

The CFTC and Prudential Regulators Grant Relief in Preparation for Brexit

April 12, 2019

On March 15, 2019, the Prudential Regulators¹ adopted interim final rules (“**Bank Final Rules**”)² permitting the transfer of qualifying uncleared swaps and security-based swaps out of the United Kingdom (“**UK**”) to the European Union (“**EU**”) or the United States in the event of a non-negotiated withdrawal of the UK from the EU (“**No-Deal Brexit**”) without triggering Prudential Regulator uncleared swap and security-based swap margin requirements.³

On March 25, 2019, the Commodity Futures Trading Commission (the “**CFTC**”) adopted parallel interim final rules (“**CFTC Final Rules**”, and together with Bank Final Rules, the “**Final Rules**”),⁴ similarly permitting transfers of qualifying uncleared swaps in the event of a No-Deal Brexit without triggering CFTC uncleared swap margin requirements.⁵

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¹ The Prudential Regulators are the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Federal Housing Finance Agency and the Farm Credit Administration.

² Margin and Capital Requirements for Covered Swap Entities, 84 FR 9940 (Mar. 19, 2019), <https://www.govinfo.gov/content/pkg/FR-2019-03-19/pdf/2019-05012.pdf>.

³ Margin and Capital Requirements for Covered Swap Entities, 80 FR 74840 (Nov. 30, 2015), <https://www.govinfo.gov/content/pkg/FR-2015-11-30/pdf/2015-28671.pdf>.

⁴ Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 84 FR 12065 (Apr. 1, 2019), <https://www.govinfo.gov/content/pkg/FR-2019-04-01/pdf/2019-06103.pdf>.

⁵ Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap participants, 81 FR 636 (Jan. 6, 2016), <https://www.govinfo.gov/content/pkg/FR-2016-01-06/pdf/2015-32320.pdf>.



On April 5, 2019, the Division of Swap Dealer and Intermediary Oversight (“**DSIO**”), Division of Market Oversight (“**DMO**”), and Division of Clearing and Risk (“**DCR**”) of the CFTC issued two joint staff letters, CFTC Letter 19-08⁶ (“**No-Action Letter 19-08**”) and CFTC Letter 19-09⁷ (“**No-Action Letter 19-09**,” and together with No-Action Letter 19-08, the “**No-Action Letters**”), to extend currently applicable no-action relief and comparability determinations to UK entities that would otherwise cease to apply following the withdrawal of the UK from the EU.

The effective date of the Bank Final Rules is March 19, 2019, and comments on the rules must be received on or before April 18, 2019. The effective date of the CFTC Final Rules is April 1, 2019, and comments on the rules must be received on or before May 31, 2019. The effective date of the No-Action Letters is the date of the UK’s withdrawal from the EU, which is currently scheduled for October 31, 2019 as of the publication date of this Memorandum. The following Memorandum provides a brief overview of the Final Rules and the No-Action Letters.

⁶ CFTC Letter 19-08 (Apr. 5, 2019), https://www.cftc.gov/system/files/csl/pdfs/19/19-08.pdf?utm_source=govdelivery.

⁷ CFTC Letter 19-09 (Apr. 5, 2019), https://www.cftc.gov/system/files/csl/pdfs/19/19-09.pdf?utm_source=govdelivery.

Brexit

Background. The UK provided formal notice of its intention to withdraw from the EU on March 29, 2017. The deadline for concluding a withdrawal agreement with the EU having been extended twice, the UK's withdrawal is currently scheduled to occur by October 31, 2019. Following the UK's withdrawal, financial entities based in the UK would no longer be able to provide financial services involving swaps using the EU passporting system. In the event of a No-Deal Brexit, this would occur immediately; however, in the event of the ratification of the current draft withdrawal agreement by the UK and EU (a "**Soft Brexit**"), the passporting regime would continue for a transitional period ending December 31, 2020.

UK Preparations for Brexit. To prepare for the possibility of a No Deal Brexit, the UK government has taken actions to provide regulatory certainty. The European Union (Withdrawal) Act 2018 ("**EU(W)A**") will convert (onshore) relevant EU law and regulations as at the date of withdrawal into UK law and regulations and gives HM Treasury power to remedy "deficiencies" in the onshored legislation.⁸ Pursuant to its deficiency-fixing power, HM Treasury has, inter alia, transferred certain functions of EU institutions to itself, the Financial Conduct Authority and the Bank of England, including the Prudential Regulation Authority. In the event of a Soft Brexit, EU laws and regulations will continue to apply to the UK, as if it were a member of the EU, during the transitional period.

