



16 January 2019

## UKMIR and what a "no-deal" Brexit means for users of derivatives in the UK

Following the result of Parliament's vote on the Government's proposed Brexit deal on Tuesday 15 January 2019, it looks increasingly likely that the UK may leave the European Union ("EU") on 29 March 2019 ("**Brexit Day**") without a negotiated deal in place.

While much could still happen between now and Brexit Day, including an extension to the exit timeline, inroads to an alternative deal based on an existing third-country model, a change of Government or even a second referendum, this short briefing note outlines how the *European Market Infrastructure Regulation on OTC derivative transactions, central counterparties and trade repositories (Regulation EU 648/2012)* ("**EMIR**") would operate, from a UK law perspective, in the event of a "no-deal" Brexit.

### WHAT WOULD HAPPEN ON BREXIT DAY?

On 26 June 2018, the *European Union (Withdrawal) Act 2018* ("**EUWA**") was enacted in the UK to provide for a planned transition of applicable EU laws in to the UK's statute book post-Brexit. Among other things, EUWA covers:

- the removal of the competence of EU institutions to legislate for the UK on and from Brexit Day;
- the transposition of all directly applicable and existing EU legislation into UK law; and
- the creation of new powers under which the UK will be able to make amendments to this body of transposed legislation through the use of Statutory Instrument procedures.

EUWA therefore provides useful clarity regarding the legislation that will be in force following Brexit Day.

### EMIR AND UKMIR

One of the most important considerations for users of derivatives in the UK is the operation of EMIR, the primary regulation that regulates derivatives and their users in the EU.

Under EUWA, EMIR will be "onshored" into UK law by way of a statutory instrument, *The Over the Counter Derivatives, Central Counterparties and Trade Repositories (Amendment, etc., and Transitional Provision)(EU Exit) Regulations 2018* ("**UKMIR**").

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Reassuringly for users of derivatives in the UK (who will have legal, operational and administrative arrangements in place already), UKMIR does **not** seek to make substantive changes to the terms of EMIR. Instead, the purpose of UKMIR is to ensure that the new regime operates effectively in the UK post Brexit Day.

Examples of the terms of UKMIR include:

- **A transfer of functions from EU to UK authorities** - functions and supervisory roles currently undertaken by EU authorities under EMIR will be transferred to equivalent UK authorities. This is to reflect the removal of EU institutional competence for what will become UK financial services matters. For example, certain matters that under EMIR are within the European Securities and Markets Authority's remit, will fall under the remit of the relevant UK regulator (which, depending on the obligation, may be the Bank of England ("**BoE**"), the Prudential Regulatory Authority ("**PRA**") or the Financial Conduct Authority ("**FCA**").
- **Amendments to definitions** – many of the provisions in EMIR include terms that are defined by reference to EU legislation. UKMIR will replace such references with references to comparable UK legislation. While we do not think that it is intended that UKMIR would diverge substantively from EMIR, there are certain differences, notably where EMIR cross-refers to EU Directives<sup>1</sup>. For example, the term "financial counterparty" in EMIR includes Alternative Investment Funds, as defined in the *Alternative Investment Fund Managers Directive 2011/61/EU* (an existing EU Directive) whose manager is authorised or registered under that Directive. From Brexit Day, the term "financial counterparty" in UKMIR will include Alternative Investment Funds, as defined in *The Alternative Investment Fund Managers Regulations 2013* (an existing UK law) whose manager is authorised or registered under that Regulation. The two definitions, while materially similar, are not identical. UK entities should consider carefully whether differences such as these could have a substantive impact on them or their counterparties.
- **Updated processes** – various cooperation requirements between UK and EU regulators will be deleted or amended by UKMIR. For example, changes will include:
  - replacing the current trade repository supervision rules with provisions that align with those contained in the *Financial Services and Markets Act 2000*;
  - substituting the BoE, FCA and PRA for the "Colleges" (groups of EU regulators that currently supervise central counterparty clearing houses ("**CCPs**") in the EU) to supervise UK CCPs; and
  - revoking the requirements to share certain information with EU authorities, although this will not necessarily preclude the sharing of information with such authorities, where necessary.
- **An intragroup clearing exemption** – a temporary "intragroup exemption" will ensure that UK entities can continue to enter into derivatives transactions, which would otherwise need to be cleared by a CCP, without being required to clear those transactions where the counterparty to those transactions is member of the UK entity's corporate group that is based in the EU.

The changes are therefore largely technical in nature and, immediately following Brexit Day, we do not anticipate a material divergence between the terms of EMIR and UKMIR. That may not, however, remain the position indefinitely.

## FORTHCOMING AMENDMENTS TO EMIR AND HOW THESE WOULD INTERACT WITH UKMIR

Currently a proposal to amend the terms of EMIR ("**EMIR 2.1**") is passing through the final stages of ratification and is expected to come into force in the EU in the first half of 2019.

