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How changing regulation impacts trading documents

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Macfarlanes

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Programme

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- **Introduction**
- **What is the main legislation affecting trading documentation?**
- **Key global thematic issues**
- **Review of practical consequences across ISDAs, GMRAs, futures agreements, prime brokerage agreements and cleared derivatives.**
- **Q&A**
- **Close**

Introduction

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- Background – the global financial crisis
- Derivatives to blame? The G20 statement in Pittsburgh

"All standardised OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end-2012 at the latest. OTC derivative contracts should be reported to trade repositories. Non-centrally cleared contracts should be subject to higher capital requirements."

- Sell-side vs buy-side
- The future



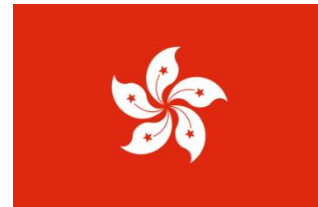
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What is the new legislation affecting trading documentation?

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- Foreign Account Tax Compliance Act (FATCA) – March 2010
- Hiring Incentives to Restore Employment Act (HIRE Act) – S.871(m) – March 2010
- The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) – July 2010
- The Alternative Investment Fund Managers Directive (AIFMD) – July 2011
- The EU Short Selling Regulation (EU SSR) – March 2012
- The European Market Infrastructure Regulation (EMIR) – November 2012
- Capital Requirements Regulation / Directive (CRD IV) – June 2013
- The Bank Recovery and Resolution Directive (BRRD) – May 2014
- The Securities Financing Transactions Regulation (SFTR) – December 2015
- Standard for Automatic Exchange of Financial Account Information (CRS) – July 2015
- Undertakings for Collective Investment in Transferable Securities Directive (UCITS V) – March 2016
- Money Markets Funds Regulations – June 2017
- Markets in Financial Instruments Directive / Regulation (MiFID II) – Jan 2018
- Local equivalents in Hong Kong, Singapore, Australia and other markets
- Plus, for those facing UK brokers – Brexit!



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Key global thematic issues

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- **Transparency**

- To investors – UCITS V / AIFMD
- To regulators – EMIR, DF and SFTR reporting
- To other market participants - SFTR disclosures, Dodd-Frank Business Conduct rules, US OCR rules

- **Reduction of counterparty risk**

- Central clearing
- Margining
- Protection on insolvency – segregation

- **Bank capital adequacy and resolution**

- Basel III / CRD IV
- BRRD / orderly liquidation authority
- Volcker Rule

Key global thematic issues (cont)

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- **Market activity**

- Short selling
- Algorithmic / high frequency trading
- Timely confirmation and portfolio reconciliation

- **Differences in approach**

- FX
- Margin collection start date
- Clearing – agency v principal models
- Reporting
- Scope

Review of practical consequences (1)

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- **Prime brokerage agreements**

- CRR IV / Basel III – ease of getting an account / ease of getting decent terms
- AIFMD / UCITS V – Depository oversight - sub-custodian issues / depo v depo lite / borrowing & security
- EU SSR – locate notices
- SFTR – rehypo issues
- FATCA / CRS – account opening formalities
- UK CASS changes – PBA amendments
- EMIR – cross-portfolio margining
- Brexit – illegality, choice of laws/jurisdiction, cross-border insolvency/bail out

- **FXPB**

- EMIR – increase in use of product?
- CRR IV – capital intensive

Review of practical consequences (2)

- **Future and options agreements**

- CRR IV / Basel III / FATCA / CRS – same as for PBAs
- AIFMD / UCITS V – sub-custodian issues where security granted over non-cash collateral
- UCITS V – UK issues around granting security for obligations other than margin
- EMIR – segregation / account issues
- EMIR – trade reporting
- SFTR – if non-cash collateral used, rehypothecation, reporting, investor transparency issues
- UK CASS changes – where non-cash collateral posted
- DF / EMIR – cross-border clearing issues
- DF
 - Ownership & Control reporting rules
 - Trading cleared derivatives on SEFs
- Brexit: illegality, equivalence

Review of practical consequences (3)

- **ISDA master agreements (1)**

- CRR IV / Basel III – same as for PBAs
- FATCA / CRS – account opening formalities, and amendments to gross-up risk allocation – FATCA protocol
- HIRE ACT – amendment to gross-up risk allocation
- DF
 - US Person classification exercise
 - External business conduct rules – August 2012 ISDA DF Protocol 1
 - Mandatory clearing – March 2013 DF Protocol 2
 - US trade reporting
- AIFMD – use of NY ISDAs where collateral pledged – sub-custody problems?

Review of practical consequences (4)

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- **ISDA master agreements (2)**
 - EMIR
 - Trade reporting
 - EMIR refit changes
 - Risk mitigation
 - Timely confirmation, portfolio compression, daily valuation
 - Portfolio reconciliation and dispute resolution – ISDA PRDR Protocol
 - Margin on uncleared derivatives.....
 - Timing
 - Process
 - Portfolio margining
 - FX exemption

Review of practical consequences (5)

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- **ISDA master agreements (3)**

- EMIR (cont)
 - Mandatory clearing
 - Frontloading ATEs
 - CDEAs
- UCITS V
 - Asset class restrictions – no commodities
 - Global exposure must be covered
 - Counterparty threshold – 5% / 10% of NAV;
 - How is this calculated in a cleared context? ESMA opinion issues
 - Bank solutions
- Must be approved counterparty

Review of practical consequences (6)

- **ISDA master agreements (4)**

- UCITS V (cont)
 - Details of collateral policy to be set out in prospectus.
 - Derivatives must be subject to reliable and verifiable valuation
 - must be able to be sold, liquidated or closed by an offsetting transactions at any time
 - Other common UCITS inclusions?
 - Depository oversight - sub-custodian issues where security granted over non-cash collateral – NY law CSAs
 - Share class hedging issues
- SFTR – for TRS, rehypo, reporting, investor transparency issues
- BRRD - Article 55 BRRD and Protocols
- Brexit: illegality / force majeure / choice of law/jurisdiction

Review of practical consequences (7)

- **Global master repurchase agreements**

- CRR IV / Basel III – same as for ISDAs.
- FATCA / CRS – account opening formalities, and amendments to gross-up risk allocation – ICMA FATCA wording
- SFTR – rehypo, reporting, investor transparency issues
- BRRD
 - ISDA Universal Resolution Stay Protocol (through SFT annex) – though GMRA is always English law. MRA affected.
- UCITS V
 - Permitted for efficient portfolio management only – ESMA guidelines make use for collateral transformation trades difficult
 - Terms in accordance with good market practice
- Brexit – illegality, choice of law / jurisdiction

Q&A

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