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Global Practice Guides

Derivatives

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2025

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INTRODUCTION

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Katten Muchin Rosenman LLP has a futures and derivatives team that leverages extensive knowledge of futures and derivatives products to help clients achieve their commercial goals. Serving a diverse clientele that includes dealers, end-users, proprietary traders, brokers, advisers, exchanges and clearing organisations, the team of more than 25 attorneys handles various commercial transactions across multiple asset classes. With a solid grasp of regulations, market practices and documentation, its attorneys focus on efficient deal closure and compliance while adeptly navigating regulatory and litigation challenges. The practice is bolstered by the firm's ability to successfully obtain regulatory relief that resolves issues before they escalate. Katten's strong US and UK teams are fully co-ordinated to efficiently and consistently serve the needs of clients who do business on both sides of the Atlantic. Clients often rely on Katten as a trusted adviser to design three-cornered analyses for their activities in the United Kingdom, the European Union and the United States.

Contributing Editor

Carl Kennedy is a partner and co-chair of the financial markets and regulation group at Katten. Clients value his diverse and well-informed perspective formed through his diverse background as a former regulator with the Commodity Futures Trading Commission and a former senior in-house counsel at a large investment bank, particularly in relation to the commodities and derivatives markets. Carl's extensive experience makes him a trusted adviser to large and small financial institutions, asset managers, clearinghouses, intermediaries, hedge funds and proprietary trading firms. Clients depend on his guidance regarding derivatives-related litigation and enforcement actions, investigations and complex regulatory issues relating to transactions.

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Daniel Davis is a partner and co-chair of the financial markets and regulation group at Katten. From derivatives products to cryptocurrencies, he helps clients navigate evolving regulatory requirements. Drawing on his experience as General Counsel at the Commodity Futures Trading Commission, Dan deeply understands financial services agencies and is trusted by clients to mitigate risks during investigations and enforcement actions. He also provides guidance on rules issued by financial agencies for entities such as futures commission merchants, swap dealers and derivatives clearing organisations. Regarding fraud-related allegations under the Commodity Exchange Act, Dan assists clients in developing compliance practices to meet regulatory standards.

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Introduction to Derivatives

Derivatives have become an integral part of the global financial landscape, with transaction volumes growing dramatically over the years. These powerful, capital-efficient financial instruments, whose value is derived from the value of underlying assets such as stocks, bonds, commodities, currencies, interest rates and market indexes, play a crucial role in risk management and speculative opportunities worldwide.

The derivatives industry has undergone significant changes, shaped by global events like the 2008 financial crisis, which prompted a wave of regulatory reforms aimed at enhancing market stability and transparency. Today, derivatives are traded on regulated exchanges and via the over-the-counter (OTC) markets in major financial centres around the world, including New York, London, Tokyo, Singapore and Hong Kong.

There are several main types of derivatives, each with its own unique characteristics and purposes.

- Futures: contracts obligating the buyer to purchase, or the seller to sell, an asset at a predetermined future date and price. These are traded on regulated futures exchanges.
- Commodity options: contracts giving the buyer the right, but not the obligation, to buy or sell an asset at a set price within a specific period. Options on futures are traded on regulated futures exchanges, while OTC options are bilaterally executed between two parties off-exchange.
- Forwards: customised contracts between two parties to buy, sell and deliver an asset at a specified future date for a price agreed upon today (which is often modified during the course of the contract).
- Swaps: agreements to exchange cash flows or other financial instruments between parties over a set period.
- Contracts for Difference (CFDs): these are derivatives that allow traders to speculate on price movements of assets, settling the difference in value between opening and closing prices in cash, without physical delivery of the underlying commodity. CFDs are deemed to be swaps in the United States but are considered a distinct type of derivatives product in some other jurisdictions.

While derivatives are powerful tools for risk management, allowing businesses to protect against price volatility, currency fluctuations and interest rate changes, they also carry significant risks, including market, credit and liquidity risks. Most jurisdictions place considerable restrictions on who can trade derivatives, how these instruments are traded, and whether certain post-execution activities (eg, mandatory clearing, imposition of margin, risk mitigation measures) must occur.

