BLOG

Post Brexit regulations in derivatives market

Darshan Rao

Brexit a major event witnessed in the global financial market since the United Kingdom decided to exit European Union. This article looks at the challenges and changes that the financial derivatives market will face with respect to Brexit and the amendment in regulation that Brexit will impose on EU and UK financial institutions and their clients.

UK's share in EU's financial spectrum

- UK, being the financial hub of the EU, accounts up to 80% of the EU's financial market activities.
- UK handles 77% of EUR-denominated derivatives according to data from the Bank of International Settlements.
- London and New York control 80% of the multi-trillion pound derivatives market, which is worth more than five times the global GDP
- US companies contribute a third of the £GBP230trn of derivatives contracts traded annually in the UK which is the highest contribution by a region.

Regulatory body for OTC derivatives in EU

European Markets Infrastructure Regulation (EMIR) was introduced following the 2008 financial crisis with the objective of eliminating the risks that stood evident in the over-the-counter (OTC) derivatives market. EMIR is a EU's regulation for OTC derivatives, central counterparties and trade repositories. With the introduction of EMIR, new requirements were brought in place to improve transparency and reduce the risks associated with the derivatives market. All EU countries, including the UK, should be reporting derivatives contracts traded as per the EMIR requirements. Post-Brexit, there is requirement for a regulatory body that must replace the duties of EMIR.

Impacts of Brexit

Brexit could potentially make along-lasting impact on the global financial sector, with London being one of the major leaders in the derivatives market. This will lead to UK based financial firms losing their pas-porting. Pass-porting allows EU countries conduct trading activities with EU as a single market.

- Upon the end of the transition period, there will be cliff-edge changes that may make an adverse impact on EU organisations and clients and their counterparties in the UK.
- Brexit will impact on trade repositories and central securities depositories. Since after Brexit UK will become a third country, which require regulations of both UK and the EU to be fulfilled.
- EU clearing members would cease to be clearing members if UK central counterparties (CCPs) are not recognised by the EU at the end of the transition, which would lead to operational challenges related to the migration of OTC derivatives contracts to alternative CCPs.
- EU and UK CCPs and clearing houses would need to follow the regulations of both EU and UK regulators in order to have transaction crossways when UK is treated as a third country. The increasing obligations to meet both regulatory requirements would increase the complexity in derivatives trading.

Possible outcomes in the absence of a regulatory framework for UK's financial institutions post Brexit.

- As noted earlier, New York being the major player in the derivatives market could become the emerging leader post Brexit and the businesses from the UK could be moved over to New York due to its dominance in the derivatives market. The fact that about a third of the derivatives contracts traded in the UK comes from US companies would also help New York emerge as the winner of this clash.
- UK being a highly liquid market, the EU will try to still maintain access to the market by providing some kind of a solution to its member countries. Towards this, it may allow EU traders follow the UK regulatory guidelines. However, for this to happen, UK regulations should be in line with the EU's securities law.
- In case a new trading regime provided to EU clients operating in UK, the trading systems would need quick implementation and continuous monitoring. A high level of expertise must be required to carry out such a transformation smoothly and effectively.

How Acuity can help?

Acuity Knowledge Partners is a leader in the financial outsourcing Industry with expertise on different asset classes including derivatives. Acuity's services include research and analytics, investment and regulatory compliance services. Our established compliance teams have the ability to implement and manage regulatory requirements in the trading systems.

Sources:

https://www.reuters.com/article/us-britain-eu-derivatives-idUSKBN2701KZ

https://www.isda.org/2020/07/31/the-impact-of-a-cliff-edge-brexit-on-otc-derivatives/

About Acuity Knowledge Partners

Acuity Knowledge Partners is a leading provider of high-value research, analytics and business intelligence to the financial services sector. The company supports over 400+ financial institutions and consulting companies through a team of over 4,000+ subject matter experts who work as an extension of the clients' teams based out of various global delivery centres.

We empower our clients to drive revenues higher. We innovate using our proprietary technology and automation solutions. We enable our clients to transform their operating model and cost base.

contact@acuitykp.com | ***acuitykp.com***