund (AIF) managed by an alternative investment fund manager (AIFM) which is authorised or registered in accordance with AIFMD  
- certain other EU regulated bodies such as insurance undertakings and institutions for occupational retirement provision  
- a central securities depository |
| NFC             | A non financial counterparty (NFC) is any undertaking established in the EEA which is not a financial counterparty or a CCP |
| Third Party FC / NFC | An entity established outside the EEA which would be a FC or NFC if it were established in the EEA |
What is the scope of counterparties’ obligations?

<table>
<thead>
<tr>
<th>Entity</th>
<th>Requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial counterparties above the Clearing Threshold (FC+s)</td>
<td>• Clearing obligation</td>
</tr>
<tr>
<td></td>
<td>• Risk mitigation techniques</td>
</tr>
<tr>
<td></td>
<td>• Reporting obligation</td>
</tr>
<tr>
<td>Financial counterparties below the Clearing Threshold (FC-s)</td>
<td>• Risk mitigation techniques</td>
</tr>
<tr>
<td></td>
<td>• Reporting obligation</td>
</tr>
<tr>
<td>Non financial counterparties above the Clearing Threshold (NFC+s)</td>
<td>• Clearing obligation (limited)</td>
</tr>
<tr>
<td></td>
<td>• Most of the risk mitigation techniques</td>
</tr>
<tr>
<td></td>
<td>• Reporting obligation</td>
</tr>
<tr>
<td>Non financial counterparties below the Clearing Threshold (NFC-s)</td>
<td>• Certain risk mitigation techniques</td>
</tr>
<tr>
<td></td>
<td>• Reporting obligation (limited)</td>
</tr>
</tbody>
</table>
Clearing Threshold for FCs and NFCs

- Clearing thresholds determined separately for each class (equity; credit etc) by reference to a specified gross notional value:
  - EUR 1 billion for OTC credit derivative contracts;
  - EUR 1 billion for OTC equity derivative contracts;
  - EUR 3 billion for OTC interest rate derivative contracts;
  - EUR 3 billion for OTC foreign exchange derivative contracts; and
  - EUR 3 billion for OTC commodity derivative contracts and all other classes of OTC derivatives combined.

- The threshold calculation currently uses AANA based on the aggregate month-end average position in OTC derivative contracts for the previous twelve months. If an entity does not perform the calculation, it is automatically considered subject to the obligation.
Phased Implementation of EMIR

Phase 1: 2013/2014
- Reporting and operational standards
  - Report to trade repositories
    - trade economics
    - collateral
  - Minimum operational standards
    - Daily valuation
    - Timely confirmation
    - Portfolio reconciliation
    - Dispute Resolution

Phase II: 2015/2018
- Mandatory clearing
  - Authorisation of clearing houses
  - Requirement to clear certain derivative transaction
  - Exemptions for intra-group transactions and pension schemes

Phase III: 2015 to 2021
- Margining obligation
  - Variation margin obligation
    - From 1 March 2017
  - Initial margin obligation - Phased in gradually until 1 September 2021
Overview of the risk mitigation obligations under EMIR

- Apply in respect of **uncleared** OTC derivatives
- Include exchange of margin (IM and VM), daily valuation of transactions, timely confirmation of transactions, portfolio compression, portfolio reconciliation and dispute resolution
- Certain of these risk mitigation obligations (such as margin) apply to FCs and NFC+s only, although NB extra-territoriality and anti-avoidance
- “Third country” FCs or NFC+s where “direct, substantial and foreseeable effect” or necessary as anti-avoidance measure
  - E.g. two EEA branches of non-EEA entities transacting with each other
## Risk Mitigation – Portfolio Reconciliation

<table>
<thead>
<tr>
<th>FC and NFC+</th>
<th>NFC-</th>
</tr>
</thead>
<tbody>
<tr>
<td>● ≥ 500 OTC derivatives contracts outstanding: each business day</td>
<td>● &gt; 100 OTC derivative contracts outstanding: once per quarter</td>
</tr>
<tr>
<td>● 51-499 OTC derivative contracts outstanding: once per week</td>
<td>● ≤ 100 OTC derivative contracts outstanding: once per year</td>
</tr>
<tr>
<td>● ≤ 50 OTC derivative contracts outstanding: once per quarter</td>
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</tbody>
</table>
Risk Mitigation – Portfolio Compression