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<sup>1</sup> EU Directives do not have direct applicability in EU Member States and so must be transposed into national law, often with some differences between jurisdictions (imposed at the behest of the relevant EU Member State's legislature).

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Broadly, the aim of EMIR 2.1 is to make technical changes to the terms of EMIR to ensure that they remain proportionate. In our July 2018 note, *EMIR 2.1*, which can be viewed [here](#), we discuss these changes in some detail.

If EMIR 2.1 comes into force before Brexit Day, under the terms of EUWA the amendments to EMIR will be transposed into UK law. If EMIR 2.1 does not come into force before Brexit Day, it will not be transposed into UK law.

## WHAT ARE THE CONSEQUENCES IF EMIR 2.1 DOES NOT COME INTO FORCE BEFORE BREXIT DAY?

If EMIR 2.1 does not come into force before Brexit Day, the good news for users of derivatives in the UK is that the changes envisaged by EMIR 2.1 can also be brought into UK law by virtue of the *Financial Services (Implementation of Legislation) Bill [HL 2017-2019]* (the "**FS Bill**").

The FS bill gives the UK government the power to choose to implement EU "in-flight" legislation, which is termed as such because it is due to come into force within the next two years or has been published but is not necessarily captured under EUWA. Such legislation must be specified within the FS Bill and does include EMIR 2.1.

The less good news is that it is unclear whether or how the power to introduce EMIR 2.1 into UK law would be exercised. This is because the Government has the power to adjust legislation as it is brought into UK law. Further, as a safeguard, the FS Bill requires Parliament to follow necessary parliamentary process, so there may be delays and/or changes made to the terms of EMIR 2.1 as it is transposed into UK law. There may therefore be a period (of uncertain duration) of unintended, and potentially unwelcome, divergence between the terms of EMIR (as amended by EMIR 2.1) and UKMIR.

## UK PENSION SCHEMES AND THE TEMPORARY EXEMPTION FROM CLEARING UNDER EMIR/UKMIR

An existing exemption from clearing under EMIR, applicable to EU pension scheme arrangements, has lapsed and, while it is proposed that a new time-limited exemption will come into force under EMIR 2.1, for the reasons noted above, unless this happens before Brexit Day the new exemption will not be transposed into UK law by EUWA. While we expect that the FCA will introduce a period of forbearance for UK pension schemes (so that they are not prejudiced compared to their EU equivalents), at this time it appears, immediately following-Brexit Day, that UK pension schemes would be required to clear any **new** derivatives transactions that they enter into where those transactions would be subject to the clearing obligation under UKMIR.

## CONCLUSION

The UK Government's proposal to implement the terms of EMIR into UK law, with minimal amendments, is clearly helpful and this continuity is likely to be welcomed by users of derivatives in the UK. It is unfortunate, however, that the same clarity does not exist with regards to the amendments contained in EMIR 2.1 (which, in substance, are helpful and which we expect that users of derivatives in the UK will want to be implemented into UK law).

What is less helpful is the ongoing uncertainty regarding what deal, or other arrangements (if any), will be in place by Brexit Day. This should remain a watching brief for UK users of derivatives.

If you wish to discuss any of the issues raised in this note, please contact one of the Derivatives and Structured Products Group.

# TRIVERS SMITH

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## FOR FURTHER INFORMATION, PLEASE CONTACT

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10 Snow Hill  
London EC1A 2AL  
T: +44 (0)20 7295 3000  
F: +44 (0)20 7295 3500  
[www.traverssmith.com](http://www.traverssmith.com)



### **Jonathan Gilmour**

Partner, Head of Derivatives & Structured Products

E: [jonathan.gilmour@traverssmith.com](mailto:jonathan.gilmour@traverssmith.com)  
T: +44 (0)20 7295 3425



### **Peter Hughes**

Partner, Derivatives & Structured Products

E: [peter.hughes@traverssmith.com](mailto:peter.hughes@traverssmith.com)  
T: +44 (0)20 7295 3377



### **Sebastian Reger**

Partner, Derivatives & Structured Products

E: [sebastian.reger@traverssmith.com](mailto:sebastian.reger@traverssmith.com)  
T: +44 (0)20 7295 3335



### **Vanessa Kalijnikoff Battaglia**

Senior Associate, Derivatives & Structured Products

E: [vanessa.battaglia@traverssmith.com](mailto:vanessa.battaglia@traverssmith.com)  
T: +44 (0)20 7295 3150



### **Cindy Smith**

Senior Associate, Derivatives & Structured Products

E: [cindy.smith@traverssmith.com](mailto:cindy.smith@traverssmith.com)  
T: +44 (0)20 7295 3455



### **Joseph Wren**

Senior Associate, Derivatives & Structured Products

E: [joseph.wren@traverssmith.com](mailto:joseph.wren@traverssmith.com)  
T: +44 (0)20 7295 3401