

# Quoted

## **Derivatives update: recent developments with respect to EMIR and Brexit**

This edition includes recent developments under EMIR, proposed changes under the EMIR II Proposal and the consequences of a potential hard Brexit with respect to:

- Clearing requirement
- Risk-mitigation measures for non-cleared OTC derivatives
- Reporting requirements
- Practical tips

# In this edition

- Clearing requirement
- Risk-mitigation measures for non-cleared OTC derivatives
- Reporting requirements
- Practical tips

## Recent developments involving derivatives: EMIR and Brexit

Regulation (EU) 648/2012<sup>1</sup>, the *European Market Infrastructure Regulation (EMIR)* provides rules for over-the-counter (OTC) derivative contracts and the parties that conclude OTC contracts. These rules pertain to the mandatory clearing of OTC derivative transactions via central counterparties (CCPs) (the clearing requirement), the risk-mitigation measures parties must implement (including the margin requirement) and the obligation to report derivative transactions to regulated trade repositories (the reporting requirement, hereinafter together with the clearing requirement and the margin requirement referred to jointly as the key obligations). In addition to Regulation (EU) 648/2012 (EMIR level 1) there are also regulatory technical standards and implementing technical standards (EMIR level 2) and question and answer documents published by the *European Securities and Markets Authority (ESMA)* (EMIR level 3).

The definitions as set forth in the *Markets in Financial Instruments Directive II*<sup>2</sup> (MiFID II) have been guiding since 3 January 2018 as regards the interpretation of the term ‘derivative’<sup>3</sup> and the *Markets in Financial Instruments Regulation*<sup>4</sup> (MiFIR) introduces the obligation to trade standardised OTC derivatives on a regulated market, a multilateral trading facility (MFT) or an organised trading facility (OTF).<sup>5</sup> On 4 May 2017, the European Commission published a proposal to amend EMIR<sup>6</sup> that includes several

amendments with respect to the clearing requirement, the reporting requirement and requirements with respect to risk mitigation concerning non-cleared OTC derivatives (**EMIR II Proposal**). The EMIR II Proposal is still the subject of negotiation between the European Commission, the European Council and the European Parliament. The European Council published an amendment to the EMIR II Proposal in this connection on 11 December 2017<sup>7</sup> and the European Parliament published an amendment to the EMIR II Proposal in June 2018.<sup>8</sup> The aim was to realise a compromise text of the EMIR II Proposal by the end of 2018, but the negotiations between the three institutions have not yet ended.

In addition, the European Commission published a second proposal for amendment of EMIR on 13 June 2017<sup>9</sup> that included amendments with respect to the granting of licenses and recognition of CCPs partly in connection with the departure of the United Kingdom (UK) from the European Union (EU). An expansion of ESMA’s role was also proposed in connection with what is known as the ESA revision in September 2017. The latter proposals will not be discussed in this edition of Quoted.

Negotiations concerning the UK’s departure from the EU (**Brexit**) have been ongoing since 29 March 2017. The negotiators of the UK and the EU reached agreement on 13 November 2018 on a withdrawal agreement (**Draft Brexit Agreement**)<sup>10</sup> in which further agreements have been laid down concerning Brexit as well as a transitional

1 Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (OJEU 2012, L 201/1).

2 Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (OJEU 2014, L 173/349).

3 See also Genoteerd, MiFID II: bent u er klaar voor, November 2017, number 117, which may be consulted at: <https://www.loyensloeff.com/media/1477582/genoteerd-117.pdf>.

4 Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012 (OJEU 2014, L 173/84).

5 For further information about general obligations under MiFID II and MiFIR, refer to Genoteerd, MiFID II: bent u er klaar voor, November 2017, number 117 en R. Steeg, OTC-Derivaten en de ISDA Master Agreement; (hoe) werkt het naar Nederlands recht? (Deel II), TvFR, number 5, November 2017, pp. 37-49.

6 Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Regulation (EU) No 648/2012 as regards the clearing requirement, the suspension of the clearing requirement, the reporting requirements, the risk-mitigation techniques for OTC derivatives contracts not cleared by a central counterparty, the registration and supervision of trade repositories and the requirements for trade repositories, COM/2017/0208 final of 4 May 2017 (**EMIR II Proposal**).

7 Proposal of the European Council for amendment of the EMIR II Proposal, 11 December 2017, 2017/0090 (COD).

8 Proposal of the European Parliament for amendment of the EMIR II Proposal, 12 June 2018, P8\_TA(2018)0244 (**EP Counterproposal EMIR II**).

9 Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Regulation (EU) No 1095/2010 establishing a European Supervisory Authority (European Securities and Markets Authority) and amending Regulation (EU) No 648/2012 as regards the procedures and authorities involved for the authorisation of CCPs and requirements for the recognition of third-country CCPs, COM/2017/0331 final of 13 June 2017.

10 The withdrawal agreement that was published on 14 November 2018 can be consulted via: [https://ec.europa.eu/commission/sites/beta-political/files/draft\\_withdrawal\\_agreement\\_0.pdf](https://ec.europa.eu/commission/sites/beta-political/files/draft_withdrawal_agreement_0.pdf).

period. A transitional period applies up to and including 31 December 2020 and the (current) law of the EU will continue to apply in the UK.<sup>11</sup> The European Council adopted the Draft Brexit Agreement on 25 November 2018. However, the UK Parliament rejected the Draft Brexit Agreement as well as an adjusted version of the Draft Brexit Agreement on 15 January 2019 and 12 March 2019 respectively. A majority of the UK Parliament subsequently voted against departure without a withdrawal agreement on 13 March 2019. On 14 March 2019, a majority of the UK Parliament voted against a proposal for postponement of the withdrawal date. On 21 March 2019, all the other 27 Member States of the EU agreed to a postponement until 22 May 2019 subject to the condition that the Draft Brexit Agreement be approved by the UK Parliament as yet before 29 March 2019. If this condition is not met, agreement must be reached between the UK and the EU on or before 12 April 2019 regarding an alternative withdrawal agreement or a longer postponement of the Brexit. The withdrawal date was thus moved up to 12 April 2019 for the time being.

If no withdrawal agreement has been concluded on or before 12 April 2019 or a request for postponement has not been approved unanimously by the other 27 EU Member States, the UK will leave the EU at midnight on the night of 12 April 2019 to 13 April 2019 without a transitional period (a **Hard Brexit**). A Hard Brexit has direct consequences for the parties established in the remaining EU Member States who have concluded (directly or indirectly via an agent) OTC derivative contracts (i) with parties regulated in the UK, (ii) that must be cleared via a CCP regulated in the UK and/or (iii) whose reporting takes place to a trade repository that is established (and regulated) in the UK.