Margin Relief

Background. Pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Dodd-Frank Act**"), the CFTC and Prudential Regulators issued rules establishing margin for uncleared swaps and security-based swaps ("**Margin Rules**"), which

require posting and collection of initial and variation margin for certain uncleared swaps and security-based swaps entered into by swap dealers or major swap participants (or in the case of the Bank Final Rules, security-based swap dealers or major security-based swap participants) ("**Covered Swap Entities**").⁹ Under the Margin Rules, the compliance dates for variation margin requirements was September 1, 2016 for the entities with the largest swap exposures and March 1, 2017 for remaining counterparties subject to the Margin Rules. Initial margin requirements have an annual rolling compliance date based on an average daily aggregate notional amount of covered swaps, which began with the largest entities in September 2016 and will end with the smallest counterparties in September 2020.

The Margin Rules do not apply to uncleared swaps or security-based swaps entered into before the applicable compliance date ("**Legacy Swaps**"). However, a Legacy Swap that would otherwise be subject to the Margin Rules may lose its legacy status and become subject to margin requirements as if it were a new transaction if (1) it is amended in a material or nonmaterial way, (2) it is novated, or (3) it is a new swap that results from the portfolio compression of Legacy Swaps.

Consequences of Brexit. To address the possibility of a No-Deal Brexit, financial entities operating in the UK, and their counterparties, may choose to transfer their swaps to affiliates located in other jurisdictions. The transfers of Legacy Swaps through novation or other means would result in such Legacy Swaps becoming subject to the Margin Rules.

Final Rules. In an attempt to mitigate the impact of the Margin Rules to Legacy Swaps, the CFTC and Prudential Regulators have adopted the Final Rules, which would permit a Legacy Swap to be transferred

⁸ European Union (Withdrawal) Act, 2018, c.16, http://www.legislation.gov.uk/ukpga/2018/16/pdfs/ukpga_20180016_en.pdf.

⁹ The CFTC's margin requirements apply to uncleared swaps entered into by registered swap dealers and major swap participants that do not have a Prudential Regulator,

whereas the Prudential Regulators' margin requirements apply to uncleared swaps and security-based swaps entered into by registered swap dealers, major swap participants, security-based swap dealers and major security-based swap participants that have a Prudential Regulator.

following a No-Deal Brexit (but not a Soft Brexit) while maintaining its legacy status if:

- The Legacy Swap is transferred in response to a No-Deal Brexit to an affiliate or branch of the transferor;¹⁰
- For a Legacy Swap subject to the Bank Final Rules, the Legacy Swap is transferred from the UK to an affiliate or branch located within the EU or United States;
- Where the transferee is a counterparty to a Covered Swap Entity, the counterparty represents that applicable conditions stated in the first two bullets above are satisfied;
- The transfer does not result in modification of the payment amount, calculation method, maturity date, or notional amount of the Legacy Swap; and
- The transfer occurs following a No-Deal Brexit and by the later of:
 - (1) one year following the No-Deal Brexit; or
 - (2) the compliance date established under a November 2018 proposal by the European Supervisory Authorities (“ESA”) that would amend margin requirements under the European Market Infrastructure Regulation (“EMIR”).¹¹

Other Requirements Applicable to Legacy Swaps. In addition to uncleared swap margin requirements, there are a number of additional requirements under the Dodd-Frank Act that could apply to an amendment or novation of certain Legacy Swaps. In particular,

CFTC requirements related to mandatory clearing, mandatory trading, reporting and business conduct requirements might be triggered by such an amendment or novation. Although the CFTC Final Rules do not directly address these requirements, the cost-benefit discussion in the preamble to the CFTC Final Rules indicates that the CFTC expects transfers of Legacy Swaps pursuant to the CFTC Final Rule to be subject to real-time reporting requirements, which suggests that other transaction-level requirements may also apply to such transactions.¹² Application of additional CFTC requirements to transfers of Legacy Swaps under the Final Rules may significantly decrease the ability of Covered Entities to transfer Legacy Swaps under the Final Rules.

CFTC No-Action Letters

Background. The CFTC has taken a series of actions, in the form of comparability determinations, exemptive orders, and no-action relief, which enable persons located in the EU to comply with, or be exempt from, applicable CFTC requirements pursuant to the Dodd-Frank Act. Following either a No-Deal Brexit or a Soft Brexit, persons located in the UK will no longer be considered to be located in the EU, resulting in a loss of eligibility under these CFTC actions. In February 2019, the CFTC, together with UK regulatory authorities, announced continued information-sharing and cooperation agreements in an effort to ensure the extension of existing regulatory relief granted by the CFTC to EU firms, and

¹⁰ Both the CFTC and Prudential Regulators requested comment on whether transfers to non-affiliated entities should be permitted under the rules. See 84 FR at 12069; 84 FR at 9945.

