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BEYOND BREXIT: EU VS UK MARGIN RULES FOR OTC DERIVATIVES

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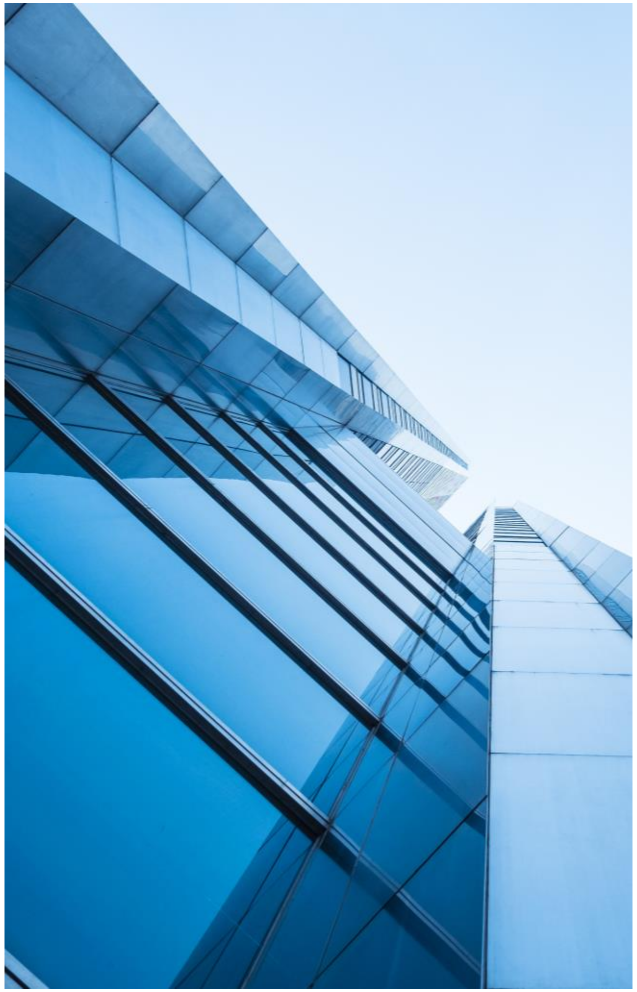

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EU VS UK MARGIN RULES FOR OTC DERIVATIVES

EU and UK margin rules will remain closely aligned after the end of the Brexit transition period – but some differences will remain

The EU Margin RTS were 'onshored' in the UK from the end of the Brexit transition period with limited changes to reflect the UK's status outside the EU.

The PRA and FCA are consulting on amendments to align elements of the UK Margin RTS with changes made to the EU Margin RTS following the end of the Brexit transition period (via EU 2021/236).

However, the end of the Brexit transition period still means some changes for both EU and UK counterparties under :

- the EU Margin RTS as a result of the UK becoming a third country for the purposes of EU law;
- the UK Margin RTS as a result of the onshoring amendments, albeit mitigated by transitional relief until 31 March 2022.

The tables below highlight some key changes and differences that will remain between the EU and the UK Margin RTS.

Unless and until the EU or the UK recognises the equivalence of the other's margin rules, transactions between EU and UK counterparties may be subject to both the EU Margin RTS and the UK Margin RTS (but see below for intragroup transactions).

EU VS UK MARGIN RTS: SCOPE

The PRA and the FCA propose to align key elements of the UK Margin RTS with the 2021 amendments to the EU Margin RTS

	EU: current rules after 2021 amendments	UK: current rules	UK: PRA/FCA proposals
IM phase-in	IM applies to counterparties: • Before 1 September 2021: with AANA above €750bn; • From 1 September 2021: with AANA above €50bn; • From 1 September 2022: with AANA above €8bn. (Art 36(1) EU Margin RTS as amended by EU 2021/236)	IM applies to counterparties with AANA above € 8bn.	UK rules to be aligned with EU rules.
IM: FX forwards, swaps and currency swaps	IM does not apply. (Art 27 EU Margin RTS)	Already aligned with EU.	N/A
VM: FX forwards and swaps	VM does not apply to physically settled foreign exchange forward contracts and physically settled foreign exchange swap contracts where one of the counterparties is not an institution. (new Art 31a EU Margin RTS added by EU 2021/236)	No exemption applies.	UK rules to be aligned with EU rules.
Single-stock equity options or index options	IM and VM does not apply to single-stock equity options or index options until 4 January 2024. (Art 38(1) EU Margin RTS as amended by EU 2021/236)	No exemption applies.	UK rules to be aligned with EU rules.
Intragroup derogation	Intragroup derogation from IM and VM requirements available until 30 June 2022 where there is no equivalence decision for the relevant third country. (Arts 36(2)/(3) and 37(3)/(4) EU Margin RTS as amended by EU 2021/236)	Temporary intragroup exemption from IM and VM requirements available until 1 January 2024 where there is no equivalence decision for the relevant non-UK country (see note).	N/A