Portfolio Compression

Applies to FCs and NFCs with over 500 uncleared OTC derivatives contracts outstanding to a single counterparty

Obligation to analyse the possibility of compression twice a year and be able to provide a reasonable and valid explanation to competent authority if conclude portfolio compression is not appropriate
Risk Mitigation – Dispute Resolution

Dispute Resolution

FCs must report to the competent authority any disputes for an amount in excess of EUR 15m and outstanding for at least 15 business days

FCs and NFCs, when concluding OTC derivatives contracts, must agree detailed procedures and processes in relation to:

• the identification, recording and monitoring of disputes relating to the recognition or valuation of the contract and exchange of collateral
• the resolution of disputes in a timely manner with a specific process for disputes outstanding for more than 5 business days
Risk Mitigation - Timely Confirmation of Transactions

<table>
<thead>
<tr>
<th>Timely Confirmation of Transactions</th>
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</thead>
<tbody>
<tr>
<td>Transactions between FCs and NFC+s – by T+1</td>
</tr>
<tr>
<td>Transactions between FCs and NFC+s – by T+2</td>
</tr>
</tbody>
</table>
Documentation

- ISDA 2013 EMIR Portfolio Reconciliation, Dispute Resolution and Disclosure Protocol
  - Typically incorporated into the ISDA Master Agreement

- Dodd-Frank March 2013 (DFP2) to EMIR Top Up Agreement
  - Helpful if parties acceded to the ISDA March 2012 D-F Protocol

- ISDA 2013 EMIR NFC Representation Protocol
  - Applicable to NFCs only
Reporting requirements

- **Product scope**
  - All OTC derivatives
  - All listed derivatives (exchanged traded derivatives)

- **Reporting responsibility**
  - FCs when entering into transactions with NFC-s
  - Otherwise, each entity is obliged to independently report the trade
  - One counterparty may delegate reporting to the other

- **Data to report**
  - Counterparty data – the details relating to the parties to the trade
  - Common data – the economic details relating to the contract
  - Post trade life cycle events
Documentation

- Confidentiality waiver
- ISDA 2013 Reporting Protocol
- Reporting Delegation Agreements
EMIR – Clearing obligation

- Clearing obligation currently applies to the following types of entities:
  - Two FC+s or NFC+s
  - Any FC+ or NFC+ and an entity established in a third country that would be an FC+ or NFC+ if it was established in the EU (TCE)
  - Two TCEs if the derivative has a direct, substantial and foreseeable effect or necessary or appropriate to prevent the evasion of EMIR

- FC+s must clear all OTC transactions subject to the clearing mandate

- NFC+s must only clear OTC transactions in respect of which they have exceeded the clearing threshold

- Transaction scope
  - Certain mandated classes of OTC derivatives (G4 IRS, EEA IRS, Index CDS)
Introduction to clearing

What is clearing?

- Process by which a central counterparty (‘CCP’) interposes itself between two parties’ derivatives transactions

- Results in the original transaction being split into two separate transactions, each with the CCP as a counterparty

- Means each counterparty has exposure to the CCP, rather than the other party

- ‘Client clearing’ a common variant, where one or both parties are clients of CMs rather than CMs themselves
Introduction to clearing

Rationale

- Aim of clearing is to promote financial stability by reducing counterparty credit risk and operational risk
- Standardises the process for managing defaults in the event a market participant insolvency
- Clearing transfers parties’ credit risk from each other to the CCP
- Concentration of credit risk means CCPs have become systematically important and subject to increased focus on their ability to manage risk
Documentation

- LCH Standard Terms for Client Clearing
- ISDA/FIA Client Clearing Addendum
- FIA Clearing Module (to an exchange traded products agreement)
3. Key MiFIR/MiFID2 obligations relating to derivatives
Key areas covered by MiFID2

- MiFID 2 can be split into key areas of rule making:
  - Conduct of business / investor protection
  - Governance
  - Licensing
  - Trading
  - Trade reporting and transparency
  - Trading venue-specific rules

- Overlap between areas, e.g. best execution goes to investor protection and trading and there are related reporting requirements.