¹¹ EMIR RTS on the novation of bilateral contracts not subject to bilateral margins, ESAs 2018 25 (Nov. 27, 2018), <https://eiopa.europa.eu/Publications/Reports/ESAs%202018%2025%20-%20Final%20Report%20-%20Bilateral%20margin%20-%28novation%29.pdf>. The

Final Rules are modeled after this proposal, which as of the date of this Memorandum has not been finalized.

¹² See 84 FR at 12071 (“To the extent that a transfer of a legacy swap . . . triggers a real-time public reporting obligation of pricing information under part 43 of the Commission’s rules, such rules require that transfers of swaps carry a notation so that the public will be aware that the swap is not a new swap and can consider the reported pricing information of such swap accordingly.”).

equivalence for U.S. firms providing services in the UK (“**Joint Statement**”).¹³

The No-Action Letters are intended to achieve the goals of the Joint Statement and provide regulatory certainty by extending currently applicable comparability determinations, orders and no-action relief to UK entities that would otherwise cease to be eligible following the withdrawal of the UK from the EU under either a No-Deal Brexit or a Soft Brexit.¹⁴

No-Action Letter 19-08: DSIO Comparability Determination Relief. Under the CFTC’s framework for the cross-border application of swaps regulations, a swap dealer or major swap participant located outside the United States may be eligible for substituted compliance with parallel requirements of a foreign jurisdiction that have been deemed comparable by the CFTC pursuant to a substituted compliance determination. To date, the CFTC has issued several substituted compliance determinations, including the following three determinations (“**EU Comparability Determinations**”) permitting substituted compliance with EU regulations:

- Comparability Determination for the European Union: Certain Entity-Level Requirements;¹⁵
- Comparability Determination for the European Union: Certain Transaction-Level Requirements;¹⁶ and
- Comparability Determination for the European Union: Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants.¹⁷

¹³ Joint Statement by UK and US Authorities on Continuity of Derivatives Trading and Clearing Post-Brexit (Feb. 25, 2019),

https://www.cftc.gov/PressRoom/PressReleases/7876-19?utm_source=govdelivery.

¹⁴ Together with the generally applicable No-Action Letters, the DSIO issued a specific no-action letter providing registration relief to a global financial institution making operational realignments in response to forthcoming regulatory changes in the UK as a result of Brexit. See CFTC Letter 19-10 (Apr. 2, 2019), <https://www.cftc.gov/system/files/csl/pdfs/19/19-10.pdf>.

No-Action Letter 19-08 permits a swap dealer or major swap participant located in the UK to continue to rely on the EU Comparability Determinations as if they were EU entities following either a No-Deal Brexit or a Soft Brexit.

In the event of a No Deal Brexit, this relief will expire upon the earlier of (i) the effective date of any comparability determination issued by the CFTC for the UK to the extent such determination encompasses the subject matter of the EU Comparability Determinations; or (ii) the date that is six months from the date of the UK’s withdrawal from the EU.

In the event of a Soft Brexit, this relief will expire upon the earlier of (i) the effective date of any amendments to the EU Comparability Determinations in order to clarify application of the determinations to entities located in the UK, or (ii) the expiration of the transition period during which the EU laws and regulations relevant to the EU Comparability Determinations continue to apply in the UK as if it were a member of the EU.

No-Action Letter 19-08: DMO Exemptive Order Relief. CEA section 5h(g) provides that the CFTC may grant an exemption from swap execution facility (“**SEF**”) registration if it determines that a foreign trading facility is subject to comparable supervision and regulation by the appropriate governmental authorities in the facility’s home country. In December 2017, the CFTC issued an order exempting certain multilateral trading facilities (“**MTFs**”) and organised trading facilities (“**OTFs**”) authorized within the EU from the requirement to register as an

¹⁵ Comparability Determination for the European Union: Certain Entity-Level Requirements (Dec. 27, 2013), <https://www.cftc.gov/sites/default/files/idc/groups/public/@1rfederalregister/documents/file/2013-30980a.pdf>.

¹⁶ Comparability Determination for the European Union: Certain Transaction-Level Requirements (Dec. 27, 2013), <https://www.cftc.gov/sites/default/files/idc/groups/public/@1rfederalregister/documents/file/2013-30981a.pdf>.

¹⁷ Comparability Determination for the European Union: Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants (Oct. 18, 2017), <https://www.cftc.gov/sites/default/files/idc/groups/public/@1rfederalregister/documents/file/2017-22616a.pdf>.

SEF, which was amended to add additional trading facilities in 2018 (the “**Exemptive Order**”).¹⁸

No-Action Letter 19-08 permits an MTF or OTF organized in the UK to rely on the Exemptive Order as if the trading facility were organized in the EU.

In the event of a No-Deal Brexit, this relief will expire upon the earlier of (i) the effective date of any exemptive order issued by the CFTC pursuant to CEA section 5h(g), for MTFs and OTFs authorized within the UK; or (ii) the date that is six months from the No-Deal Brexit.

