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Brexit-related ISDA Protocols

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The Short Read

The United Kingdom ("UK") became a "third country" for the purposes of European Union ("EU") law following the expiry of the Brexit transition period at 11:00pm on 31 December 2020 ("Transition Period End Date"), whereupon UK law is treated by the EU as a "third country" law. Equally, for the purposes of UK law, each EU member state became a "third country" and the law of any EU member state is now treated as a "third country" law.

With effect from the Transition Period End Date:

- EU law was "onshored" into domestic UK law as "retained EU law"[1] subject to further amendments by secondary legislation and/or relevant regulators to ensure its effective operation in a UK context and to remedy any deficiencies resulting from the UK no longer being an EU member state; and
- market participants previously subject to the EU regulatory regime may have become subject to a new UK regulatory landscape either in replacement of, or in addition to, the EU regulatory regime[2]; including UK-onshored EMIR[3] ("UK EMIR") being the UK version of the European Market Infrastructure Regulation[4] ("EU EMIR").

The International Swaps and Derivatives Association, Inc. ("ISDA") has published two protocols to assist market participants in meeting certain obligations which may have arisen after the Transaction Period End Date:

- the ISDA 2020 UK EMIR Portfolio Reconciliation, Dispute Resolution and Disclosure Protocol[5]: enabling parties subject to UK EMIR to amend the terms of certain derivatives agreements (including, in particular, ISDA Master Agreements) to reflect the portfolio reconciliation and dispute resolution requirements imposed by UK EMIR and to include a disclosure waiver to address confidentiality concerns that may arise when reporting derivative transactions under the UK EMIR reporting regime; and
- the ISDA 2020 UK (PRA Rule) Jurisdictional Module to the ISDA Resolution Stay Jurisdictional Modular Protocol[6]: enabling parties to comply with the rules of the UK Prudential Regulation Authority regarding contractual stays in financial contracts governed by third-country law (the "PRA Stay Rules")[7].

Market participants either directly or indirectly affected by UK EMIR and/or the PRA Stay Rules will need to consider either adhering to these protocols or contractually incorporating terms into their relevant agreements addressing the same issues.

The Full Read

UK EMIR Protocol

Which categories of agreements are covered by the UK EMIR Protocol?

The ISDA 2020 UK EMIR Portfolio Reconciliation, Dispute Resolution and Disclosure Protocol (the "UK EMIR Protocol") acts to amend: (i) an ISDA Master Agreement; or (ii) another type of agreement setting out or governing the terms of derivative contracts (each such agreement in (i) and (ii), a "Relevant Agreement"), in each case entered into between two adhering parties on or prior to the date on which both parties have adhered to the UK EMIR Protocol[8] (in other words, pre-existing Relevant Agreements).

The terms of the UK EMIR Protocol will not apply *automatically* to new Relevant Agreements, i.e., those executed *after* both parties have adhered. Rather, in order to have the terms of the UK EMIR Protocol apply to the new Relevant Agreement, a provision must be included in the Relevant Agreement to contractually incorporate the terms of the UK EMIR Protocol by reference.

What is the purpose of the UK EMIR Protocol?

Entities subject to UK EMIR must ensure that written agreements governing the terms of their OTC derivative contracts (such as ISDA Master Agreements) comply with the portfolio reconciliation and dispute resolution provisions of UK EMIR. In brief, there must be:

- an agreed arrangement under which portfolios are reconciled, with such reconciliation covering the 'key terms' of the contract and the mark-to-market valuation. For "financial counterparties" and "non-financial counterparties" exceeding a clearing threshold, the reconciliation frequency is: (a) each business day when 500 or more OTC derivative contracts are outstanding between the counterparties; (b) once per week when between 51 and 499 OTC derivative contracts are outstanding between the counterparties at any time during the week; and (c) once per quarter when 50 or fewer OTC derivative contracts are outstanding between the counterparties at any time during the quarter. For "non-financial counterparties" not exceeding a clearing threshold, the reconciliation frequency is: (a) once per quarter when more than 100 OTC derivative contracts are outstanding between the counterparties at any time during the quarter; and (b) once per year when 100 or fewer OTC derivative contracts are outstanding between the counterparties; and
- detailed procedures and processes in relation to (x) dispute identification, recording and monitoring of disputes relating to the recognition or valuation of the OTC derivative contract and the exchange of collateral between counterparties and (y) the resolution of disputes in a timely manner if such disputes are not resolved within five business days ((i) and (ii) the "UK PR DR Requirements").