This edition of Quoted provides an overview of the various key obligations under EMIR for non-financial counterparties, the impact of potential changes resulting from the EMIR II Proposal and the consequences of a Hard Brexit for the key obligations under EMIR. The final paragraph includes several practical tips.

## 1 Clearing requirement

### 1.1 EMIR

A derivative is a financial instrument that is based on an underlying value (such as an exchange rate, interest rate, share price). The performance of a derivative depends on fluctuations in the price of the underlying value. A derivative may be used to hedge certain financial risks (e.g., the fluctuation of an interest rate or exchange rate) or for speculation purposes.<sup>12</sup> Derivatives may be standardised and traded on a financial market or they may be customised and provide for a specific need of the parties.<sup>13</sup> The latter derivatives are formed by bilateral transactions and are referred to as OTC derivatives. In practice, many OTC derivatives are formed on the basis of standard derivative contracts from the *International Swaps and Derivatives Association (ISDA)*.

EMIR defines an OTC derivative contract as a derivative contract whose execution does not take place on a regulated market or on a third- country market that is considered equivalent to a regulated market.<sup>14</sup>

EMIR provides that the scope of an OTC derivative contract includes among other things options, futures, swaps and forward contracts that concern securities, currencies, interest rates, financial indices or standards and raw materials.<sup>15</sup> Reference in this Quoted to an OTC derivative contract or OTC derivatives contract is a reference to an 'OTC derivative contract' or an 'OTC derivatives contract' within the meaning of Article 2(7) EMIR.

EMIR creates a clearing requirement for certain OTC derivative contracts through the intervention of a CCP.<sup>16</sup> A CCP is a legal person that interposes itself between the counterparties to the contracts traded on one or more financial markets, becoming the buyer to every seller and the seller to every buyer.<sup>17</sup> The original counterparty risk is thus taken over by the CCP. A CCP imposes strict requirements on its members (the clearing members). Counterparties that do not or are unable to meet these requirements are therefore obliged to have their OTC derivative transactions settled directly or indirectly via a

11 Articles 126 and 127 of the Draft Brexit Agreement.

12 R.W.K. Steeg, OTC-Derivaten en de ISDA Master Agreement; (hoe) werkt het naar Nederlands recht? (Deel I), *TvFR*, number 4, September 2017, p. 1

13 *Idem*.

14 Article 2(7) EMIR.

15 Article 2(5) EMIR and Annex I, point C, points 4 to 10 MiFID II.

16 Article 4 EMIR.

17 Article 2(1) EMIR.

clearing member. Settlement by an CCP also means that the CCP establishes derivative positions, calculates net obligations, and ensures that the collateral in the form of financial instruments, cash, or both are available for the purpose of securing the risk position arising from these derivative positions.<sup>18</sup>

Following comprehensive advice from ESMA, the European Commission determined certain classes of OTC derivatives that come under the scope of the clearing requirement, the dates on which the clearing requirement enters into effect for certain categories of counterparties and the minimum remaining term of certain OTC derivative contracts that come under the scope of the clearing requirement.<sup>19</sup> In the event a counterparty has concluded an OTC derivative contract, it must be determined whether the clearing requirement applies to that counterparty.

The clearing requirement applies inter alia to:

- a. financial counterparties, and
- b. non-financial counterparties that hold positions in OTC derivatives concluded for speculative purposes<sup>20</sup> whose gross nominal value exceeds the relevant threshold value (**NFC+**).<sup>21</sup>

Financial counterparties are investment firms, credit institutions, insurance undertakings, assurance undertakings, reinsurance undertakings, UCITS and, where relevant, its management company, institutions for occupational retirement provision that are managed by managers of alternative investment funds, each of which holds a licence in accordance with the applicable directives as referred to in the definition of 'financial counterparty'.<sup>22</sup>

Non-financial counterparties are undertakings established in the EU with the exception of entities that qualify as financial counterparty, CCP, trade repository or trade platform.<sup>23</sup>

The calculation of the positions under (b) must concern all (speculative) OTC derivative contracts that are concluded by the non-financial counterparty or by other non-financial entities within the group to which that party belongs<sup>24</sup> (excluding intragroup transactions that come under the intragroup exemption of Article 4(2) EMIR). OTC derivatives concluded for speculative purposes refers to OTC derivatives in respect of which it cannot be demonstrated objectively that they mitigate risks that are related directly to the commercial activities or the treasury activities of the non-financial counterparty or of that group.<sup>25</sup> The European Commission has determined threshold values for the various categories of OTC derivative contracts to which the clearing requirement may apply.<sup>26</sup> In the event a non-financial counterparty exceeds the threshold value of a category, all OTC derivative contracts (including OTC derivative contracts that are part of other categories) will be subject to the clearing requirement, provided the relevant OTC derivative contracts can be settled technically by a CCP. So far, this only applies to certain interest rate derivatives and foreign exchange derivatives.

The clearing requirement does not apply with respect to OTC derivative contracts concluded with a non-financial party that does not qualify as an NFC+ (i.e., an **NFC-**). An exemption also applies to intragroup transactions that satisfy the conditions of Article 3 EMIR. This concerns

18 Article 2(3) EMIR.

19 Article 5(2) EMIR, Commission Delegated Regulation (EU) 2015/2205 of 6 August 2015 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on the clearing requirement (OJEU 2015, L 314/13), Commission Delegated Regulation (EU) 2016/592 of 1 March 2016 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on the clearing requirement (OJEU 2016, L 103/5) and Commission Delegated Regulation (EU) 2017/751 of 16 March 2017 amending Delegated Regulations (EU) 2015/2205, (EU) 2016/592 and (EU) 2016/1178 as regards the deadline for compliance with clearing requirements for certain counterparties dealing with OTC derivatives (OJEU 2017, L 113/15).

20 Article 10(3) EMIR.

21 Articles 10(1) and (3) EMIR.

22 Article 2(8) EMIR.

23 Article 2(9) EMIR.

24 Article 10(3) EMIR.

25 Article 10(3) EMIR. Article 10 of the Commission Delegated Regulation (EU) No 149/2013 of 19 December 2012 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on indirect clearing arrangements, the clearing requirement, the public register, access to a trading venue, non-financial counterparties, and risk mitigation techniques for OTC derivatives contracts not cleared by a CCP (OJEU 2013, L52/11) (**Regulation 149/2013**) provides a further qualification of what is meant by a non-speculative OTC derivative contract.

26 Based on the gross nominal value, these threshold values are as follows: 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 other OTC derivative contracts (see Article 11 Regulations 149/2013).