- Focus today is on trading, reporting and transparency but lots of other general regulations applicable, e.g. best execution, costs and charges, inducements and research, etc.
Market Infrastructure

Central Counterparties, e.g. LME Clear

Settlement systems, e.g. CLS (CCPs may also be settlement systems)

Regulated Markets e.g. London Metal Exchange

Multilateral Trading Facilities, e.g. Bloomberg MTF

Organised Trading Facilities e.g. ICAP OTF

Systematic Internalisers and other liquidity providers e.g. broker dealers

Green = Trading Venues
Purple + Green = Execution Venues
Key concepts: Trading venues and systematic internalisers

- EU trading venue = regulated market ("RM"), multi-lateral facility ("MTF") or an organised trading facility ("OTF")

- An MTF is a multilateral system that brings together multiple third-party buying and selling interests in financial instruments in the system, in accordance with non-discretionary rules, in a way that results in a contract in accordance with the provisions of Title II of the MiFID II.

- RM is essentially an MTF that is regulated as an RM – a higher standard of regulation.

- An OTF is a system in which multiple third party buying and selling interests in bonds, structured finance product, emissions allowances or derivatives (note limited products, not equities) are able to interact in the system in a way which results in a contract and where the operator retains a level of discretion.

- Systematic internaliser is an investment firm which, on an organised, frequent systematic and substantial basis deals on own account when executing client orders outside a regulated market, an MTF or an OTF.
MiFIR Derivatives Trading Obligation

■ What is it?
  - Art. 28 MiFIR
  - Obligation to trade certain derivatives on EU trading venue or equivalent third country trading venues

■ To whom does it apply?
  - FC or NFC+ when facing FC, NFC+, or hypothetical FC or NFC+
  - Hypothetical FC or NFC+ when facing another hypothetical FC or NFC+ if “direct, substantial and foreseeable effect” or necessary as anti-avoidance measure
  - Does not include small financial counterparties (SFCs)
  - To what does it apply?
    - G3 currency IRS + iTraxx CDS (EMIR clearing obligation sub-set)
MiFIR Derivatives Trading Obligation

- Third country trading venues
  - Requires Commission ruling of third country equivalence, and third country effective supervision and enforcement
  - So far equivalence determinations in respect of certain venues in:
    - the United States of America
    - Hong Kong
    - Australia
    - Switzerland

- Brexit issues to be discussed
MiFIR/MiFID2 Transaction Reporting and Transparency Obligations

- **Pre-Trade Transparency**: SIs and trading venues required to make the price of certain quotes public and allow certain clients to trade against those prices.

- **Post-Trade Data Disclosure**: Applicable to systematic internalisers and trading venues only. Populates financial information reference data system (FIRDS).

- **Post-Trade Transparency**: Firms that conclude transactions in ToTV instruments must make certain information (e.g. price, volume) public via an APA.

- **Transaction Reporting**: Firms executing ToTV transactions must report specific details to competent authorities. ToTV and the meaning of execute are expanded for this obligation.

- **Commodity position limit reporting**: Members and participants of venues to report their commodity derivative positions and their clients’ (down the chain). Some EEOTC reporting for investment firms but unlikely to be many (if any) EEOTC commodity derivatives.

- Others, e.g. top 5 venues, quality of execution, etc..
ToTV concept

- Impacts pre- and post-trade transparency, T+1 and other obligations

- For securities, the ISIN is determinative

- For derivatives look to the reference data which includes the ISIN:

- T+1 also looks at the underlyer and composites of an index or basket
4. Capital rules impact on derivatives
Capital Requirements Regulation (CRR) and derivatives

- Credit risk mitigation opinions reduce exposure:
  - Close out netting enforceability – requirement for opinions – Article 296 CRR – to hold capital against net rather than gross exposure
  - Collateral enforceability – requirements for opinions Article 194 CRR
  - Article 305 CCP “look through” opinions for client cleared derivatives

- Credit Valuation Adjustment (CVA) is an adjustment (i.e. a discount) to the market value of derivative positions to account for counterparty credit risk. By clearing contracts CVA can be eliminated.
Netting opinions

Art 295

Net sum = sum of + ve and – ve MtM values

Legal opinion confirming validity

No walkaway clauses

Credit risk aggregated to give single exposure

Netting agreement of an approved type

Art 296 (2)

Net sum also includes close out values of bilateral master agreements

Legal opinion also addresses impact of bilateral master agreements

Green relevant for cross-product netting

Art 296 (3)
Impact of clearing on capital

**CM exposure to client**
CCR methods modified slightly for margin period of risk*. See Art 304.

**Client exposure to CM**
Where:
- positions and margin segregated and bankruptcy-remote;
- porting; and
- legal opinion,
then CCR modified as follows:
- 2% or 4% risk weight
- 0 exposure value for margin (if bankruptcy remote at CCP)
See Art 305.