The UK EMIR Protocol amends Relevant Agreements to reflect these UK PR DR Requirements. An adhering party will adhere to the UK EMIR Protocol either as a 'Portfolio Data Receiving Entity' or as a 'Portfolio Data Sending Entity'. Where one party to a Relevant Agreement is a Portfolio Data Receiving Entity and the other is a Portfolio Data Sending Entity, the Portfolio Data Receiving Entity will reconcile the portfolio data sent to it by the Portfolio Data Sending Entity (with negative affirmation applying after five business days). Where both adhering parties are Portfolio Data Sending Entities, each party will send portfolio data to the other and each will then perform a reconciliation of the data received. If both adhering parties are Portfolio Data Receiving Entities, they are required to separately agree a process that would meet the UK PR DR Requirements with respect to portfolio reconciliation.

In addition, the UK EMIR Protocol includes a disclosure waiver to allow parties to meet the various reporting and record keeping requirements under UK EMIR without breaching applicable confidentiality restrictions.

Similarities to the EU EMIR Protocol

The UK EMIR Protocol has been based on the ISDA 2013 EMIR Portfolio Reconciliation, Dispute Resolution and Disclosure Protocol (the "EU EMIR Protocol"), with adjustments only as necessary to reflect the equivalent provisions of UK EMIR.

Who is the UK EMIR Protocol relevant to?

Entities classified as "financial counterparties" (for example, non-UK alternative investment funds managed by UK alternative investment fund managers) and "non-financial counterparties" (for example, UK-established corporate entities) under UK EMIR are directly subject to the UK PR DR Requirements. The UK EMIR Protocol, therefore, provides a means of assisting such entities in complying with their obligations.

Entities not directly subject to UK EMIR (for example, Irish alternative investment funds with EU alternative investment fund managers) but which trade OTC derivatives with a counterparty directly in scope of UK EMIR (for example, a swap dealer based in the UK), can expect to be required to include provisions in their agreements to allow the UK-based counterparty to meet its own UK EMIR regulatory obligations. This may be achieved by adhering to the UK EMIR Protocol or including equivalent bilateral terms in their Relevant Agreements.

Is adherence to, or contractual incorporation of the terms of, the EU EMIR Protocol – or any other protocol – sufficient to meet UK EMIR obligations?

In short, no – because the UK PR DR Requirements are not covered in full under the EU EMIR Protocol, or any other protocol.

Whilst the EU EMIR Protocol and the UK EMIR Protocol are substantially similar, the EU EMIR Protocol is concerned solely with EU EMIR and so will not address UK EMIR issues. It is possible to adhere to both the EU EMIR Protocol and the UK EMIR Protocol and, to the extent that the EU EMIR Protocol also applies to one or both counterparties, both the UK EMIR Protocol and the EU EMIR Protocol will apply to each Relevant Agreement.

The ISDA 2013 Reporting Protocol contains a confidentiality waiver intended to apply to disclosures vis-à-vis all global reporting regimes, whereas the equivalent waiver provision in the UK EMIR Protocol is limited to the UK EMIR regime.

Is adherence to the UK EMIR Protocol mandatory?

Adherence to the UK EMIR Protocol is not mandatory. However, parties subject to UK EMIR will need to agree a way of complying with their obligations under UK EMIR, which will mean a choice between:

- adhering to the UK EMIR Protocol (remembering to incorporate the terms of the UK EMIR Protocol in new Relevant Agreements);
- contractually incorporating the terms of the UK EMIR Protocol into each Relevant Agreement without adhering to the UK EMIR Protocol; or
- contractually agreeing (whether by separate bilateral agreement or in each Relevant Agreement) other terms which satisfy the UK PR DR Requirements.

Can an investment manager adhere as agent to the UK EMIR Protocol?