The regulatory environment for derivatives varies by country but has seen increased oversight and reform over the last decade. The primary regulatory bodies in some of the most active trading jurisdictions (by trading volumes) include:

- the U.S. Commodity Futures Trading Commission (CFTC);
- the European Securities and Markets Authority (ESMA);

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- the Financial Conduct Authority (FCA) of the United Kingdom;
- the Financial Services Agency of Japan (FSA); and
- the Monetary Authority of Singapore (MAS).

This guide aims to provide a clear understanding of derivatives, their types, global market impact and regulatory landscape, helping business professionals navigate the complexities of this rapidly evolving financial environment. This guide will also cover recent developments in the derivatives market, including but not limited to international co-operation, novel products, technological innovations and improved risk management of central counterparties (CCPs).

Markets and size

Derivatives markets play a vital role in the global economy, such as enabling commercial businesses to raise financing at competitive rates and effectively manage their exposures to various. This, in turn, allows these businesses to invest and grow, spurring economic growth. The size of the derivatives market is staggering, with the notional value of outstanding derivatives growing by 5% in 2024 to reach USD699 trillion. Interest rate derivates (IRDs) are the largest component of the global aggregate, and rose by 3% year-on-year to USD548 trillion (Report, Global OTC Derivatives Market, Bank for International Settlements, 2025, available at data.bis.org).

As noted above, derivatives are traded on both regulated exchanges and OTC markets. Exchange-traded derivatives are standardised contracts traded on regulated exchanges, offering price transparency and liquidity. Major derivatives exchanges include the Chicago Mercantile Exchange, Eurex and the Tokyo Financial Exchange. These exchanges operate under strict regulatory frameworks to ensure market integrity and protect investors, with rules covering contract specifications, trading procedures, margin requirements and reporting obligations. In some jurisdictions, certain derivatives – such as futures contracts, options on futures contracts and certain types of standardised swaps – are required to trade on a regulated exchange.

On the other hand, many bespoke derivatives are traded OTC, which means that these contracts are traded directly between parties or through brokers or electronic trading platforms. While the OTC markets offer flexibility, they come with higher counterparty risk compared to exchange-traded derivatives. Post-2008 financial crisis reforms, such as the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) in the United States and the European Market Infrastructure Regulation (EMIR) in Europe, have increased oversight of OTC markets, introducing requirements for trade reporting, central clearing, registration of certain large market participants and risk mitigation.

Clearing of derivatives ensures that trades are settled efficiently and securely through a central clearinghouse. A clearinghouse manages the risk between buyers and sellers by guaranteeing the terms of the contract, ensuring each party fulfils its respective obligations. Clearinghouses centralise and standardise transactions, reducing counterparty risk and enhancing market stability, thereby playing a crucial role in safeguarding the global financial system against systemic shocks. This process fosters market stability and trust, enabling businesses to manage their financial exposures effectively. With more and more derivatives becoming subject to mandatory clearing, systemic risk concerns have shifted from too-big-to-fail market participants to regulated clearinghouses.

Key participants in derivatives markets include:

- institutional investors;
- commodity trading advisers;
- fund managers and hedge funds (commodity pools);
- commercial hedgers;
- retail traders;
- banks;
- corporations;
- insurance companies;
- pension plans; and
- asset managers.

Each group has different motivations, ranging from hedging risk to seeking profit through speculation. While derivatives offer many benefits, they also involve various risks, including market risk, liquidity risk, operational risk and counterparty risk. Effective

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risk management strategies and regulatory compliance are essential for mitigating these risks.

Regulators monitor and assess the activities of key players in the derivatives market by requiring the registration of clearinghouses, trade repositories and large market participants. By mandating registration, regulators gain valuable insights into the operations, risk management practices and financial health of these entities. This transparency allows for more effective supervision, and helps to identify potential systemic risks before they escalate. Furthermore, registration often comes with specific compliance obligations, ensuring that these institutions adhere to established standards of conduct, reporting and risk management. As the derivatives market continues to evolve, the registration process also provides a framework for regulators to adapt their oversight to new and emerging market developments.

History of derivatives

Derivatives have a rich history dating back to ancient civilisations, where farmers and merchants used forward contracts to lock in prices for agricultural products. Aristotle recounts the renowned case of Thales's market corner in the 6th century BCE. Thales, so the story goes, was weary of the jeers of his contemporaries that his interest in philosophy and astronomy was useless, and the reason for his impoverished state. Having observed the correlations between climate and olive harvests in his native Miletus (on the west coast of present-day Türkiye), he predicted over the course of an unusually mild winter that there was going to be a large crop of olives, so he raised a small sum of money and bought or rented all the olive presses in the region. When the bumper harvest came and the demand for presses exploded, Thales's corner of the market for olive presses paid off – proving, as Aristotle concludes, "that it is easy for philosophers to be rich if they choose, but this is not what they care about".

