

17 November 2020

## **Response to Consultation Paper CP13/20 – UK withdrawal from the EU: Changes before the end of the transition period**

The International Swaps and Derivatives Association (**ISDA**) welcomes the opportunity to respond to the Bank of England's consultation paper on UK withdrawal from the EU: Changes before the end of the transition period.

In particular, we would like to make the following comments, which we discuss in more detail below:

- **Update on the temporary transitional power:** we would ask that any further changes to the transitional directions be published as soon as these are available, rather than waiting until all expected changes are available. We would also welcome a consolidated and exhaustive summary from the Bank and the PRA of all the areas in which they do not propose to use the temporary transitional power.
- **Joint Bank and PRA consultation on changes to rules and BTS:** we welcome the PRA's confirmation that firms can continue to rely on existing operational and legal arrangements for compliance with the BTS on risk-mitigation techniques for the duration of the transitional period and ask that the Bank and PRA consider extending the transitional period for the full 2 years permitted under the Financial Services and Markets Act 2000 (Amendment)(EU Exit) Regulations 2019.
- **PRA consultation on changes to rules and BTS:** In relation to the new market risk BTS on the Fundamental Review of the Trading Book, we would ask the PRA to retain the existing scope of qualifying indices for the purposes of the BTS on liquidity horizons. In relation to the BTS on risk-mitigation techniques we would ask that the PRA clarify the position regarding UK phase-in of Phases 5 and 6 IM and would also ask that the PRA take note of the concerns that we have flagged below regarding the operation of the exemption for intragroup transactions.

### **About ISDA**

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 925 member institutions from 75 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](http://www.isda.org).

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## **1. Section A – Update on the temporary transitional power**

ISDA members welcome the proposal for the Bank, the PRA and the FCA to set the same 15-month period for transitional relief under their temporary transitional power, allowing firms a consistent period of time to adjust to the changes made as a result of onshoring.

While the Bank and the PRA have already published amended draft transitional directions and guidance on their intended use of the temporary transitional power, we would welcome final directions and guidance being made available as soon as possible prior to the end of the transitional period, to give firms the certainty that they need regarding their ability to rely on this transitional relief. We appreciate that further changes to the transitional directions may be required dependent on changes to onshored CRD V and BRRD II derived legislation, but would ask that these be published separately in order to avoid holding up publication of the final transitional directions and guidance covering all other areas.

We would also welcome a consolidated and exhaustive summary from the Bank and the PRA of all the areas in which they do not propose to use the temporary transitional power, confirming that the exceptions identified in the February version of PS5/19 and the additional exceptions identified in this CP13/20 are the only exceptions and that in all other cases firms may rely on the temporary transitional relief (and also confirming the provisions where transitional relief will be available for firms in TPR and FSCR).

## **2. Part 1: Joint Bank and PRA consultation: Section B – Changes to rules and Binding Technical Standards**

With the exception of the comments set out below, we note the proposed changes and do not have any further comments.

### **Update to the duration of transitional relief in BTS 2016/2251 on risk-mitigation techniques for OTC derivative contracts**

We welcome the PRA's confirmation that firms can continue to rely on existing operational and legal arrangements for compliance with this BTS for the duration of the transitional relief, and the confirmation that the transitional relief will be available until Thursday 31 March 2022.

While we appreciate that the PRA is aiming to provide a consistent period of transitional relief to the extent possible, we note that the proposed changes to the BTS on risk-mitigation techniques have the potential to involve a significant degree of repapering work. We outlined the key challenges in our response to the PRA's Consultation Paper CP26/18: UK withdrawal from the EU: Changes to the PRA Rulebook and onshored Binding Technical Standards in December 2018<sup>1</sup>. We have not set these out again in this response, but we would note that as a result of the proposed changes to the EU EMIR margin RTS it is likely that firms will have to go through the process of implementing both sets of

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<sup>1</sup> <https://www.isda.org/a/buEME/ISDA-response-to-PRA-CP26-18-33362-3-620-v1.pdf>

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requirements over the same period and this may have an impact on their ability to complete the process within the current proposed transitional period. As mentioned in our previous response, member firms' experiences with margin repapering exercises to date indicate that it could take up to two years to effect the required changes and avoid adverse impacts on existing projects to prepare for Phases 5 and 6 of Initial Margin.

As a result, we would ask the Bank and PRA to extend this transitional period to the full 2 year period permitted under the Financial Services and Markets Act 2000 (Amendment) (EU Exit) Regulations 2019.

### **3. Part 2: PRA consultation: Section B – Changes to rules and Binding Technical Standards**

With the exception of the comments set out below, we note the proposed changes and do not have any further comments.

#### **New market risk BTS as part of the Fundamental Review of the Trading Book**

We note that the PRA proposes to amend the BTS on liquidity horizons to replace existing references to "the Union" with references to "the United Kingdom". This will mean that equities will only qualify as large market capitalisation equities if they have a market capitalisation in excess of EUR 1.75 billion or if they are included in one of the indices set out in Annex I of BTS 2016/1646 where all the components are quoted in the UK. This is likely to have the result that, unless the size test is met, only equities included in the FTSE 350 will qualify.

