# ISDA – ‘No deal’ Brexit FAQs

***Dated: 17 October 2019***

*These FAQs provide a high-level summary of the key impacts of a ‘no deal’ Brexit on the OTC derivatives market and ISDA documentation. These FAQs are not intended to be exhaustive and the exact consequences of a ‘no deal’ Brexit will depend on the specific fact pattern and documentation. Market participants should seek their own independent legal and tax advice, and consult with any other adviser they deem appropriate, in respect of the points addressed in these FAQs and the consequences of a ‘no deal’ Brexit on their individual position and arrangements. More information can be found in the ISDA Brexit FAQs at https://www.isda.org/2019/07/17/brexit-faq-copy/* (the “**ISDA Brexit FAQs**”).

*These FAQs focus on the consequences which arise* ***immediately upon exit day*** *and do not consider consequences which will or may arise at a later point (e.g. due to the use of the UK regulators’ ‘temporary transitional power’ to delay/modify the application of certain obligations or EU ‘no deal’ Brexit contingency measures).*

*Certain of the FAQs refer to the template clauses and related FAQs published by ISDA (the “****Template Clauses****”) to facilitate adding language to ISDA published documents to comply with regulatory requirements in the event of a ‘no deal’ Brexit. The Template Clauses are available in the ISDA Bookstore.*

*Disclaimer: This page does not contain legal advice and is merely intended as an information resource to assist market participants in planning for the exit of the UK from the EU.*

## 1. *What is a ‘no deal’ Brexit and when/how will this take place?*

A ‘no deal’ Brexit (also known as a ‘hard’ Brexit) is the situation where the UK leaves the EU with no transitional arrangements (agreed between the UK and EU, as opposed to unilateral contingency measures) and without a trade arrangement or other deal with the EU.

The earliest date on which a ‘no deal’ Brexit could take place is **31 October 2019** at 11 p.m. (UK time) (‘exit day’ for the purposes of these FAQs). A ‘no deal’ Brexit will not take place on this date if, prior to this date, (i) the proposed withdrawal agreement[1] (with any amendments that may be agreed between the parties) is approved by the UK government and comes into force in both the UK and EU, (ii) the UK proposes (and the European Council agrees to) a further extension of the two year withdrawal period set out in Article 50(3) of the Treaty of the European Union (“**TEU**”) or (iii) the UK revokes Article 50 TEU (it is possible that (i) would in any case require a further extension to provide time to obtain the necessary approvals and pass the required legislation).

Were a ‘no deal’ Brexit to take place, with immediate effect on exit day:

- In the UK, EU law would no longer take precedence over UK law and directly applicable EU law would be converted into UK domestic law (and EU law which has been nationally implemented in the UK will be saved) via the European Union (Withdrawal) Act 2018 (a

[1] Agreement on the withdrawal of the UK from the EU and European Atomic Energy Community (draft endorsed by leaders at a special meeting of the European Council on 25 November 2018)

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process colloquially known as 'on-shoring'). The amendments made to EU and UK domestic law as part of this on-shoring process by the UK government[2] or UK regulators[3] will take effect.

- In the EU, the UK will no longer be treated as an EU member state and will lose the benefits and obligations of EU membership. The UK will (generally) be treated in the same way as other non-EU member states under EU law.

## 2. *If I am an entity subject to EU law as on-shored into UK domestic law post-Brexit (including EEA entities looking to access the UK market post-Brexit), what are the key new or modified obligations that I will need to comply with from exit day?*

*Whether an entity is subject to a particular provision of EU law, as on-shored into UK domestic law in the event of a 'no deal' Brexit, will depend on the law in question and specific fact pattern. Specific advice should be obtained.*

To the extent the obligation is within their remit, the FCA has stated that firms must take 'reasonable steps' to comply from exit day with any new/modified obligation to which they are not applying their temporary transitional power.[4] The UK regulators have stated that they will not apply their temporary transitional power where (i) a specific transitional regime is in place under UK 'on-shoring', (ii) the issue is potentially subject to an equivalence decision by HM Treasury or (iii) they specifically disapply this transitional relief. These specific exceptions to transitional relief include reporting requirements under UK on-shored EMIR and MiFID II (as described below).