The 19th century saw the creation of futures exchanges for agricultural commodities, with the Chicago Board of Trade (CBOT) in the United States, established in 1848, playing a pivotal role in the development of standardised futures contracts. With the introduction of financial futures in the 1970s, the derivatives market expanded beyond derivatives on agricultural commodities to encompass derivatives on financial products such as interest rates, currencies and stock indices.

Swaps emerged as a key derivative product in the 1980s, starting with currency swaps and followed by interest rate swaps. Companies and financial institutions entered into swaps to manage exposure to fluctuations in interest rates and exchange rates. The 1990s witnessed a rapid expansion in the use and variety of derivatives, including the introduction of credit default swaps (CDS) and the significant growth of OTC markets.

However, global financial crises have highlighted the risks associated with derivatives. The 1997 Asian Financial Crisis and the 2008 Global Financial Crisis underscored the systemic risks posed by derivatives, particularly in the mortgage-backed securities market and CDS, leading to catastrophic losses for major financial institutions and prompting calls for regulatory reform.

In response to the 2008 Global Financial Crisis, leaders of the G-20 met in Pittsburgh in 2009 and agreed on comprehensive reforms to increase transparency and reduce risks in the OTC derivatives markets. These agreements reached among world leaders resulted in the establishment of key principles for the regulation of OTC derivatives, including required clearing of standardised OTC derivatives through CCPs and reporting of OTC derivatives trades to trade repositories. Policymakers in various jurisdictions enacted significant regulatory reforms, including Dodd-Frank and EMIR, and regulatory bodies promulgated stringent rules to oversee derivatives activities, aiming to mitigate systemic risks, enhance market transparency and protect market participants.

Organisation of topics

The world of derivatives is complex, dynamic and critically important to global financial markets. This comprehensive guide aims to provide a thorough understanding of derivatives, from their fundamental concepts to the intricate regulatory landscape and current enforcement trends. By exploring the various types of derivatives, their regulation, documentation practices and recent enforcement activities, readers will gain valuable insights into this sophisticated financial domain.

This guide is organised into the following chapters.

- General: this section provides a foundational understanding of the derivatives markets, setting the stage for a more detailed explanation of specific derivative types, their regulation, documentation and enforcement trends.
- Types of derivatives: building on the general overview and historical context, this section delves into the specific types of derivatives, examining their unique characteristics, regulatory aspects and emerging trends.
- Regulation of derivatives: this section focuses on the roles of various regulatory bodies and specific regulatory requirements. It identifies national regulators and their jurisdictions, and outlines rules on clearing, mandatory trading, position limits and reporting. It also covers the regulation of derivatives at subnational and supranational levels. Lastly, it considers oversight by self-regulatory organisations and exchanges.
- Documentation issues: after establishing the regulatory framework, this section addresses the documentation practices critical for trading and clearing derivatives, highlighting industry standards and specific requirements. It covers industry standards for derivatives documentation and addresses specific requirements for trading agreements, margin documentation and legal opinions.
- Enforcement trends: this section examines recent enforcement activities and trends, providing insights into regulatory priorities and compliance expectations.

Recent developments

In recent years, the global derivatives market has undergone significant changes, driven by geopolitical trends and deregulation, demand for 24/7 trading, tokenisation and stablecoins, perpetual futures and event contracts. These advancements have aimed to create a more transparent, inclusive and accessible financial landscape, expanding the reach of derivatives markets.

Geopolitical trends/deregulation

Over the past year, fluctuating tariffs, trade negotiations amongst major nations, and ongoing and recent military conflicts around the world have impacted pricing and trading in derivatives markets. In addition, the collective worldwide, growing deregulatory agenda has shifted the regulatory priorities for derivatives, focusing instead on practical safeguards for investors and markets, and on defined requirements as opposed to regulation by enforcement or large comprehensive rule proposals. European regulators have sought feedback on opportunities to streamline financial regulatory reporting requirements. The expansion of an open-source data standard for financial products and trade reporting to Asia and Australia is optimising regulatory compliance and improving reporting efficiency.