In the event of a Soft Brexit, this relief will expire upon the earlier of the effective date of (i) any amendment to the Exemptive Order to clarify application of the order to entities located in the UK, or (ii) the expiration of the transition period during which the EU laws and regulations relevant to the Exemptive Order continue to apply in the UK as if it were a member of the EU.

No-Action Letter 19-09: Extension of Additional No-Action Relief. DSIO, DMO, and DCR jointly issued No-Action Letter 19-09 to allow UK entities to continue to rely on the following no-action relief granted to entities located in the EU, following a No-Deal Brexit or Soft Brexit:

- Letter 12-70: Relief for Certain Swap Dealers, De Minimis Dealers, Agent Affiliates, and Associated Persons from Registration as an Introducing Broker under Section 4d or a Commodity Trading Advisor under Section 4m of the Commodity Exchange Act, and Interpretation that Certain Employees of De Minimis Dealers are not an Introducing Broker as defined in Section 1a(31) of the Commodity Exchange Act;

- Letter 13-45: No-Action Relief for Registered Swap Dealers and Major Swap Participants from Certain Requirements under Subpart I of Part 23 of Commission Regulations in Connection with Uncleared Swaps Subject to Risk Mitigation Techniques under EMIR;
- Letter 17-64: Extension of Time-Limited No-Action Relief from Certain Requirements of Part 45 and Part 46 of the CFTC’s Regulations, for Certain Swap Dealers and Major Swap Participants Established under the Laws of Australia, Canada, the European Union, Japan or Switzerland;
- Letter 17-66: No-Action Relief from Certain Provisions of the Outward-Facing Swaps Condition in the Inter-Affiliate Exemption from the Clearing Requirement;
- Letter 17-67: Extension of No-Action Relief from Commodity Exchange Act Section 2(h)(8) for Swaps Executed Between Certain Affiliated Entities that Are Not Exempt from Clearing Under CFTC Regulation 50.52.

No-Action Letter 19-09 provides that, upon the occurrence of a No-Deal Brexit or a Soft Brexit, DSIO, DMO, and DCR will consider the identified relief to apply to or reference the UK, UK financial regulatory bodies, and UK laws and regulations transposed pursuant to EU(W)A in the same manner that it applies to the EU, EU financial regulatory bodies, or corresponding EU laws and regulations, subject in each case to the respective expiration dates contained in the underlying relief.

Remaining Relief for CCPs: The relief provided under the No-Action Letters is consistent with the scope of relief specifically cited in the Joint Statement.

¹⁸ See In the Matter of the Exemption of Multilateral Trading Facilities and Organised Trading Facilities Authorized Within the European Union from the Requirement to Register with the Commodity Futures Trading Commission as Swap Execution Facilities (Dec. 8, 2017), [https://www.cftc.gov/sites/default/files/idc/groups/public/@requestsandactions/documents/ifdocs/mtf_otforder12-08-](https://www.cftc.gov/sites/default/files/idc/groups/public/@requestsandactions/documents/ifdocs/mtf_otforder12-08-17.pdf)

[17.pdf](https://www.cftc.gov/sites/default/files/idc/groups/public/@requestsandactions/documents/ifdocs/mtf_otforder12-08-17.pdf); In the Matter of the Exemption of Multilateral Trading Facilities and Organised Trading Facilities Authorized Within the European Union from the Requirement to Register with the Commodity Futures Trading Commission as Swap Execution Facilities: Amendment To Appendix A To Order Of Exemption (Dec. 3, 2018), https://www.cftc.gov/sites/default/files/2018-12/MTF_OTF_AmendmentOrderExemption120318.pdf.

However, the Joint Statement also notes that the CFTC is in the process of making equivalence and recognition decisions in relation to UK central counterparties (“CCPs”) registered as derivatives clearing organizations (“DCOs”) with the CFTC. The No-Action Letters do not address these equivalence or recognition decisions, and they do not extend relief in connection with the comparability determination for EU CCPs registered as DCOs¹⁹ or the related no-action relief letter under CFTC Letter 16-26 to UK CCPs.²⁰ It is unclear when or whether the CFTC will issue further relief addressing applicability of this relief following a No-Deal Brexit or Soft Brexit.

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¹⁹ Comparability Determination for the European Union: Dually-Registered Derivatives Clearing Organizations and Central Counterparties, 81 FR 15260 (Mar. 22, 2016), <https://www.cftc.gov/sites/default/files/idc/groups/public/@lfederalregister/documents/file/2016-06261a.pdf>.

²⁰ CFTC Letter 16-26 (Mar. 16, 2016), <https://www.cftc.gov/sites/default/files/idc/groups/public/@llettergeneral/documents/letter/16-26.pdf>.