Notes: For PRA and FCA proposals, see Consultation paper PRA CP6/21 FCA 7/21 Margin requirements for non-centrally cleared derivatives: Amendments to BTS 2016/2251 (March 2021). The PRA has indicated that the PRA and FCA are aware of the gaps and that, pending the outcome of the consultation, they will supervise the requirements of the UK Margin RTS on a risk-based and proportionate basis where the corresponding EU requirements are affected by the amendments made via EU 2021/236. See Bank of England and PRA Policy Statement PS27/20 (December 2020).

For the UK temporary intragroup exemption, see Part 5 of the Over the Counter Derivatives, Central Counterparties and Trade Repositories (Amendment, etc., and Transitional Provision) (EU Exit) Regulations 2019/335. HM Treasury has made an equivalence decision in respect of the EU's margin requirements for the purposes of the intragroup exemption under UK EMIR. The Commission has not made a corresponding equivalence decision in respect of the UK's margin requirements for the purposes of the intragroup exemption under EMIR.

EU MARGIN RTS: ELIGIBLE COLLATERAL

The end of the Brexit transition period had limited impact on the eligibility of collateral for EU counterparties under EU Margin RTS

Eligibility criteria	Summary	Impact of end of Brexit transition on previously eligible collateral
Cash and allocated gold		No change.
Government securities	Debt securities issued by Member State and third country governments and central banks.	No change.
Other public sector securities	Debt securities issued by Member State and third country regional governments, local authorities and public sector entities.	Debt securities issued by UK regional government, local authority and public sector entities continue to be eligible but may be subject to increased haircut.
International organisation securities	Debt securities issued by multilateral development banks and international organisations listed in CRR.	No change.
Credit institution and investment firm securities	Debt securities issued by credit institutions or investment firms, including covered bonds issued by EU credit institutions.	See note below.
Corporate bonds		No change.
Securitisations	Most senior tranche of a securitisation (as defined in CRR) other than a re-securitisation.	No change.
Convertible bonds	Convertible bonds, convertible into equities included in indices specified under CRR.	No change.
Equities	Equities included in indices specified under CRR.	No change.
UCITS	Shares or units in UCITS meeting specified criteria.	Shares/units in UK UCITS no longer eligible.

Notes: See Article 4 of EU Margin RTS.

Debt securities issued by UK regional governments, local authorities and public sector entities may only be eligible collateral under Article 4(1)(l) UK Margin RTS and therefore may be subject to a higher haircut under Table 1 Annex I EU Margin RTS.

There is uncertainty as to whether the references in the RTS to credit institutions and investment firms include third-country credit institutions and investment firms and thus whether this category will cover securities issued by UK credit institutions and investment firms after Brexit (and if not whether those securities and any UK covered bonds might qualify as corporate bonds instead).

UK MARGIN RTS: ELIGIBLE COLLATERAL

The end of the Brexit transition period had limited impact on the eligibility of collateral for UK counterparties under the UK Margin RTS

Eligibility criteria	Summary of criteria as amended by onshoring	Impact of end of Brexit transition on previously eligible collateral
Cash and allocated gold		No change
Government securities	Debt securities issued by ~~Member State~~ UK and EU and other third country governments and central banks.	No change
Public sector securities	Debt securities issued by ~~Member State~~ UK and EU and other third country regional governments, local authorities and public sector entities.	Debt securities issued by EU regional governments, local authorities and public sector entities continue to be eligible but may be subject to increased haircut (although transitional relief may be available until 31 March 2022).
International organisation securities	Debt securities issued by multilateral development banks and international organisations listed in UK CRR.	No change.
Credit institution and investment firm securities	Debt securities issued by credit institutions or investment firms, including covered bonds ~~issued by EU credit institutions~~ admitted to UK register.	See note below.
Corporate bonds		No change.
Securitisations	Most senior tranche of a securitisation (as defined in UK CRR) other than a re-securitisation.	No change.
Convertible bonds	Convertible bonds, convertible into equities included in indices specified under UK CRR.	No change.
Equities	Equities included in indices specified under UK CRR.	No change.
UCITS	Shares or units in UK UCITS meeting specified criteria.	Shares/units in EU UCITS no longer eligible (but transitional relief applies until 31 March 2022).

Notes: See Article 4 of UK Margin RTS.

Debt securities issued by EU regional governments, local authorities and public sector entities may only be eligible collateral under Article 4(1)(l) UK Margin RTS and therefore may be subject to a higher haircut under Table 1 Annex I UK Margin RTS.