OTC derivative contracts concluded between two counterparties that are part of the same group, which are both included in the same consolidation<sup>27</sup> and are subject to appropriate centralised risk evaluation, measurement and control procedures and that counterparty is established in the EU or in a third country accepted by the European Commission.<sup>28</sup> Specific further requirements also apply, which include the following:

1. in the case of OTC derivative contracts concluded between two counterparties established in the EU, the relevant competent authority (in the Netherlands: De Nederlandsche Bank (**DNB**)) must have received written notification in advance of the intention to apply the exemption, whereby that authority is competent to object to the application of the exemption if the exemption requirements are not or are no longer satisfied,<sup>29</sup> and
2. in the case of OTC derivative contracts concluded between a counterparty established in the EU and a counterparty established in a third country, the relevant competent authority must have granted consent allowing application of the exemption.<sup>30</sup>

In addition, pursuant to EMIR, OTC derivative contracts concluded with the entities mentioned in Article 1(4) EMIR (including the central banks of the Member States) are not subject to the clearing requirement either. Furthermore, a temporary exemption from the clearing requirement for OTC derivative contracts concluded by pension funds for the purpose of mitigating investment risks existed until 18 August 2018.<sup>31</sup> The EMIR II Proposal includes a three-year extension of that exemption as from the effective date of the regulations of the EMIR II Proposal.<sup>32</sup> The exemption no longer applies from a formal perspective, because this

proposal has not yet been adopted. ESMA indicated in its letter dated 3 July 2018 that it expects the competent authorities not to prioritise taking measures against pension funds that would come under the exemption from the clearing requirement.<sup>33</sup> ESMA therefore encourages a 'tolerance policy'. The Dutch Authority for the Financial Markets (**AFM**) and DNB indicated on 14 August 2018 that they support this request from ESMA.<sup>34</sup>

## 1.2 EMIR II Proposal

The European Commission's aim with the EMIR II Proposal is to simplify the rules, reduce costs and burden, and to facilitate reporting and access to clearing.<sup>35</sup> The EMIR II Proposal includes the following changes with respect to the clearing requirement:

1. Expansion of the definition of financial counterparty to include (i) central securities depositories and (ii) *special purpose entities* for securitisation purposes (**SPV**s).<sup>36</sup>
2. The scope of application of the threshold values for the clearing requirement that apply only to non-financial counterparties under EMIR is expanded to include financial counterparties. The consequence thereof is that certain small financial counterparties are released from the clearing requirement.<sup>37</sup> A financial counterparty does have to include all OTC derivative contracts concluded by that financial party or by other entities within the group in the calculation and therefore not just the speculative OTC derivative contracts.<sup>38</sup>
3. Addition of a power on the part of ESMA to request the European Commission to suspend the clearing requirement of a certain class of OTC derivative contracts or for a specific type of counterparty for a period of three months (with the option of extending this period each time by three months) provided one of the following requirements is satisfied:

27 Consolidation is defined in Article 3(3) EMIR and this includes, for example, consolidation in accordance with the International Financial Reporting Standards (IFRS).

28 This refers to a third country in respect of which the European Commission has adopted an implementing act as referred to in Article 13(2) EMIR.

29 Article 4(2)(a) EMIR.

30 Article 4(2)(b) EMIR.

31 Article 1 Commission Delegated Regulation (EU) 2017/610 of 20 December 2016 amending Regulation (EU) No 648/2012 of the European Parliament and of the Council as regards the extension of the transitional periods related to pension scheme arrangements (OJEU 2017, L 86/3).

32 Article 89(1) EMIR II.

33 ESMA, 'Clearing requirement for pension scheme arrangements', 3 July 2018, ESMA70-151-1462, which can be consulted at [https://www.esma.europa.eu/sites/default/files/library/esma70-151-1462\\_communication\\_on\\_clearing\\_obligation\\_for\\_pension\\_scheme\\_arrangements\\_0.pdf](https://www.esma.europa.eu/sites/default/files/library/esma70-151-1462_communication_on_clearing_obligation_for_pension_scheme_arrangements_0.pdf).

34 DNB, 'AFM en DNB volgen statement ESMA over clearing- en handelsverplichting pensioenfondsen', 14 August 2018, which can be consulted via: <http://www.toezicht.dnb.nl/7/50-237281.jsp>.

35 Paragraphs 1.1 and 1.2 of the explanation to EMIR II.

36 Article 1(1) EMIR II.

37 Articles 1(2) and (3) EMIR II.

38 Article 1(3) EMIR II.

- (a) the class of OTC derivatives no longer qualifies for central clearing,
  - (b) a CCP is likely to stop clearing a specific class of OTC derivatives and no other CCP is able to settle this specific class of OTC derivatives without interruption, or
  - (c) suspension of the clearing requirement for a specific class of OTC derivatives or a specific type of counterparty is necessary to prevent or deal with a serious threat to the financial stability within the EU and is proportionate to this purpose.<sup>39</sup>
4. The method for calculating the clearing thresholds for a non-financial counterparty that assumes positions in OTC derivative contracts changes and the clearing requirement applies if its aggregate average position at the end of the month for the months of March, April and May exceeds the clearing thresholds and no longer applies if the average current position over a period of 30 days exceeds the thresholds.<sup>40</sup>
  5. The exemption from the clearing requirement for pension funds described in paragraph 1.1.

### 1.3 Consequences of a Hard Brexit

A financial undertaking that is established in the UK (such as an English bank) and that concludes an OTC derivative contract with a counterparty established in the EU, in so far as it qualifies as a MiFID investment service, must in principle hold a licence for offering that investment service pursuant to Dutch law. Following a Hard Brexit effective as from 13 April 2019, the UK will lose its access to the European internal market and financial undertakings can no longer use their 'European passport' for the purpose of providing their investment services in the EU.<sup>41</sup> Following a Hard Brexit, the UK will qualify as a 'third country' (i.e., a country that is not a member of the EU or the European Economic Area (**EEA**)). This has several consequences that will be discussed below.

#### *Authorised counterparties in the UK*

One consequence of a Hard Brexit is that counterparties that are established in the UK and are supervised in the

UK can no longer benefit from their European passport. This means that the following financial undertakings require a European passport, in so far as the undertaking qualifies as a MiFID investment risk, to conclude or maintain OTC derivative contracts with or on behalf of a counterparty established in the EU (**EU Counterparty**):

1. a financial undertaking that qualifies as a bank or investment institution and is supervised in the UK, which does not pass the initiative test described below and concludes OTC derivative contracts with counterparties established in the EU (a **UK Regulated Counterparty**),
2. a financial undertaking that is supervised in the UK and acts as a clearing member for the purpose of clearing OTC derivative contracts,
3. a financial undertaking that is supervised in the UK and concludes OTC derivative contracts for clients established in the EU as an agent or broker, the financial undertakings referred to under 2 and 3 are referred to hereinafter as: **UK Financial Service Providers**.