Key areas where there may be an immediate impact on exit day are set out below:

**(i) Entities subject to UK on-shored EMIR[5]**

- **Reporting** – Report details of any derivative contract concluded, modified or terminated, after exit day to a trade repository which is registered with, or recognised by, the FCA.

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[2] The statutory instruments published by the UK government under the European Union (Withdrawal) Act 2018 (which, in large part, correct 'deficiencies' in on-shored EU law) can be found at: https://www.gov.uk/eu-withdrawal-act-2018-statutory-instruments

[3] Final rules and guidance published by the FCA can be found at: https://www.handbook.fca.org.uk/news/60. The Bank of England and PRA have also published final rules and guidance, which can be found at: https://www.bankofengland.co.uk/paper/2019/the-boes-amendments-to-financial-services-legislation-under-the-eu-withdrawal-act-2018. Both the FCA and the Bank of England/PRA are consulting on further changes to their rules and guidance in light of the extension of the Article 50(3) TEU withdrawal period to 31 October 2019, which can be found at https://www.fca.org.uk/publication/consultation/cp19-27.pdf and https://www.bankofengland.co.uk/prudential-regulation/publication/2019/uk-withdrawal-from-the-eu-changes-following-extension-of-article-50?utm_source=Bank+of+England+updates&utm_campaign=0e66e17a1d-EMAIL_CAMPAIGN_2019_07_25_08_40&utm_medium=email&utm_term=0_556dbefcdc-0e66e17a1d-113479169, respectively.

[4] HM Treasury has enabled the Bank of England, PRA and FCA to use their 'temporary transitional power' to waive or modify firms' regulatory obligations to the extent they have changed as a result of the on-shoring of EU law. This only applies to regulatory obligations within the relevant regulator's remit and is subject to certain restrictions e.g. it must be consistent with the regulator's statutory objectives. See https://www.gov.uk/government/publications/proposal-for-a-temporary-transitional-power-to-be-exercised-by-uk-regulators/proposal-for-a-temporary-transitional-power-to-be-exercised-by-uk-regulators. The UK regulators have set out how they intend to use this power in the event of a 'no deal' Brexit (although this approach is to be confirmed in light of the extension of the Article 50(3) TEU withdrawal period to 31 October 2019).

[5] Regulation (EU) No 648/2012

The list of trade repositories that have applied or stated their intention to apply for registration with the FCA can be found at: https://www.fca.org.uk/firms/trade-repositories.

- **Scope of 'OTC derivatives'** – Derivatives executed on EEA (non-UK) regulated markets will be 'OTC derivatives' under UK on-shored EMIR (in the absence of any equivalence decision by HM Treasury with respect to the relevant EEA regulated market). This could impact your (or your counterparties') classification as an FC+/- or NFC+/-[6], as applicable, as well as the scope of OTC derivatives which are subject to the risk mitigation requirements under UK on-shored EMIR.

**(ii) Entities subject to UK on-shored MiFID II**[7]

- **Reporting –** Report transactions in financial instruments (including derivative contracts) to the FCA or an approved reporting mechanism for the purposes of, and in compliance with, UK on-shored MiFID II. This will apply to both UK and EU TOTV (traded on a trading venue) instruments and some adjustments are required to the data provided, please see https://www.fca.org.uk/markets/market-data-regimes/fca-firds-and-transaction-reporting for more information.

- **Derivatives trading obligation** – Required to conclude in-scope derivative transactions on UK trading venues or third-country trading venues which have been assessed to be equivalent. This will not include EEA (non-UK) trading venues on exit day (assuming no equivalence decision is made by HM Treasury). Transactions between UK and EEA entities (as well as certain transactions entered into via branches or by firms using the 'temporary permissions regime' to operate in the UK market after exit day) may therefore, post-Brexit, be subject to conflicting derivatives trading obligations (see FAQ 4).