References to credit institutions and investment firms may include EU and other third-country credit institutions and investment firms (given the definitions of these terms in UK EMIR). See the Regulated Covered Bonds Regulation 2008 for the UK register of covered bonds.

OTHER DIFFERENCES

Article	EU Margin RTS	UK Margin RTS
6(1)(b)	EU collecting counterparties can no longer use the **internal ratings** of a UK posting counterparty to assess the credit quality of certain assets unless the counterparty is subject to equivalent consolidated supervision assessed under Art 127 Capital Requirements Directive as equivalent to that under the CRR.	UK collecting counterparties can no longer use the **internal ratings** of a non-UK posting counterparty to assess the credit quality of certain assets unless the counterparty is subject to consolidated supervision assessed by the PRA or FCA as equivalent to that under the UK CRR. There is transitional relief for EU and certain third country counterparties until 31 March 2022 (Art 35A(6)).
6(1)(c)	EU collecting counterparties can no longer use **credit ratings** of UK credit rating agencies unless endorsed in the EU (or, if there is an equivalence decision in respect of UK regulation of CRAs, certified in the EU).	UK collecting counterparties can no longer use **credit ratings** of EU credit rating agencies unless endorsed or certified in the UK (EU agencies may be certified in the UK as a result of an equivalence decision in respect of the EU). There is transitional relief until 31 December 2021 for certain existing ratings (Art 35A(7)).
8(3)(b)	EU counterparties that are G-SIIs or O-SIIs no longer have to apply additional **concentration limits** to UK counterparties formerly classified as O-SIIs in the EU.	UK counterparties that are G-SIIs or O-SIIs will no longer have to apply additional **concentration limits** to EU counterparties classified as O-SIIs in the EU after the expiry of transitional provisions on 31 March 2022 (Art 35A(8)).
19(1)(e)	EU counterparties can no longer keep **cash IM** with UK credit institutions unless and until there is a relevant equivalence decision in respect of the UK under CRR.	UK counterparties can continue to keep **cash IM** at EU credit institutions (even after the expiry of transitional relief under Art 35A(9) on 31 March 2022) because there is now a relevant equivalence decision in respect of the EU under UK CRR.
23	EU counterparties are only exempt from margin requirements for **transactions with CCPs authorised as credit institutions** in the EU. However, there are no UK CCPs authorised as credit institutions.	UK counterparties are exempt from margin requirements for **transactions with CCPs authorised as credit institutions** in the UK, subject to transitional relief for CCPs authorised as credit institutions in the EU until 31 March 2022 (Art 35A(10)).
28(3) and 39(2)	The provisions allowing **UCITS and AIFs** to be treated as distinct entities for the purposes of calculating AANA thresholds no longer apply to UK UCITS or AIFs managed by UK AIFMs.	The provisions allowing **UCITS and AIFs** to be treated as distinct entities for the purposes of calculating AANA thresholds will no longer apply to EU UCITS or AIFs managed by EU AIFMs after the expiry of transitional relief on 31 March 2022 (Art 35A(11)).
35	EU counterparties may continue to benefit from transitional relief when legacy **transactions are novated from UK to EU counterparties** between 1 January 2021 and 1 January 2022 (added by EU 2021/236).	No corresponding provision.
13A EMIR (new)	EU counterparties may continue to benefit from transitional relief where, after 13 February 2021, legacy transactions are amended or novated for the sole purpose of **replacing a reference benchmark or introducing a fallback provision** in relation to any benchmark referenced in that contract.	No corresponding provision. But FCA's view is that **amending a reference rate or adding a fall-back rate** would not trigger margin requirements where this relates to the treatment of legacy LIBOR trades (see webpage here).

GLOSSARY

AANA
Aggregate average notional amount of non-centrally cleared derivatives.

AIFs/AIFMs
Alternative investment funds/alternative investment fund managers

CRR
EU Capital Requirements Regulation

EMIR
European Market Infrastructure Regulation.

EU Margin RTS
Commission Delegated Regulation (EU) 2016/2251 on risk mitigation techniques under EMIR.

EU 2021/236
Commission Delegated Regulation (EU) 2021/236 amending the EU Margin RTS.

EUWA
UK European Union (Withdrawal) Act 2018**.**
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IM or VM
Initial margin or variation margin.

UCITS
Undertakings for collective investment in securities.

UK CRR
CRR as it forms part of UK domestic law under the EUWA.

UK EMIR
EMIR as it forms part of UK domestic law under the EUWA.

UK Margin RTS
EU Margin RTS as it forms part of UK domestic law under the EUWA.

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