**Clearing Member**

**CM exposure to QCCP**
Use Articles 306-7 or 310
Articles 306-7 modify CCR as follows:
- 2% risk weight
- 0 exposure value if CM not required to compensate client for changes in value if CCP defaults
- 0 exposure value for margin
Article 310 replaces CCR

*Margin period of risk = time between: (1) last exchange of collateral; and (2) close out and re-hedging
Credit Valuation Adjustment (CVA)

Example: A swap position with a counterparty with a rating of AAA is downgraded to BBB. The value of that swap is adjusted as below.

1. Decline in counterparty’s creditworthiness
2. Decline in market value of option
3. Decline in accounting value of option, thus reducing value of asset
4. Loss in P&L account
5. Deduct from retained profits on balance sheet
6. Reduction in value of capital
### Key capital developments on the horizon

<table>
<thead>
<tr>
<th>CRD5 and CRR2</th>
<th>IFD and IFR</th>
<th>Basel 4</th>
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<tbody>
<tr>
<td>• An EU Regulation and Directive</td>
<td>• A new prudential regime for non-systemic investment firms</td>
<td>• Informal name for December 2017 finalisation of the Basel 3 standards</td>
</tr>
<tr>
<td>• CRR2 amends the CRR</td>
<td>• Not yet published in the OJ. Small possibility of further changes.</td>
<td>• Will require legislation to implement in the EU and UK. Unlikely to be implemented exactly.</td>
</tr>
<tr>
<td>• CRD5 amends CRD4. Will require national implementation in Member States.</td>
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[1] CRD5 and CRR2

- An EU Regulation and Directive
- CRR2 amends the CRR
- CRD5 amends CRD4. Will require national implementation in Member States.

[2] IFD and IFR

- A new prudential regime for non-systemic investment firms
- Not yet published in the OJ. Small possibility of further changes.

[3] Basel 4

- Informal name for December 2017 finalisation of the Basel 3 standards
- Will require legislation to implement in the EU and UK. Unlikely to be implemented exactly.
Capital Developments Timeline

- **CRR2** starts coming into force on 27 June 2019
- Commission may adopt DA to amend market risk provisions
- Most of CRR2 comes into force on 28 June 2021
- IFD and IFR likely to come into force Q2 2021
- Almost all of CRD5 comes into force on 29 December 2020
- Commission likely to adopt proposal to implement Basel 4
- Commission may adopt proposal to amend market risk provisions in CRR2
- Remainder of CRR2 in force (may depend on L2)
- Likely end of IFR/IFD transitional period in Q2 2026
- Basel 4 output floor might be fully in force
5. Brexit
Some derivative-specific Brexit issues

- Licensing issues with lifecycle events and, e.g.:
  - Existing trade payments and collateral transfers
  - Novations and compressions
  - Changes to notional or other amendments
  - Exercise of options

- Mandatory Trading obligation for derivatives – UK and EU not currently intending to deem each others venues as equivalent.

- Cleared derivatives and ETD:
  - Access to venues and CCPs as member / client of a member
  - Settlement finality and CSDR
Some derivative-specific Brexit issues

- **Choice of governing law**: the recognition, both in the EU27 and the UK, of the parties' choice of English law in the ISDA Master Agreement is expected to be respected in the same way immediately post Brexit as it is pre-Brexit.

- **Enforcement of English court judgments**: expectation that EU27 courts would continue to give effect to provisions conferring exclusive jurisdiction on the English courts in contracts and to enforce the resulting judgment.

- **Impact on netting**: assuming English contractual law and the substantive insolvency rules applicable in England remaining the same after Brexit, Brexit should not affect the enforceability in England of contractual netting as provided for in the ISDA Master Agreement.

- **Insolvency proceedings**: post-Brexit EU27 courts would no longer be restricted from opening insolvency proceedings for a UK credit institution or investment firm.
Key contacts

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