**(iii) Other**

- **Authorisations** – EEA (non-UK) entities which are currently carrying out regulated activities in the UK pursuant to passporting rights under MiFID II will need to consider whether they are required to obtain authorisations in the UK (as passporting rights will cease to apply on exit day). This will be relevant both where you are considering (i) entering into new OTC derivative contracts or (ii) remaining party to existing OTC derivative contracts, in each case with UK counterparties after exit day. For (ii), this will also depend on whether any 'lifecycle events' (i.e. events which occur during the life of the OTC derivative contract) are seen to require authorisation in the UK (e.g. if such event could be classified as dealing in a financial instrument).

  EEA (non-UK) firms who wish to make use of the UK's 'temporary permissions regime' ("**TPR**") to continue to operate in the UK as if their MiFID II passporting rights continued for up to three years after exit day must, if they are solo-regulated by the FCA, notify the FCA before the end of <u>**30 October 2019**</u> (see https://www.fca.org.uk/brexit/temporary-

[6] Whether you are (i) a financial counterparty above the clearing threshold in any asset class (an "**FC+**") or below the clearing threshold in all asset classes (an "**FC-**") or (ii) a non-financial counterparty above the clearing threshold with respect to that asset class (an "**NFC+**") or below the clearing threshold with respect to that asset class ("**NFC-**"), in each case under UK on-shored EMIR. This threshold is determined on the basis of the number of 'OTC derivative contracts' entered into by such entity (or by other entities (in the case of an FC+/- calculation) or non-financial entities (in the case of an NFC+/- calculation) within the group). In the case of an NFC+/- calculation, only those OTC derivative contracts which are not objectively measurable as reducing risks directly relating to the commercial activity or treasury financing activity of the NFC or of that group are included.

[7] Directive 2014/65/EU and Regulation (EU) No 600/2014

permissions-regime for further details). This will be relevant for EEA firms which rely on passporting rights either to act on a cross-border basis into the UK or through a UK branch. EEA firms within the TPR will need to apply for authorisation in the UK when instructed by the FCA and, whilst within the TPR, comply with certain UK rules (firms should familiarise themselves with these requirements – see the FCA website above for further details). EEA firms relying on passporting rights who do not enter into the TPR will automatically enter the financial services contracts regime (https://www.fca.org.uk/news/statements/financial-services-contracts-regime). There is a similar TPR for firms regulated by the PRA (e.g. credit institutions), however the deadline for notifying the PRA ended on 11 April 2019.

- **Contractual recognition of bail-in and resolution stays**[8] – Include contractual recognition of bail-in and resolution stays language in in-scope EEA law governed liabilities which are entered into or materially amended after exit day. This will include any EEA law governed ISDA Master Agreement under which a transaction is entered into after exit day.

  The FCA and PRA have stated that they will apply their temporary transitional power to delay the application of the contractual recognition of bail-in requirement (only) to 'unsecured liabilities' that are not 'debt instruments' until 31 December 2020 (fully secured liabilities are in any case excluded from the contractual recognition of bail-in obligation).[9] This is likely to be relevant to liabilities which arise under ISDA Master Agreements.

- **Credit ratings** – Credit ratings may only be used for regulatory purposes in the UK if they have been issued or endorsed by a credit rating agency ("**CRA**") established in the UK and registered with the FCA (or issued by a certified third country CRA under the UK regime). This change is mitigated by (i) UK CRAs currently registered with ESMA, and third country CRAs currently certified under the EU regime, being able to convert this into registration/certification with the FCA on exit day (the list of CRAs that are intending to operate in the UK post-Brexit can be found at: https://www.fca.org.uk/markets/credit-rating-agencies/list-cras-intending-operate-uk-after-brexit), (ii) UK CRAs being able to endorse credit ratings of affiliated EU CRAs and (iii) the ability to use a credit rating in the UK for one year if it was issued or endorsed by an EU CRA before exit day and was not withdrawn immediately before exit day.

