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Industry Groups Set Out Impact of Hard Brexit on Derivatives

BRUSSELS, October 9, 2018 – The International Swaps and Derivatives Association, Inc. (ISDA), the Association of German Banks (Bundesverband deutscher Banken), the Italian Financial Markets Intermediaries Association (Associazione Intermediari Mercati Finanziari), the Banking and Payments Federation Ireland (BPFI), the Danish Securities Dealers Association (Børsmæglerforening Danmark), the Dutch Banking Association (Nederlandse Vereniging van Banken) and the Swedish Securities Dealers Association (Svenska Fondhandlareföreningen) have jointly published a paper that warns of the disruptive impact of a 'hard' Brexit on derivatives markets.

The paper describes the cliff-edge risks and the European Union (EU) regulatory requirements that would apply to derivatives in the event of a 'no deal', and the immediate adverse impacts on EU 27 firms and EU 27 clients of UK entities. UK firms and UK clients of EU 27 entities would also be affected in some cases.

The issues arise because the UK will become a third country under EU law at the point it exits the EU, and this could occur suddenly if the UK leaves on March 29, 2019 without a withdrawal agreement and transition period in place. This would result in a variety of regulatory requirements that would immediately restrict the ability of EU 27 firms to transact derivatives with UK entities and infrastructures and could have a systemic impact.

For example, EU 27 counterparties would be unable to act as clearing members at UK central counterparties (CCPs) at the point the UK becomes a third country, and neither they nor their clients would be able to clear products subject to the EU clearing mandate until UK CCPs are recognized by the EU. The resulting migration of thousands of contracts to EU-recognized CCPs – if even possible – would result in higher costs and would pose significant operational challenges. A migration of this scale has never before been attempted.

The paper points out that EU law gives the EU or EU 27 national competent authorities the power to take mitigating action – for instance, by adopting equivalence decisions or approving applications for recognition. However, there is a risk that these actions would only be taken after the UK has left the EU and become a third country. The perceived risk of such a hiatus would be likely to cause severe market disruption months in advance of Brexit.

The industry groups have made several recommendations on steps that can be taken now to address the risk of a cliff-edge Brexit.

- In a no-deal scenario, the European Commission (EC) and other EU authorities should consider taking necessary steps in advance of Brexit to avoid a disruptive hiatus by ensuring that mitigating actions take effect from the date when the UK leaves the EU. This would include taking all available preparatory steps and, where possible, accepting applications and adopting advance formal decisions that take effect on that date.

- The European Securities and Markets Authority (ESMA) should consider working with relevant CCPs, trade repositories, credit rating agencies and benchmark administrators in advance of Brexit to facilitate applications for recognition, endorsement or registration in the event of a no-deal scenario. This is so that, to the extent possible, any decision on recognition, endorsement or registration can take effect from the date the UK leaves the EU.

- As part of its contingency planning for a no-deal scenario, the EC should consider proposing EU legislation adapting EU law in advance of Brexit to create a temporary regime deferring the impacts addressed by these mitigating actions and allowing time for necessary actions to be taken after Brexit. The UK has already announced that it plans to address these issues by creating temporary permissions and recognition regimes to minimize disruption to UK markets in a hard Brexit scenario.

- The EC, ESMA, the Single Resolution Board and EU 27 national competent authorities, in cooperation with the UK authorities, should consider taking all other actions available to them to eliminate or at least shorten any disruptive gap between Brexit and any mitigating action becoming effective.

- The EU should consider providing early transparency to market participants about the mitigating actions that the authorities expect to take, and any likely gap before those actions become effective after Brexit, so firms and their clients and counterparties can plan accordingly.

In the absence of transparency, market participants may be forced to take disruptive, risky, costly and potentially irreversible (and ultimately unnecessary) steps to mitigate adverse impacts (where mitigation of such impacts is possible) far in advance of Brexit.

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The impact of these issues could be mitigated through a withdrawal agreement and transition period. Even then, there is a risk that similar issues to those discussed in the paper would arise at the end of that transition period, moving the 'cliff edge' to that date.

The hard Brexit paper is available on the ISDA website.

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About ISDA
Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has more than 900 member institutions from 70 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org. Follow us on Twitter @ISDA.

About the Association of German Banks
The Association of German Banks (Bundesverband deutscher Banken, or BdB) is the voice of the private banks in Germany. As a leading trade association, it coordinates, shapes and represents the interests of the private banking industry and acts as a mediator between the private banks, policy-makers, administrators, consumers and the business sector. The BdB represents more than 200 private commercial banks and 11 member associations, as well as around 20 fintechs, which are associated members.

About the Italian Financial Markets Intermediaries Association
The Italian Financial Markets Intermediaries Association (Associazione Intermediari Mercati Finanziari) represents the interests of the intermediaries active on the Italian financial markets – namely, Italian investment firms, investment banks and subsidiaries of foreign investment services providers. Its members account for nearly the entire amount of the transactions carried out on the Italian stock markets from Italy, and more than 80% when considering cross-border transactions.

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About Banking and Payments Federation Ireland (BPFI)

Banking and Payments Federation Ireland is the voice of banking and payments in Ireland, representing over 70 member institutions and associates, including licensed domestic and foreign banks and institutions operating in the financial marketplace in Ireland.

About the Danish Securities Dealers Association

The Danish Securities Dealers Association (Børsmæglerforening Danmark) is open to members of a regulated market and others with main activities related to the Danish securities market. Its objectives are: to promote a positive development within trading in securities by attending the common interests of its members; to represent the securities dealers and promote their economical and professional interests facing the government, the Danish parliament (Folketinget) and other public authorities, as well as national and international organizations relevant to the market, such as regulated markets, clearing and settlement providers; to provide service and assistance to members.

About the Dutch Banking Association

The Dutch Banking Association (Nederlandse Vereniging van Banken, or NVB) strives to achieve a strong, healthy and internationally competitive banking system for the approximately 70 Dutch and foreign banks and credit institutions operating in the Netherlands. The NVB is the link between the banking sector, the government and the public and contributes to a vital and sustainable sector. We want to bridge the gap between the banks and the public by facilitating dialogue between all parties involved in the sector. Together, we work on innovation, security, stability and transparency.

About the Swedish Securities Dealers Association

The SSDA was founded in 1908, and represents the common interest of banks and investment firms active in the Swedish securities market. The Association's main objective is to promote a sustainable, strong and efficient securities market and it regularly raises its members' views on regulatory, market and infrastructure-related issues. It also provides a neutral forum for its members to discuss matters that are of common interest.