If an investment manager has itself entered into the Relevant Agreements on behalf of its underlying funds/accounts (for example, 'umbrella' agreements), it may adhere to the UK EMIR Protocol on behalf of: (i) all of its underlying funds/accounts; (ii) those underlying funds/accounts specifically named or identified by it; or (iii) all of its underlying funds/accounts other than those specifically agreed to be excluded vis-à-vis another adhering party.

Alternatively, the counterparty itself adheres by way of a 'single entity' adherence, which is generally the simplest way of adhering.

Are there disadvantages to adhering?

Unless a party wishes to negotiate bespoke procedures for UK EMIR portfolio reconciliation and dispute resolution with each of its counterparties, adherence should not raise concerns.

Alternative to adherence

A similar outcome to adherence can be achieved by amending each Relevant Agreement (individually) to include a provision incorporating the terms of the UK EMIR Protocol or other equivalent terms. This may result in a time intensive (and inefficient) exercise, engaging with each counterparty and agreeing each amendment.

Generally, the larger the number of counterparties, the more adherence to the UK EMIR Protocol will smooth the way forward.

Does the UK EMIR Protocol cover all UK PR DR Requirements?

Firstly, the UK EMIR Protocol only acts to *amend* the terms of Relevant Agreements to reflect the UK PR DR Requirements. Parties must ensure from an operational and legal perspective that such requirements are *in fact* met and fulfilled – for example, agreeing the scope of 'key terms' to be reconciled and further granularity with respect to dispute resolution procedures. Additionally, the UK PR DR Requirements also require a "financial counterparty" to report to the UK Financial Conduct Authority any disputes between counterparties relating to an OTC derivative contract, its valuation or the exchange of collateral, for an amount higher than €15 million where the dispute is outstanding for at least 15 business days. Financial counterparties will need to ensure that this threshold is monitored, and that they are able to report, as necessary.

As noted above, only Relevant Agreements already in effect at the time both parties have adhered are *automatically* covered by the terms of the UK EMIR Protocol. New Relevant Agreements should include a provision to contractually incorporate the terms of the UK EMIR Protocol by reference.

UK PRA Rule Module

Jurisdictional Modular Protocol Architecture

Statutory resolution regimes applicable in certain jurisdictions require major financial institutions and/or certain of their subsidiaries to amend certain of their agreements to ensure that stays (i.e., suspensions) or restrictions on, or overrides of, certain termination rights under those resolution regimes ("Stay Regulations") are recognised by the contracting parties as contractually-binding where the governing law of the agreements is a 'third country' law (i.e., not the governing law of the jurisdiction in which the statutory resolution regime is applicable).

The concern is that whilst the application of the Stay Regulations would be effective as a matter of national law, they may not be recognised as contractually-binding where the agreement is governed by the law of a third country. The ISDA Resolution Stay Jurisdictional Modular Protocol (the "Jurisdictional Modular Protocol") was published by ISDA in May 2016 to facilitate compliance with Stay Regulations by providing a

mechanism to incorporate the requirements of Stay Regulations in agreements, thus ensuring effective cross-border enforceability[9].

Whilst the Jurisdictional Modular Protocol itself contains the 'boilerplate' provisions, ISDA have separately published a number of jurisdictional modules which contain the operative amending provisions relating to a specific jurisdiction's Stay Regulations, as well as the scope of relevant agreements to be amended. This 'modular' structure enables market participants to incorporate only those Stay Regulations relevant to their trading relationships. One such jurisdictional module is the ISDA 2020 UK (PRA Rule) Jurisdictional Module (the "UK PRA Rule Module").

How does one adhere to the UK PRA Rule Module?

A party adheres to the UK PRA Rule Module as either a 'Regulated Entity' (being an entity subject to the PRA Stay Rules (as defined above)) or a 'Module Adhering Party' (being an entity not subject to the PRA Stay Rules). A Module Adhering Party then chooses which Regulated Entity or Regulated Entities to amend its in-scope agreements with. This may mean (i) all Regulated Entities, (ii) only those Regulated Entities which are part of a banking group designated by the Financial Stability Board as a 'global systemically important bank' or (iii) one or more identified Regulated Entities (the Regulated Entities so elected being designated as "Regulated Entity Counterparties" under the UK PRA Rule Module).