In principle, continuation of an existing OTC derivative transaction does not qualify as a MiFID activity and the loss of a European passport will therefore not lead to an illegal activity.<sup>42</sup> An illegal activity could constitute grounds for (early) termination under the standard ISDA derivative contracts and thus prejudice the continuation of an existing OTC derivative contract (including the transactions concluded thereunder).<sup>43</sup> It might be the case, however, that an EU Member State has implemented the MiFID II rules more strictly in national legislation, which means that an illegal activity may very well exist after all.

In the event new transactions are concluded under an existing OTC derivative contract, an existing OTC derivative contract is changed (in a material) sense, or the transactions under an OTC derivative contract are rolled over (hereinafter referred to as **Relevant Lifecycle Events**), such will be considered to constitute a new

<sup>39</sup> Article 1(6) EMIR II.

<sup>40</sup> Article 1(8) EMIR II.

<sup>41</sup> Financial undertakings that hold a licence in a country in the EEA granted by the supervisory authority of that country and that wishes to offer products and services in one of the other countries of the EEA can have themselves registered with that supervisory authority and will then obtain a European passport. A European passport allows a financial undertaking to offer products and services in one of the other countries of the EEA as well without being supervised in that country by the national supervisory authority.

<sup>42</sup> See for a comprehensive overview of the potential consequences of a Hard Brexit for ISDA contracts, ISDA Brexit FAQs, 10 April 2018, which can be consulted at: <https://www.isda.org/2018/04/10/brexit-faq/>.

<sup>43</sup> See for example paragraph 5(b)(i) ISDA Master Agreement.

transaction or a new contract. This may mean that a UK Regulated Counterparty requires a European passport in order to avoid acting in contravention of applicable regulatory law.<sup>44</sup> This depends on national legislation as well. In the Netherlands, a UK Regulated Party will usually require a European passport to act or continue to act (legally) in accordance with regulatory law with respect to Relevant Lifecycle Events and to prevent a termination event from arising.<sup>45</sup>

In principle, a UK Regulated Counterparty cannot continue an OTC derivative contract concluded with a counterparty established in the Netherlands and in respect of which a Relevant Lifecycle Event occurs without acting in contravention of regulatory law. As indicated above, an illegal activity may constitute a termination event under the standard ISDA contracts.<sup>46</sup> In addition to the option of terminating the OTC derivative contract, the counterparty also has the option of transferring the entire contract (novating under English law) to an EU Counterparty. In this connection, ESMA made a proposal for these situations on 8 November 2018 to adopt a temporary exemption from the clearing requirement.<sup>47</sup> This exemption is limited to twelve months after the UK has withdrawn, so that the counterparties have time to conclude new OTC derivative contracts and to determine whether the new (or novated) OTC derivative contracts can be settled via an EU CCP instead of via a UK CCP.<sup>48</sup> In order to prevent abuse, this exemption applies only with respect to a novation to a new EU Counterparty that is not subject to a clearing requirement and the exemption does not apply to Relevant Lifecycle Events that occur with respect to the novated OTC derivative contract.<sup>49</sup>

Following a Hard Brexit, UK Financial Service Providers will no longer be able to benefit from a European passport either and this means in principle that they will no longer be allowed to offer their services to clients in the EU.

Following a Hard Brexit, a non-financial EU Counterparty on whose behalf a UK Financial Service Provider (acting as an agent) concludes and maintains new OTC derivative contracts will be required to engage another financial undertaking, which is established in the EU and holds the correct licence to carry out such activities.

Dutch regulatory law includes several exemptions from the licence requirement that applies to investment firms and that may offer a solution after a Hard Brexit.

An investment firm with its registered office in a third country (the UK after a Hard Brexit) that provides investment services to or that carries out investment activities for non-professional investors in the Netherlands, is obliged in principle to establish a branch office in the Netherlands and to apply for a licence from the AFM. An investment firm with its registered office in a third country that provides investment services or performs investment activities exclusively at the initiative of a Dutch client does not require a licence for those investment services and activities.<sup>50</sup> This exception to the MiFID II rules is included in the Financial Supervision Act (**Wft**). What is known as the 'initiative test' is a test of the facts that is applied strictly. For example, the initiative test is failed if an investment firm from a third country actively offers, promotes or advertises services to clients in the Netherlands or if the investment firm will be performing additional investment services or investment activities supplementary to the investment services or investment activities initiated by the client.<sup>51</sup>

In addition, an investment firm with its registered office in a third country that trades in the Netherlands exclusively in the conduct of its profession or business for its own account with a counterparty established in the Netherlands that also acts in the conduct of its profession or business for its own account, does not require a licence

44 ISDA Brexit Advice – Summary of Preliminary Analysis of Lifecycle and Other Events, 1 October 2017, which can be consulted via: [https://www.isda.org/a/ggKDE/ISDA\\_Brexit\\_Summary-of-Lifecycle-Events-Analysis.pdf](https://www.isda.org/a/ggKDE/ISDA_Brexit_Summary-of-Lifecycle-Events-Analysis.pdf).

45 *Idem*.

46 See for example paragraph 5(b)(i) ISDA Master Agreement.

47 ESMA's Final Report EMIR RTS on the novation of contracts for which the clearing requirement has not yet taken effect, 8 November 2018, ESMA70-151-1854 (**ESMA Clearing Exemption RTS**), which can be consulted via: [https://www.esma.europa.eu/sites/default/files/library/esma70-151-1854\\_final\\_report\\_on\\_the\\_co\\_regarding\\_novated\\_trades\\_to\\_the\\_eu.pdf](https://www.esma.europa.eu/sites/default/files/library/esma70-151-1854_final_report_on_the_co_regarding_novated_trades_to_the_eu.pdf).

48 Paragraph 2.3, subparagraph 15(b) ESMA Clearing Exemption RTS.

49 Paragraph 2.3, subparagraph 15(a) ESMA Clearing Exemption RTS.

50 Section 1:19c Wft.

51 AFM, 'MiFID II – Initiatietest', which can be consulted via: <https://www.afm.nl/nl-nl/professionals/onderwerpen/mifid-2/vergunningen-initiatietest>.



for that investment activity.<sup>52</sup> However, that exemption does not apply if an investment firm also performs another investment service or activity in addition to the abovementioned trade for its own account.