  This should mean that, in large part, UK regulated entities can continue to use credit ratings in the same way as they did prior to exit day, at least for a limited time period. However, UK regulated entities should consider the impact of a 'no deal' Brexit on credit ratings which they use and, in particular, their ability to rely on credit ratings which are newly issued on or after exit day, or credit ratings that were issued or endorsed before exit day that are subject to subsequent rating action on or after exit day, and ensure that such ratings have been issued or endorsed by an appropriate CRA.

[8] This requirement applies to the entities set out in IFPRU 11 of the FCA Handbook (https://www.handbook.fca.org.uk/handbook/IFPRU/11/?view=chapter), the Contractual Recognition of Bail-in part of the PRA Rulebook (http://www.prarulebook.co.uk/rulebook/Content/Part/211722/29-03-2019) and the Stay in Resolution part of the PRA Rulebook (http://www.prarulebook.co.uk/rulebook/Content/Part/318771/29-03-2019), in each case as amended as a result of the on-shoring process.

[9] Please see the relevant rules (set out in footnote 8), as amended by the on-shoring process (see footnote 3), for the relevant scope of 'unsecured liabilities' and 'debt instruments', as well as secured liabilities which are excluded from the overall requirement.

3. ***If I am an entity as described in FAQ 2, what changes should I consider making to my ISDA documentation in preparation for exit day?***

Such entities should consider:

- **Reporting under UK on-shored EMIR -** In order to report under UK on-shored EMIR, whether you have obtained any consent required from your counterparty to disclose trade details to a trade repository under the UK regulatory regime (the consent to disclosure in the ISDA 2013 EMIR Portfolio Reconciliation, Dispute Resolution and Disclosure Protocol will not be broad enough to capture this regime) and whether this is necessary from a contractual or wider legal perspective. See paragraph 2 of the Template Clauses. Entities should also consider whether any consent needs to cater for a scenario where there is forbearance (or similar relief) during which reporting can continue to be made to an EMIR registered trade repository for a certain period after exit day.
- **Delegated reporting arrangements -** Whether your delegated reporting arrangements are appropriate, both in situations where (i) you are subject to UK on-shored EMIR and have delegated reporting to another entity or (ii) you are reporting on behalf of an entity subject to UK on-shored EMIR (regardless of whether you are subject to UK on-shored EMIR yourself). In both circumstances, you will need to consider whether the documentation allows reporting to the correct type of trade repository (see FAQ 2) and more generally whether the documentation contemplates reporting under UK on-shored EMIR. Similar to the above, entities should also consider whether these arrangements need to cater for a scenario where there is forbearance (or similar relief) during which reporting can continue to be made to an EMIR registered trade repository for a certain period after exit day.
- **Contractual recognition of bail-in** - Adding language to EEA law governed ISDA Master Agreements (or other documents) to comply with this requirement in the circumstances described in FAQ 2. See paragraph 5.1 of the Template Clauses.
- **Contractual recognition of resolution stays** – Adding language to EEA law governed ISDA Master Agreements (or other agreements) to comply with this requirement in the circumstances described in FAQ 2. ISDA is intending to publish a new 2019 UK Module to the ISDA Resolution Stay Jurisdictional Modular Protocol which reflects the post-Brexit UK stay resolution requirement for these purposes. This 2019 UK Module is currently in draft form and subject to member consultation.

Such entities could also consider (i) expanding their portfolio reconciliation and dispute resolution provisions in their ISDA Master Agreements to contemplate UK on-shored EMIR (see paragraph 3 of the Template Clauses), (ii) specifying UK on-shored EMIR as a 'Regime' for the purposes of their initial margin documentation (see paragraph 4.1 of the Template Clauses), (iii) using a definition of 'OTC derivative' which is based on UK on-shored EMIR to determine the scope of transactions brought within the scope of their variation margin documentation (see paragraph 4.2 of the Template Clauses) or (iv) adjusting their ISDA 2017 Portfolio Compression Agreements to contemplate UK on-shored MiFID II (in particular, to provide for the reporting of

portfolio compression exercises to an ‘approved publication arrangement’ under this regulatory regime) (see paragraph 6 of the Template Clauses).