In the event that the BTS on liquidity horizons are adopted and applicable before the end of the transition period, ISDA members would like to highlight that a requirement for firms to use a different set of indices in the definition of market capitalisation will lead to different delta risk weights and ultimately different shock sizes for the calculation of equity curvature. The complexity of having to calculate different versions of the curvature risk per jurisdiction will be costly to implement and run for internationally active firms. ISDA members recommend keeping the list of qualifying indices aligned, as this will support a level playing field and foster regulatory consistency across jurisdictions.

#### **Amendments to BTS 2016/2251 on risk-mitigation techniques for OTC derivative contracts**

- **Phase-in for Phases 5 and 6 IM:**

We note that the proposed ESA amendments to Articles 36(1)(d) – (e) update timelines and thresholds beyond the expiry of the transition period, so these amendments will not be onshored as a matter of course under the Act and the PRA proposes to update the proposed approach post-transition period in due course. We would welcome confirmation of the PRA's proposed approach as soon as possible post-transition period in order to minimise potential disruption to the ongoing projects that firms already have in place for implementation of these requirements.

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- **Intragroup transactions under the BTS on risk-mitigation techniques:**

We note the PRA's proposal to amend these BTS to delete the intragroup derogations in Articles 36 and 37 in light of the separate temporary UK regime for intragroup transactions set out in Part 5 of the Over the Counter Derivatives, Central Counterparties and Trade Repositories (Amendment, etc., and Transitional Provision)(EU Exit) Regulations 2019 ("**2019 Regulations**"), which is to be amended by the recently published draft Securities Financing Transactions, Securitisation and Miscellaneous Amendments (EU Exit) Regulations 2020.

We would like to take this opportunity to flag a number of questions and concerns that we have in relation to the proposed UK regime for intragroup transactions. While we appreciate that some of these questions may not be questions for the PRA or Bank of England, we consider it critically important that the PRA, FCA and HMT work together to ensure that this regime operates to allow UK firms to continue to trade with non-UK affiliates after IP completion day.

- **Contracts entered into between 21 December 2020 and IP completion day:** we understand that UK counterparties will be able to rely on ESMA forbearance for relief from clearing and margin obligations during the period until the end of the transition period. However, after the end of the transition period, they will not benefit from the continuation of the intragroup exemptions provided for in regulation 80(1) of the 2019 Regulations (as firms relying on ESMA forbearance are not required to submit an application to their competent authority in order to do so). We would welcome confirmation that the FCA will be able to grant exemptions in relation to these transactions with effect from IP completion day.
- **Ability to submit applications for new and existing contracts prior to IP completion day:** Regulation 80 of the 2019 Regulations appears to be limited to OTC derivatives contracts (rather than exempt counterparty pairs) existing as at 21 December 2020 (for contracts with third-country affiliates) or as at the end of the transition period (for contracts with EU affiliates). Our understanding is based on the fact that Regulation 80 refers to contracts in existence as at the relevant date – while contracts entered into after that date may be entered into by an exempt counterparty pair, they would not be "contracts in existence as at the relevant date". As a result, it appears that UK counterparties will need to seek new exemptions under regulation 82 of the 2019 Regulations from both the clearing obligation and margin obligations for new contracts with non-UK affiliates entered into after the end of the transition period (and applications/notifications made to the FCA before the end of the transition period can be treated as applications/notifications made for this purpose – see regulation 82(5) of the 2019 Regulations). We would welcome confirmation that the FCA will be able to indicate its non-objection in relation to these applications prior to IP completion day, so that firms have comfort that they can rely on the exemption immediately upon IP completion day.

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- **Treatment of contracts when the Part 5 exemptions expire:** Regulations 80 and 82 of the 2019 Regulations state that both the intragroup exemptions for existing contracts and the new intragroup exemptions authorised by the FCA apply until three years after the end of the transition period (or, if earlier, four months after a relevant equivalence decision). This could be read to suggest that, when the exemptions expire (and in the absence of an equivalence decision), contracts become retroactively subject to the clearing obligation or become subject to margin requirements going forward. It clearly would be impractical to clear these contracts retroactively. In addition, subjecting these contracts to margin requirements would be inconsistent with the treatment of legacy contracts under the Margin RTS (under Article 35 of the Margin RTS, contracts entered into before the Margin RTS apply are not subject to margin requirements). We would welcome confirmation of how these provisions will apply.
- **Ability to use EEA UCITS as eligible collateral for Initial Margin:** The transitional relief until 31 March 2022 permits member firms subject to the UK margin requirements to continue to accept EEA UCITS as Initial Margin until that date. While this is very welcome, we believe that this permission should be permanent, continuing after 31 March 2022, and would support amendments to the UK EMIR Margin RTS. Such a limitation does not seem justified on prudential grounds. Given the regulatory and practical limitations on the ability to use cash as initial margin, this will also create a further layer of complexity and potentially cost for member firms engaging in derivatives business. In particular, it would adversely affect the ability of UK counterparties to continue to trade with EU counterparties which may wish to post EEA UCITS as margin to them. Those EU counterparties may otherwise choose to trade with EU counterparties that can accept EEA UCITS as eligible collateral under the EU Margin RTS. ISDA will revert to the PRA, FCA and HMT on this issue in more detail on this issue in due course.

We would welcome the opportunity to discuss these and any related issues further with you and are also very happy to answer any questions you may have in the meantime.

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