On 4 February 2019, the Dutch legislator adopted a temporary exemption for investment firms that are regulated in the UK in case of a Hard Brexit.<sup>53</sup> In short, the exemption means that during a temporary period (i.e., until 1 January 2021) (i) a UK Financial Service Provider may continue to act as agent/broker, after notifying the AFM, for the purpose of concluding derivative transactions on behalf of a non-financial EU Counterparty that is established in the Netherlands and (ii) a counterparty to a derivative that is established in the UK and requires a licence to offer investment services to a non-financial EU Counterparty that is established in the Netherlands may continue to offer investment services (including the conclusion of derivative transactions) after notifying the AFM.<sup>54</sup> In order to qualify for the exemption, the abovementioned EU Counterparty must be a professional investor as referred to in Section 1:1 Wft or a qualifying counterparty as referred to in annex II, part I of MiFID II. The temporary period is intended to afford Dutch users of services provided by investment institutions regulated in the UK more time to find a new service provider in the EU.

#### *Authorised CCP's in the UK*

A Hard Brexit also means that a CCP that is established and regulated in the UK (a **UK CCP**) no longer qualifies as an “authorised CCP” on the basis of the provisions of EMIR and is therefore no longer able to clear derivatives in the manner prescribed by EMIR. This means that EU Counterparties can no longer have their OTC derivative transactions cleared by a UK CCP in order to comply with their own obligations under EMIR and will have to have their OTC derivative transactions cleared via CCPs established in the EU and registered under EMIR (an

**EU CCP**) if they wish to comply with EMIR. Following a Hard Brexit, settlement via a clearing member established in the UK will no longer be in accordance with the rules either (a clearing member in the UK will usually wish to clear transactions with a UK CCP) and will logically take place via a clearing member established in the EU. These rules therefore apply to parties that are subject to a clearing requirement on the basis of EMIR. A large part of derivative transactions are currently cleared by LCH Limited (a UK CCP)<sup>55</sup>. The European Commission may approve a third country (the UK following a Hard Brexit) for recognition by ESMA of a CCP established there.<sup>56</sup> If this is the case, several requirements will have to be satisfied and for this purpose ESMA will be required to conclude a cooperation agreement with the relevant competent authority in the UK as one of the final steps for decision-making by the European Commission.<sup>57</sup> ESMA communicated on 4 February 2019 that it reached agreement with the central bank of England concerning collaboration on the recognition of UK CCPs in case of a Hard Brexit.<sup>58</sup> ESMA announced on 18 February 2019 that three UK CCPs (LCH Limited, ICE Clear Europe Limited and LME Clear Limited) qualify for recognition by the European Commission as regards their clearing services for the remaining EU Member States in case of a Hard Brexit.<sup>59</sup> The European Commission will include these CCPs in its decision concerning recognition.

#### *Calculation of clearing thresholds*

A Hard Brexit will also have consequences for the calculation of the clearing thresholds. For example, following a Hard Brexit all derivative transactions that are carried out on a market in the UK will be covered by the definition of an OTC derivative contract until the market in the UK is deemed to be equivalent to the regulated market in the EU. This could mean that following a Hard Brexit the positions of non-financial counterparties to OTC derivatives concluded for speculative purposes exceed a threshold

<sup>52</sup> Section 10a Wft.

<sup>53</sup> Order of the Minister of Finance of 4 February 2019, 2019-16957, Financial Markets directorate, amending the Designated States (Financial Supervision Act) Decree and the Exemption Regulations under the Financial Supervision Act in connection with the withdrawal of the United Kingdom from the European Union.

<sup>54</sup> Section 10 Exemption Regulations under the Financial Supervision Act.

<sup>55</sup> ISDA Margin Survey 2017, September 2017, which can be consulted via: <https://www.isda.org/a/VeiDE/margin-survey-final1.pdf>.

<sup>56</sup> Article 25(6) EMIR.

<sup>57</sup> Article 25 EMIR.

<sup>58</sup> ESMA's press release, ESMA agrees no-deal Brexit MOUs with the Bank of England for recognition of UK CCPs and the UK CSD, 4 February 2019, which can be consulted via: <https://www.esma.europa.eu/press-news/esma-news/esma-agrees-no-deal-brex-it-mous-bank-england-recognition-uk-ccps-and-uk-csd>.

<sup>59</sup> ESMA's press release, ESMA to recognise three UK CCPs in the event of a no-deal Brexit, 18 February 2019, which can be consulted via: <https://www.esma.europa.eu/press-news/esma-news/esma-recognise-three-uk-ccps-in-event-no-deal-brex-it>.

value irrespective of whether such derivative contracts were cleared by a CCP before the Hard Brexit or not. It is also relevant in this connection to have the clearing of derivative transactions carried out by an EU CCP or that the UK CCP is recognised by the European Commission. It is not likely that this point will give rise to significant problems in view of the progress that has been made in the equivalence decision set out above.

#### *Intragroup exemption*

A Hard Brexit also has consequences for the intragroup exemption provided for in Article 3 EMIR. A counterparty that is established in the UK and forms part of the same group no longer qualifies as an EU Counterparty, but rather as a counterparty established in a third country. The European Commission will have to recognise the UK as a third country within the context of equivalence supervision in accordance with the requirements of Article 13(2) EMIR before the intragroup exemption can be applied. In addition, the competent authority will have to consent to the application of the intragroup exemption and a written notification of the intention to apply the exemption (including the possibility of objection by the relevant competent authority) will not be sufficient. The intragroup exemption will lapse and an exemption will have to be applied for again in the event EU Counterparties apply the intragroup exemption and one of the counterparties is established in the UK.

#### *Derivative contracts concluded with the central bank of England and the United Kingdom Debt Management Office*

And finally, following a Hard Brexit, OTC derivative contracts concluded with the central bank of England and United Kingdom Debt Management Office will no longer fall outside the scope of EMIR. Such derivative transactions may therefore come under the clearing requirement and must be included in the calculation of the clearing thresholds.<sup>60</sup> The European Commission is authorised in accordance with Article 82 EMIR to determine delegated acts for the purpose of changing the list referred to in Article 1(4) EMIR.<sup>61</sup> The proposal of the European Parliament for amendment of the EMIR II

Proposal proposes a broadening of Article 1(4) EMIR so that the central bank of England and the United Kingdom Debt Management Office still come under the scope of application of EMIR as part of that proposal.<sup>62</sup> It is still unclear whether this proposal will be accepted by the European Commission and the European Council.