Which categories of agreements are covered by the UK PRA Rule Module?

The UK PRA Rule Module will amend all 'third country law financial arrangements'[10] (i) between each Regulated Entity Counterparty and a Module Adhering Party, (ii) provided by a Regulated Entity Counterparty for the benefit of the Module Adhering Party and (iii) provided by the Module Adhering Party for the benefit of a Regulated Entity Counterparty ("UK PRA Covered Agreements"), which are entered into between two adhering parties on or prior to the date on which both parties have adhered to the UK PRA Rule Module.

The terms of the UK PRA Rule Module will not apply *automatically* to new agreements, i.e., those executed *after* both parties have adhered. In order to have the terms of the UK PRA Rule Module apply to the new agreement, a provision must be included in the agreement to contractually incorporate the terms of the UK PRA Rule Module by reference.

What is the purpose of the UK PRA Rule Module?

Entities subject to the PRA Stay Rules must ensure that all financial arrangements they enter into which are not governed by UK law contain provisions to contractually recognise the application of stays on, or overrides of, termination rights under the Special Resolution Regime set out in the UK Banking Act 2009.

The UK PRA Rule Module provides a mechanism to ensure that PRA Stay Rules are recognised by the contracting parties as contractually-binding in the context of non-UK law governed arrangements.

The UK PRA Rule Module is an update of an earlier 2016 version published by ISDA, the update being necessary to reflect a number of Brexit-related updates to the PRA Stay Rules.

Who is the UK PRA Rule Module relevant to?

Following Brexit, EU law is now treated by the UK as a 'third-country' law, in which case entities subject to the PRA Stay Rules must ensure that the PRA Stay Rules are contractually-binding.

Although a typical buy-side market participant will not be directly subject to the PRA Stay Rules, the UK PRA Rule Module will be relevant where (i) its counterparty is a Regulated Entity Counterparty, (ii) the relevant contract is a UK PRA Covered Agreement and (iii) obligations have been created or materially amended following Brexit (for example, entering into a new transaction would constitute a material amendment for this purpose). In these circumstances, provisions will need to be included in UK PRA Covered Agreements to allow the Regulated Entity Counterparty to meet its own regulatory obligations vis-à-vis the PRA Stay Rules, either by adhering to the UK PRA Rule Module or by agreeing equivalent bilateral terms.

Is adherence to the UK PRA Rule Module mandatory?

Whilst there is no mandatory requirement to adhere, practically-speaking adherence (or other contractual incorporation of equivalent terms) will be a requirement of a Regulated Entity Counterparty to be able to continue the trading relationship.

Parties who have previously adhered to the 2016 version published by ISDA will need to separately adhere to the UK PRA Rule Module, which will then replace the 2016 version.

Can an investment manager adhere as agent to the UK PRA Rule Module?

If an investment manager has 'entered into, received or provided' the relevant UK PRA Covered Agreement on behalf of its underlying funds/accounts, it may adhere to the UK PRA Rule Module on behalf of: (i) all of its underlying funds/accounts; (ii) those underlying funds/accounts specifically named or identified by it; or (iii) all of its underlying funds/accounts other than those specifically agreed to be excluded vis-à-vis an adhering Regulated Entity Counterparty.

Alternatively, the counterparty itself adheres by way of a 'single entity' adherence, which is generally the simplest way of adhering.

Are there disadvantages to adhering?

A point to note: the amendments made to UK PRA Covered Agreements by the UK PRA Rule Module will apply on a retrospective basis even where the PRA Stay Rules do not require such application (this is a function of how the Jurisdictional Modular Protocol is drafted and will be the case for all jurisdiction modules). However, we have not observed market participants seeking to bilaterally agree to limit the scope of the UK PRA Rule Module.

Alternative to adherence

A similar outcome to adherence can be achieved by amending each UK PRA Covered Agreement (individually) to include a provision incorporating the terms of the UK PRA Rule Module or other equivalent terms. This may result in a time intensive (and inefficient) exercise, engaging with each counterparty and agreeing each amendment.