## 4. *If I am an entity subject to EU law post-Brexit (including UK entities looking to access the EEA market post-Brexit), what are the key new or modified obligations that I will need to comply with from exit day?*

*Whether an entity is subject to a particular provision of EU law post-Brexit will depend on the law in question and specific fact pattern. Specific advice should be obtained.*

**(i) Entities subject to EMIR**

- **Reporting** – Report details of any derivative contract concluded, modified or terminated after exit day to a trade repository which is registered with, or recognised by, ESMA. This will no longer include UK trade repositories (although certain UK trade repositories have set up EU affiliates to be registered with ESMA in anticipation of Brexit[10]).
- **Scope of ‘OTC derivatives’** – Derivatives executed on UK regulated markets will be ‘OTC derivatives’ under EMIR (in the absence of any equivalence decision by the European Commission with respect to the relevant UK regulated market). This could impact your (or your counterparties’) classification as an FC+/- or NFC+/-, as applicable, as well as the scope of OTC derivatives which are subject to the risk mitigation requirements under EMIR.

**(ii) Entities subject to MiFID II**

- **Reporting –** Report transactions in financial instruments (including derivative contracts) to the relevant competent authority or an approved reporting mechanism for the purposes of, and in compliance with, MiFID II – this will no longer include the FCA or UK approved reporting mechanisms. This will apply only to EU TOTV (traded on a trading venue) instruments.
- **Derivatives trading obligation** – Required to conclude in-scope derivative transactions on EEA (non-UK) trading venues or third-country trading venues which have been assessed to be equivalent. This will not include UK trading venues on exit day (assuming no equivalence decision is made by the European Commission). Transactions between UK and EEA entities (as well as certain transactions entered into via branches) may therefore, post-Brexit, be subject to conflicting derivatives trading obligations (see FAQ 2).

**(iii) Other**

- **Authorisations** – UK entities which are currently carrying out regulated activities in the EEA (outside the UK) pursuant to passporting rights under MiFID II will need to consider whether they are required to obtain authorisations in EEA member states (as passporting rights will cease to apply on exit day). This will be relevant both where you are considering (i) entering into new OTC derivative contracts or (ii) remaining party to existing OTC derivative contracts, in each case with EEA counterparties after exit day.

[10] UnaVista TRADEcho B.V. and DTCC Data Repository (Ireland) plc have been registered with ESMA (https://www.esma.europa.eu/press-news/esma-news/esma-registers-unavista-tradecho-bv-trade-repository and https://www.esma.europa.eu/press-news/esma-news/esma-registers-dtcc-data-repository-ireland-plc-trade-repository, respectively).

Whether this is needed will depend on the legal position in the relevant EEA jurisdiction, including whether there are any exemptions to authorisation requirements which are available, or 'no deal' Brexit contingency measures which have been introduced at a national level. For (ii), it will also depend on whether any 'lifecycle events' (i.e. events which occur during the life of the OTC derivative contract) are seen to require authorisation in the relevant EEA jurisdiction (e.g. if such event could be classified as dealing in a financial instrument).

- **Contractual recognition of bail-in and resolution stays**[11] – Include contractual recognition of bail-in and (if required by national law in your jurisdiction) resolution stays language in in-scope English law governed liabilities. As there is no grandfathering of this requirement proposed at this stage, this will in principle apply to any English law governed OTC derivative contract entered into since the requirement originally came into force in the relevant jurisdiction (subject, in the case of contractual recognition of bail-in, to the possible application of the exception to this requirement set out in Article 55(1) BRRD).

- **Credit ratings** – Credit ratings may only be used for regulatory purposes in the EU27 after exit day if they have been issued or endorsed by a CRA established in the EU27 and registered with ESMA (or issued by a certified third country CRA under the EU regime). Ratings issued or endorsed by UK CRAs will no longer be permitted for such purpose. This is mitigated by the fact that EU CRAs will be able to endorse credit ratings of affiliated UK CRAs.[12] EU regulated entities should consider the impact of a 'no deal' Brexit on credit ratings which they use and ensure that they have been issued or endorsed by an appropriate CRA.