## **2 Risk-mitigation measures for non-cleared OTC derivatives**

### **2.1 EMIR**

Pursuant to Article 11(1) EMIR, counterparties that have concluded non-cleared OTC derivative contracts must have introduced appropriate procedures and regulations to measure, monitor and limit operation risk and counterparty credit risks. Counterparties must (a) have electronic means available to ensure timely confirmation of the conditions of an OTC derivative contract and (b) have formalised processes that are robust, resilient and auditable, for the purpose of reconciling the underlying value of the derivative portfolios with each other, to control the related risk, to identify and resolve disputes between parties at an early stage and to monitor the value of the outstanding derivative contracts.<sup>63</sup> Counterparties have the right to delegate risk-mitigation measures under Article 11(1) EMIR to asset managers.<sup>64</sup>

#### *Laying down agreements on time*

Laying down the conditions of OTC derivative contracts concluded (by telephone) between parties must take place electronically as much as possible.<sup>65</sup> The term within which an OTC derivative contract must be confirmed is as soon as possible and in any event the next business day for OTC derivative contracts concluded between financial counterparties and non-financial counterparties that qualify as NFC+, and the second business day for OTC derivative contracts concluded with non-financial counterparties that qualify as NFC-.<sup>66</sup>

#### *Margin requirements*

Financial counterparties and non-financial counterparties that qualify as NFC+ are required to value their outstanding

60 Article 1(4) EMIR.

61 Article 1(6) EMIR.

62 Article 1 EP Counterproposal EMIR II.

63 Article 11(1)(a) and (b) Commission Delegated Regulation (EU) No 149/2013.

64 Q&A, *Implementation of the Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories (EMIR)*, 3 December 2018, ESMA70-1861941480-52, p. 30.

65 Article 11(1)(a) EMIR.

66 Article 11(1)(a) EMIR and Article 12 Commission Delegated Regulation (EU) No 149/2013.

OTC derivative contracts daily against fair value<sup>67</sup> and to exchange collateral on time by way of security for the counterparty risk<sup>68</sup> (known as the margin requirements). Non-financial counterparties that qualify as NFC- are not required to demand collateral from their counterparties. The counterparty risk is the risk that the counterparty fails to comply with its payment obligations under certain OTC derivative contracts. OTC derivative transactions performed under a framework agreement, the ISDA Master Agreement, jointly form a single agreement.<sup>69</sup> In case a termination event arises under the ISDA Master Agreement, the other party will have the right to terminate all OTC derivative transactions agreed within the context of that framework agreement.<sup>70</sup> All OTC derivative transactions are valued and netted into a single payment obligation of one counterparty to the other counterparty.<sup>71</sup>

A distinction is made between the variation margin and the initial margin. Variation margin must be collected to mitigate the risk inherent in fluctuations in the current market value.<sup>72</sup> This means that the (balanced) counterparty risk may differ on a day-to-day basis and the variation margin in principle must be calculated daily.<sup>73</sup> The counterparty that owes the variation margin is required in principle to provide collateral on the business day on which the calculation of the variation margin takes place

and is communicated.<sup>74</sup> The obligation to collect the variation margin has already entered into force.<sup>75</sup>

Furthermore, it is the case that in the event of counterparty default there is a risk that an OTC derivative transaction has to be concluded again, while its market value and the collateral already collected is subject to change between the moment of the last collection of variation margin and the termination of the derivative transactions or mitigation of market risk following non-payment by the other counterparty. Initial margin must therefore be collected to mitigate that risk.<sup>76</sup> Initial margin must be calculated at the latest on the business day following the day on which a certain transaction takes place or a contract that has been concluded is subject to a change in value.<sup>77</sup> The obligation to collect the initial margin enters into effect in a phased manner. In the event both counterparties hold or are part of groups that each hold an aggregated average notional amount in OTC derivatives not cleared centrally in excess of (i) EUR 750 billion, the obligation applies as from 1 September 2019, and in excess of (ii) EUR 8 billion, as from 1 September 2019.<sup>78</sup> Counterparties are allowed to agree that no initial margin is collected if the aggregate average notional amount in OTC derivatives not cleared centrally and the amount to be collected remains below certain threshold values.<sup>79</sup>

67 Article 11(2) EMIR and Articles 16 and 17 Commission Delegated Regulation (EU) No 149/2013.

68 Article 11(3) EMIR.

69 Paragraph 1(c) ISDA Master Agreement.

70 Paragraph 6(a) ISDA Master Agreement.

71 Paragraph 6(e) ISDA Master Agreement.

72 Article 1(2) Commission Delegated Regulation (EU) No 2016/2251 of 4 October 2016 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories with regard to regulatory technical standards for risk-mitigation techniques for OTC derivative contracts not cleared by a central counterparty (OJEU 2016, L 340/9) (**Commission Delegated Regulation (EU) No 2016/2251**).

73 Articles 9(1) and 10 Commission Delegated Regulation (EU) No 2016/2251.

74 Article 12(1)(a) Commission Delegated Regulation (EU) No 2016/2251. Article 12(1)(b) Commission Delegated Regulation (EU) No 2016/2251 describes subject to which conditions the collection of variation margin may take place within two business days.

75 For a more comprehensive discussion of the variation margin, reference is made to (i) R.A. Stegeman, D.A. Gerrits en A. Berket, De gevolgen van de EMIR op de ISDA Credit Support Annex voor niet-geclearde otc-derivaten (Deel I), *TvFR*, number 6, June 2017, pp. 253 – 259.

76 Article 1(1) Commission Delegated Regulation (EU) No 2016/2251.

77 This refers to an 'event' as described in Article 9(2) Commission Delegated Regulation (EU) No 2016/2251. For a more comprehensive discussion of the initial margin, reference is made to (i) R.A. Stegeman, D.A. Gerrits en A. Berket, De gevolgen van de EMIR op de ISDA Credit Support Annex voor niet-geclearde otc-derivaten (Deel II), *TvFR*, number 7/8, July/August 2017, pp. 322 - 329 and (ii) R. Steeg, OTC-Derivaten en de ISDA Master Agreement; (hoe) werkt het naar Nederlands recht? (Deel II), *TvFR*, number 5, November 2017, pp. 43-44.

78 Article 36(1)(d) and (e) Commission Delegated Regulation (EU) No 2016/2251.

79 Counterparties are allowed to agree that no initial margin will be collected (i) for all new OTC derivative contracts that are concluded within a calendar year if the aggregate average notional amount of OTC derivatives not cleared centrally on one of the two counterparties for the months of March, April and May of the previous year at the end of the month is less than EUR 8 billion (Article 28 Commission Delegated Regulation (EU) No 2016/2251), and (ii) in the event the amount to be collected is less than EUR 50 million in so far as the counterparties are not part of a group or form part of different groups (Article 29(1)(a) and (b) Commission Delegated Regulation (EU) No 2016/2251) and the amount to be collected is less than EUR 10 million in so far as the counterparties are part of the same group (Article 29(1)(c) Commission Delegated Regulation (EU) No 2016/2251).

