Client Alert

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Brexit: Recognition of UK Derivatives Regulation

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Key Points

- Under Swiss law, to fulfil the clearing, reporting and risk mitigation obligations applying to derivatives trading under foreign law, the Swiss Financial Market Supervisory Authority (FINMA) must recognize the foreign law and the foreign financial market infrastructures as equivalent
- FINMA provisionally recognized the European Union provisions for regulating OTC derivatives (EMIR) by means of FINMA Guidance 01/2016 [permitting Swiss firms to discharge their obligations under Swiss law by relying on "substituted compliance" under recognized foreign law]
- Following the departure of the United Kingdom from the European Union ("Brexit") the FINMA Guidance would not extend to U.K. regulations given that they refer explicitly to EMIR. This is the case notwithstanding the U.K.'s "onshoring" of EMIR requirements into U.K. domestic law.
- In this context, FINMA has, as communicated in its Guidance 01/2019, provisionally recognized the UK derivatives regulations

EU derivatives regulations

In Regulation No. 648/2012 of the European Parliament and of the Council of 4 July 2012 on over the counter (OTC) derivatives, central counterparties and trade repositories (EMIR), the European Union introduced provisions for regulating OTC derivatives, including obligations regarding the clearing of OTC transactions in derivatives, reporting of derivative transactions and certain risk mitigation measures regarding uncleared OTC derivative transactions.

Swiss derivatives regulations

On 1 January 2016, the Swiss Financial Market Infrastructure Act (FMIA) entered into force. FMIA implements the Swiss regulations on financial market infrastructures and derivatives trading in line with international standards.

The FMIA applies to the trade in derivatives. Derivatives are widely defined as financial contracts whose value depends on one or several underlying assets and which are not cash transactions. The obligations apply irrespective of the underlying of

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the derivatives, for example (i) assets such as shares, bonds, commodities and precious metals and (ii) reference values such as currencies, interest rates and indices. The following products are not deemed to be derivatives: (i) spot transactions (i.e. transactions that are settled either immediately or following expiry of the deferred settlement deadline within two business days or such longer settlement cycle applicable to the asset concerned), (ii) derivatives transactions relating to electricity and gas as underlying traded on an organized trading facility, provided that they must be physically delivered and (iii) derivatives transactions relating to climatic variables, freight rates, inflation rates or other official economic statistics that are settled in cash only in the event of a default or other termination event.

The rules apply to financial and non-financial counterparties that trade in derivatives. Financial counterparties means: banks, securities dealers, insurance and reinsurances companies, parent companies of a financial or insurance group or financial or insurance conglomerate, fund management companies and asset managers of collective investment schemes, collective investment schemes, occupational pension schemes and investment foundations. All other undertakings fall by default in the category of non-financial counterparties. Therefore, only private persons acting in a private capacity are out of scope of the derivatives trading of the FMIA.

Within the scope are all market participants that are defined as companies (i.e. all kind of businesses established in Switzerland and entered in the commercial register and their foreign branches). Foreign legal entities (e.g. personal investment companies, foundations and family offices as well as similar structures and individuals) are also defined as companies if they engage in economic activities. Foreign legal entities are only affected by the FMIA if they enter into derivative transactions with Swiss undertakings.

Recognition of the EU derivative regulations

FMIA and it implementing ordinances provide that counterparties subject to FMIA obligations regarding the trading of derivatives may fulfil such duties if (a) they are fulfilled under foreign law recognised as being equivalent by FINMA and (b) a foreign financial market infrastructure recognized by FINMA was used to execute the transaction.

Foreign law is deemed equivalent if the duties that apply for derivatives trading and the provisions on supervision are in their material effects to the Swiss equivalent provisions. The requirement is deemed satisfied with respect to the (a) clearing duty, if the clearing under foreign law largely reduces the systemic and counterparty risks of standardised OTC derivatives, (b) reporting, if the report contains at least the information set out under the FMIA, (c) risk mitigation duty, if the corresponding measures largely reduce the systemic and counterparty risks of non-standardised OTC derivatives and (d) the platform trading duty under the FMIA, if pre-trade and post-trade transparency in the derivatives market is adequately improved.

From a legal point of view, EMIR and FMIA both define very similar regulations for the clearing of OTC derivatives transactions through a central counterparty, the reporting of derivatives transactions to a trade repository and risk mitigation for OTC derivatives transactions.

In this context, FINMA recognised the above-mentioned European Union regulations as provisionally equivalent in its FINMA Guidance 01/2016. This allows counterparties

which are subject to the Swiss obligations to meet these obligations by fulfilling the European regulations, provided the relevant conditions are met.

As the European Union has not yet definitively adopted all of its derivatives regulations, a results-based comparison with the definitively adopted Swiss rules on derivatives trading at the level of implementing provisions could not be completed yet.

Brexit

On 26 June 2018, the European Union (Withdrawal) Act 2018 (EUWA) was enacted in the U.K. to transpose applicable EU laws into domestic law. Under EUWA, EMIR will be transferred into U.K. law by way of a statutory instrument, The Over the Counter Derivatives, Central Counterparties and Trade Repositories Regulations 2018 ("U.K. Transposition Act") with a number of minor formal changes.

Recognition of the UK's transposition of EMIR requirements into domestic law

In this context, FINMA has, as communicated in its Guidance 01/2019, provisionally recognised the U.K. derivatives regulations with regard to the clearing, reporting and risk mitigation obligations as being equivalent to the relevant Swiss legislation. The provisional recognition of equivalence will enter into force as soon as the U.K. Transposition Act is passed by the British parliament.

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