A note post Brexit

Article 71(a)(1) of the EU Bank Recovery and Resolution Directive, as amended (the "BRRD") requires that certain financial institutions entering into in-scope financial contracts governed by the law of a non-EEA member state must ensure that the parties to the contract recognise that (i) the contract may be subject to the exercise of powers by the resolution authority to suspend or restrict rights and obligations under the BRRD (as transposed into national law), which includes powers to be exercised pre-resolution and (ii) they are bound by certain requirements of the BRRD (as transposed into national law)[11].

Following Brexit, English law is a non-EEA law and so we expect that in-scope entities (for example, a French bank) will in due course be seeking to include such contractual recognition provisions in their in-scope English law governed ISDA Master Agreements (and other in-scope financial agreements governed by a 'third-country law') where necessary.

The PRA Stay Rules remain narrower than the BRRD's contractual recognition of stay provision as the former do not apply to pre-resolution moratorium powers.

AB Trading Advisors' View and Comment

ISDA has been tireless in its work to provide market-wide standardised solutions to Brexit-related issues in derivatives documentation. Some other documentation that market participants should be aware of:

- a bank of template clauses published by ISDA to reflect updates to relevant legislative references following a no-deal Brexit[12]; and
- an updated Master Regulatory Disclosure Letter[13], a template letter to allow market participants to exchange information regarding their counterparty status under relevant regulatory regimes, now including a UK EMIR appendix. (In fact, we see this letter being used only rarely, parties preferring to communicate and exchange information relating to their regulatory status by other means.)

[1] Pursuant to the European Union (Withdrawal) Act 2018 (as amended by the European Union (Withdrawal Agreement) Act 2020) (the "Withdrawal Act").

[2] With respect to derivatives, this resulted in a number of unresolved issues which we covered in our December 2020 edition of *Briefs for the Buy side* (available at: https://www.abderivs.com/client-news/brexit-unresolved-issues-in-derivatives-regulation).

[3] The full suite of amending instruments making changes to onshore EMIR at the end of the Transition Period End Date by operation of the Withdrawal Act can be found at: https://www.fca.org.uk/markets/uk-emir/library

[4] Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (available at: https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ%3AL%3A2012%3A201%3A0001%3A0059%3AEN%3APDF), as amended from time to time including by EMIR REFIT (available at: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019R0834&from=EN).

[5] Available at: https://www.isda.org/protocol/isda-2020-uk-emir-portfolio-reconciliation-dispute-resolution-and-disclosure-protocol/; together with associated FAQs.

[6] Both the UK PRA Rule Module and the Jurisdictional Modular Protocol are available at: https://www.isda.org/protocol/isda-2020-uk-pra-rule-jurisdictional-module-to-the-isda-resolution-stay-jurisdictional-modular-protocol/; together with associated FAQs.

[7] Available at: https://www.prarulebook.co.uk/rulebook/Content/Part/318771/11-02-2021

[8] There is a nuance, in that 'long-form' Confirmations entered into after the Effective Date still constitute a Relevant Agreement.

[9] Further analysis and commentary on the Jurisdictional Modular Protocol can be found in our August 2016 edition of *Briefs of the Buy side* (available at: https://www.abderivs.com/client-news/isda-resolution-stay-jurisdictional-modular-protocol).

[10] Broadly, financial arrangements governed by a law other than UK law which contain a termination right or security interest, the exercise or enforcement of which could be suspended or prevented or the application of which would be disregarded under the UK Special Resolution Regime if the financial arrangement were governed by UK law.

[11] The exact requirements of such contractual recognition terms are included in the current final draft '*regulatory technical standards on the contractual recognition of stay powers under Article 71(a)(5) of the BRRD*' (available at: https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Draft%20Technical%20Standards/2020/RTS/961455/Draft%20RTS%20on%20stay%20powers%20%28art71a_BRRD%29.pdf).

[12] Available at: https://www.isda.org/book/amendments-to-isda-documentation-no-deal-brexit/

[13] Available at: https://www.isda.org/book/isda-master-regulatory-disclosure-letter-and-accompanying-guidance-note/