Furthermore, it is the case that it may be agreed with respect to the obligation to collect initial and variation margin that no collateral will be collected from a counterparty if the value of collateral to be deposited is lower than a certain minimum amount.<sup>80</sup> This 'minimum transfer amount' must not exceed EUR 500,000 or the equivalent amount in a different currency.<sup>81</sup> Despite the fact that non-financial counterparties that qualify as NFC- are not obliged to collect margin, financial counterparties and non-financial counterparties that qualify as NFC+ are obliged in principle to claim collateral, initial and variation margin from those non-financial counterparties. However, in their risk management procedures they could arrange for no collateral to be exchanged with respect to OTC derivative contracts concluded with non-financial counterparties that qualify as NFT-.<sup>82</sup> The maximum requirement concerning the minimum transfer amount does not apply in that case. There is also an exemption for OTC derivative contracts that have been concluded in relation to the issuance of so-called covered bonds provided certain cumulative requirements have been satisfied.<sup>83</sup> The issuer of covered bonds nevertheless remains obliged to collect variable margin from the counterparty and to refund variation margin collected in so far as owed.<sup>84</sup>

And finally, an exemption applies to intragroup transactions that satisfy the conditions of Article 3 EMIR as set out in paragraph 1.1 and Article 11 paragraphs 5 to 11 EMIR as regards the margin requirements.

#### *Other risk-mitigation measures*

Counterparties must agree in writing or electronically what method will be used to reconcile portfolios.<sup>85</sup> Reconciliation allows counterparties to investigate how a portfolio of transactions is valued by the counterparty so that certain

valuation differences can be identified.<sup>86</sup> The frequency of reconciliation varies between daily (business days), weekly, quarterly or annually and depends on the number of outstanding OTC derivative transactions and whether the OTC derivative transactions were concluded with a non-financial counterparty that qualifies as NFC-.<sup>87</sup> Counterparties that have 500 or more OTC derivative contracts outstanding against a counterparty, which are not settled centrally, have operational procedures in place to analyse on a regular basis whether the portfolio can be comprised by bundling or closing transactions in order to reduce the counterparty risk.<sup>88</sup> Counterparties must also agree on detailed procedures and processes with respect to disputes.<sup>89</sup>

## 2.2 EMIR II Proposal

The expansion of the definition of a financial counterparty has an impact on the margin requirements of counterparties that previously qualified as NFC- (such as an SPV defined above). Financial counterparties and non-financial counterparties that qualify as NFC+ are obliged under the EMIR II Proposal to claim a variation and an initial margin from those new financial counterparties. Pursuant to Commission Delegated Regulation (EU) No 2016/2251, they cannot provide in their risk management procedures that no collateral will be exchanged with respect to OTC derivative contracts concluded with financial counterparties that do not exceed the clearing thresholds. This means among other things that an SPV will have to post variation and initial margin. The entry into effect of Regulation 2402/2017<sup>90</sup> on 1 January 2019 means that an exemption from posting variation and initial margin applies to SPVs that exclusively perform securitisation transactions that satisfy the conditions for simple, transparent and standardised securitisations (**STS**)<sup>91</sup> subject to similar conditions that apply to the

80 Article 25 Commission Delegated Regulation (EU) No 2016/2251.

81 Article 25(1) Commission Delegated Regulation (EU) No 2016/2251.

82 Article 24 Commission Delegated Regulation (EU) No 2016/2251.

83 Article 30 Commission Delegated Regulation (EU) No 2016/2251.

84 Article 30(1)(a) Commission Delegated Regulation (EU) No 2016/2251.

85 Article 11(1)(b) EMIR and Article 13 Commission Delegated Regulation (EU) No 149/2013.

86 Recital 28 of Commission Delegated Regulation (EU) No 149/2013. For a comprehensive discussion of reconciliation, reference is made to S.N. Demper, 'EMIR: de verplichtingen voor de niet-financiële tegenpartij (onder de clearingdrempel)', in *V&O* 2014 (4).

87 Article 13(3) Commission Delegated Regulation (EU) No 149/2013.

88 Article 14 Commission Delegated Regulation (EU) No 149/2013.

89 Article 11(1)(b) EMIR and Article 15 Commission Delegated Regulation (EU) No 149/2013.

90 Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012 (**Regulation 2402/2017**).

91 The STS conditions are the requirements of Articles 18 and of Articles 19 to 22 or Articles 23 to 26 of Regulation 2017/2402.

issuers of covered bonds. The margin requirements apply in full to SPVs that conclude non STS securitisations if the EMIR II Proposal is adopted. However, the European supervisory authorities (*European Banking Authority, European Insurance and Occupational Pensions Authority and ESMA*), united in the *European Supervisory Authorities (ESAs)* proposed in the consultation document dated 4 May 2018 to expand the exemption that currently applies for issuers of covered bonds to include SPVs of non-STs securitisations.<sup>92</sup> Similar conditions will then also apply to SPVs for non-STs securitisations.

### 2.3 Consequences of a Hard Brexit

One consequence of a Hard Brexit is that EU Counterparties that have concluded OTC derivative contracts with counterparties established in the UK may be faced with the margin requirements that apply under EMIR and the possible margin requirements that apply under English regulations. The European Commission may adopt an implementing act in which it declares among other things that the legal, regulatory and enforcement framework of the UK is equal to the margin requirements under EMIR as a result of which the parties to the OTC derivative contract only have to comply with one of the two regimes.<sup>93</sup>

If and in so far as a non-financial counterparty decides to novate an existing OTC derivative contract with a UK Regulated Party to an EU Counterparty, such may have consequences for the margin requirements. The phased entry into effect of the margin requirements<sup>94</sup> may mean that the margin requirement did not exist for the existing OTC derivative contract, but that they will apply after the date on which the contract was novated to an EU Counterparty. As indicated above, the novated OTC derivative contract applies as a new contract that was consequently concluded after the margin requirement

entered into effect. ESMA made a proposal for an exemption to the margin requirement on 27 November 2018 in connection with this situation.<sup>95</sup> This exemption is limited to a period of twelve months after the UK has withdrawn so that counterparties have time to conclude new OTC derivative contracts.<sup>96</sup> In order to prevent abuse, this exemption applies only with respect to a novation to a new EU Counterparty that is not subject to a clearing requirement and the exemption does not apply to Relevant Lifecycle Events that occur with respect to the novated OTC derivative contract.<sup>97</sup>

The consequences for the intragroup exemption discussed in paragraph 1.3 are also relevant to the margin requirements. Different requirements will also apply to the margin requirements after a counterparty that forms part of the group is no longer established in the EU and a new positive decision will have to be made by the relevant supervisory authority.