### 5. *If I am an entity as described in FAQ 4, what changes should I consider making to my ISDA documentation in preparation for exit day?*

Such entities should consider:

- **Delegated reporting arrangements –** Whether your delegated reporting arrangements are appropriate, both in situations where (i) you are subject to EMIR and have delegated reporting to another entity or (ii) you are reporting on behalf of an entity subject to EMIR (regardless of whether you are subject to EMIR yourself). In both circumstances, you will need to consider whether the documentation allows reporting to the correct type of trade repository (see FAQ 4).

- **Contractual recognition of bail-in** - Adding language to English law governed ISDA Master Agreements (or other agreements) to comply with this requirement in the circumstances described in FAQ 4. See paragraph 5.3 of the Template Clauses.

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[11] The contractual recognition of bail-in requirement is set out in Article 55(1) BRRD (Directive 2014/59/EU) and has been implemented in all EU27 member states (it applies, broadly, to credit institutions and large investment firms). The contractual recognition of resolution stays requirement does not stem from BRRD but has been introduced at a national level in France, Germany and Italy.

[12] ESMA has published a statement which notes that UK CRAs generally either have an existing affiliated EU CRA, or have set one up in anticipation of a 'no deal' Brexit, who can carry out such endorsements (https://www.esma.europa.eu/system/files_force/library/esma33-5-735_public_statement.pdf). The only UK CRA which was an exception at the time of this statement was The Economist Intelligence Unit Ltd.

- **Contractual recognition of resolution stays** – To the extent you are subject to this requirement under national law, adding language to English law governed ISDA Master Agreements (or other agreements) to comply with this requirement in the circumstances described in FAQ 4. See paragraphs 5.4 to 5.6 of the Template Clauses.

## 6. *What will be the impact of a 'no deal' Brexit on my legacy ISDA Master Agreements?*

Where entering into new transactions, or continuing to perform existing transactions, under a legacy ISDA Master Agreement requires a party to obtain authorisations as a result of a 'no deal' Brexit (see FAQ 2 or 4, as applicable), it is possible that in certain circumstances carrying out such action without obtaining the necessary authorisations could have implications for your ISDA Master Agreement. In particular:

- Consideration will need to be given to whether a loss of passporting rights could constitute a Force Majeure or Illegality Termination Event under your ISDA Master Agreement.
- To the extent the representations under Section 3(a)(iii) (*No Violation or Conflict*) or (iv) (*Consents*) of the ISDA Master Agreement are repeated post-exit day (i.e. where a new transaction is entered into), consideration could be given to whether they remain true – in particular, a loss of passporting rights may in certain circumstances mean that the representation under Section 3(a)(iv) is no longer accurate. This would give rise to the risk of an Event of Default for misrepresentation under Section 5(a)(iv) (*Misrepresentation*) of the ISDA Master Agreement.
- Consideration should also be given to Section 4(b) (*Maintain Authorisations*) of the ISDA Master Agreement and whether a failure to obtain new authorisations in the UK or EEA, as applicable, would constitute a breach of this requirement (which, in turn, would give rise to the risk of an Event of Default under Section 5(a)(ii) (*Breach of Agreement; Repudiation of Agreement*) of the ISDA Master Agreement).
- Consideration should be given to the tax implications of a 'no deal' Brexit for OTC derivative contracts (which is outside the scope of these FAQs) and, in particular, whether any change in applicable tax law could give rise to a Tax Event Termination Event under Section 5(b)(iii) (*Tax Event*) of the ISDA Master Agreement.

A 'no deal' Brexit may also have implications for the treatment of jurisdiction clauses with respect to the English courts in legacy ISDA Master Agreements.

To the extent specific Brexit-related clauses have been added to your ISDA Master Agreements, these may be triggered in the event of a 'no deal' Brexit (depending on the exact drafting).

Please see the ISDA Brexit FAQs for further details.