## 3 Reporting requirements

### 3.1 EMIR

All counterparties are obliged to report data concerning the OTC derivative transactions concluded and every amendment or termination of OTC derivative contracts to a trade repository.<sup>98</sup> This requirement applies to OTC derivatives and derivatives that are traded via a regulated exchange that are still outstanding or were concluded on or after 16 August 2012. The data that must be reported include at least the parties to the derivative contract and the main characteristics thereof (i.e., type, underlying value, term, nominal value, price and settlement date).<sup>99</sup> The report must be submitted on the business day following the day on which the transaction was concluded, amended or terminated.<sup>100</sup> Each counterparty must obtain a unique identification code (i.e., Legal Entity Identifier (LEI))

92 ESA's Consultation Paper on extending the requirements for risk-mitigation techniques for OTC-derivative contracts not cleared by a CCP to derivatives used in STS securitisations, 4 May 2018, JC 2018 15.

93 Articles 13(2) and (3) EMIR.

94 Articles 35 up to and including 38 Commission Delegated Regulation (EU) No 2016/2251.

95 ESAs' Final Report EMIR RTS on the novation of bilateral contracts not subject to bilateral margins, 27 November 2018, ESAs 2018 25 (**ESAs Margin Exemption RTS**), which can be consulted at: <https://eba.europa.eu/documents/10180/1398349/ESAs+2018+25+-+Final+Report+-+Bilateral+margin+-+%28novation%29.pdf>.

96 Paragraph 2.3, subparagraph 16(b) ESAs Margin Exemption RTS.

97 Paragraph 2.3, subparagraph 16(a) ESAs Margin Exemption RTS.

98 Article 9 EMIR.

99 Article 9(5) EMIR.

100 Article 9(1) EMIR.

from the global LEI system) in order to be able to comply with the reporting requirement.<sup>101</sup> Trade repositories must be registered with ESMA. In order to qualify for registration, the legal entity must be established in the EU and comply with the requirements for trade repositories included in Title VII EMIR.<sup>102</sup> Counterparties are allowed to delegate the reporting requirements to a third party (i.e., a CCP or a counterparty to the derivative contract). Compliance with reporting requirements for a counterparty is not regulated and does not require a licence. Regulatory technical standards concerning the reporting of data and the models that must be applied for reporting are determined in Commission Delegated Regulation (EU) No 148/2013<sup>103</sup>.

### 3.2 EMIR II Proposal

The EMIR II Proposal proposes that the reporting of data with respect to derivative contracts that are traded via a regulated exchange by the CCP should be reported on behalf of both counterparties.<sup>104</sup> Under the EMIR II Proposal, the financial counterparty will be responsible for reporting the data with respect to OTC derivative contracts concluded with a non-financial counterparty.<sup>105</sup> The EMIR II Proposal also introduces an exemption from the reporting requirement regarding intragroup transactions in so far as one of the two parties is a non-financial counterparty.<sup>106</sup> ESMA's mandate has also been expanded to formulate regulatory technical standards with a view to further harmonisation of the reporting rules including data standards and formats, reporting methods and regulations, the frequency of reporting and the final date for reporting.<sup>107</sup>

### 3.3 Consequences of a Hard Brexit

Trade repositories that are established in the UK (such as the Depository Trust & Clearing Corporation that is currently active in the UK) will no longer be able to comply with their obligations in a legally valid manner. This means that after a Hard Brexit parties to an OTC derivative contract are required to report the mandatory data to a

trade repository that is established in the EU. The fact that the delegation of reporting requirements is not regulated means that a UK Regulated Counterparty is allowed to carry out reporting on behalf of the other counterparty in so far as reporting is done to a trade repository that is established in the EU.

## 4 Practical tips

This edition of Quoted has discussed several proposed changes as well as the potential consequences of a Hard Brexit. We provide the following recommendations in order to ensure that your organisation is ready for a Hard Brexit within the context of derivative positions:

- Determine whether your organisation has concluded derivative contracts with financial counterparties that are established in the UK and/or that are regulated in the UK and qualify as a bank or an investment institution. Contact those counterparties and discuss the possibility with a view to a Hard Brexit of (i) novating the derivative contracts to (possibly affiliated) counterparties established in the EU and (ii) notify the AFM under the temporary exemption for users of services provided by investment institutions that are regulated in the UK, which applies in case of a Hard Brexit.
- Determine whether your organisation clears derivative contracts via a financial undertaking that is regulated in the UK and that acts as CCP or broker during the clearing process. It is likely that the European Commission will recognise LCH Limited, ICE Clear Europe Limited and LME Clear Limited following a Hard Brexit. Contact those financial undertakings and discuss the possibility of having the derivative contracts that have been concluded cleared via a (possibly affiliated) financial undertaking that is regulated in the EU (if and in so far as it does not concern a UK CCP recognised by the European Commission) following a Hard Brexit.

101 Commission Implementing Regulation (EU) No 1247/2012 of 19 December 2012 laying down implementing technical standards with regard to the format and frequency of trade reports to trade repositories according to Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories, OJEU L17/17.

102 Article 9(1) EMIR.

103 Commission Delegated Regulation (EU) No 148/2013 of 19 December 2012 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories with regard to regulatory technical standards on the minimum details of the data to be reported to trade repositories, PJEU 2013, L52/1 (**Commission Delegated Regulation (EU) No 148/2013**).

104 Article 1(7)(b) EMIR II Proposal.

105 Idem.

106 Article 1(7)(a) EMIR II Proposal.

107 Article 1(7)(c) EMIR II Proposal.

- Determine whether your organisation uses the services of a financial undertaking established in the UK that concludes derivative contracts with counterparties on your behalf as an agent / broker. Contact that financial undertaking and discuss the possibility of (i) using the services of an (affiliated) financial undertaking established in the EU following a Hard Brexit and (ii) notify the AFM under the temporary exemption for users of services provided by investment institutions that are regulated in the UK, which applies in case of a Hard Brexit.
- Determine whether the data of the derivative contracts you have concluded are reported to a trade repository in the UK. If this is the case, your organisation (or the counterparty to the relevant derivative contract) will have to report the data to a trade repository established in the EU following a Hard Brexit.
- Determine whether your organisation applies a group exemption with respect to OTC derivative contracts concluded with counterparties established in the UK. Following a Hard Brexit, new group exemptions must be applied for in respect of these OTC derivative contracts.
- Determine whether your organisation has concluded derivative contracts with the central bank of England or the United Kingdom Debt Management Office and determine whether including such derivative positions could have a (negative) impact on the calculation of the clearing thresholds.

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