This deregulatory trend induced delays in the implementation of Basel III and the U.S. Treasury clearing mandate, which will both fundamentally alter derivatives markets. This shift has led to new product launches, such as perpetual-style futures and event contracts, and growing sentiment of a business-friendly environment for market participants.

24/7 trading

Designated contract markets (DCMs) and swap execution facilities (SEFs) are evaluating the extension of trading and clearing operations to a 24/7 schedule, encompassing weekends and holidays. This potential departure from the traditional business hours model would align derivatives markets with the continuous access already offered by certain digital asset platforms. 24/7 trading functionality would allow derivatives exchanges to access global demand, which is currently channelled through alternative trading platforms.

However, implementing 24/7 trading presents challenges for exchanges and clearinghouses, as they must maintain liquidity across time zones, manage risk and margin in real time, and build operational systems that can withstand continuous use. In addition, thinly traded periods may increase susceptibility to price manipulation, and continuous use could strain infrastructure to address defaults and disruptions.

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Tokenisation and stablecoins

Blockchain and distributed ledger technologies have the potential to transform the infrastructure supporting derivatives markets, particularly with collateral management. Tokenisation is the process of creating digital representations of assets such as cash and securities on a blockchain, and offers a way to mitigate operational difficulties and settlement delays in post-trade processes. In cleared derivatives markets, where participants must post both initial and variation margin to CCPs, the ability to move tokenised assets in near real time has the potential to reduce settlement times from days to minutes. Tokenised assets, such as stablecoins, can be transferred and recorded on-chain, which would increase liquidity and ease the burden of intraday margin calls for participants. Moreover, reduced settlement times allow for near instant collateral movement – a crucial step towards 24/7 derivatives trading and risk management.

Perpetual futures

Amidst ongoing efforts to classify perpetual derivatives as either swaps or futures contracts, particularly in the US, regulators are exploring their potential uses, benefits and risks. In contrast to traditional futures, perpetual futures do not have an expiration date and use a funding rate mechanism to keep them aligned with the spot price of the underlying asset. Moreover, traditional futures are price benchmarked near the expiration of the contract, whereas perpetual futures are price monitored and settled on an ongoing basis. New crypto-based perpetual futures have flourished across the globe.

Resolving the classification issue in some jurisdictions will lead to clarity on the tax status, capital requirements, reporting, account structure and risk management of these products. As perpetual futures often allow for higher leverage, traders are exposed to higher gains and losses as price fluctuations will amplify these positions. Other issues with perpetual futures include divergence from the actual value of the underlying asset, the need to maintain funding rate payments, and the risk of market manipulation, such as traders holding large positions open in an attempt to influence prices.

Event contracts

Event contracts are financial instruments that allow market participants to take positions on the outcomes of specific events, often allowing traders to buy “yes” or “no” positions, functioning as a marketplace between traders. Popular examples include political event contracts such as which candidate will win in national presidential elections or sporting event contracts such as which country will win the World Cup. Their popularity has increased as investors look for new ways to hedge or speculate on news-driven outcomes and as digital platforms simplify access to markets. As a progression from interest rates, energy and weather contracts, political and sporting event contracts pose new questions surrounding what defines betting on elections or sports gaming or gambling. The continued proliferation of types and volume of event contracts will shape prediction and information markets and retail investor access to derivatives.

Conclusion

Derivatives have evolved significantly from their early origins and become integral to modern financial markets. Despite their benefits in risk management, the complexity and potential risks of derivatives require ongoing regulatory oversight and prudent use by market participants. The future of derivatives will likely continue to be shaped by technological innovations, regulatory developments and the changing needs of the global economy.

CHINA

Law and Practice

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Han Kun Law Offices is a full-service law firm in China and has been widely recognised as a leader in complex cross-border and domestic transactions. Its main practice areas include, among others, private equity, banking and finance, asset management, M&A, capital markets, investment funds, compliance, intellectual property and dispute resolution. It has nearly 800 professionals located in its Beijing, Shanghai, Shenzhen, Hong Kong, Haikou, Wuhan, Singapore, New York City and Silicon Valley offices. It has integrated the best Chinese and Western practices to develop a client-oriented, first-class firm. Its Asset Management & Financial Services team has extensive practice in futures and derivatives regimes. It advises major Chinese exchanges, including the Shanghai Futures Exchange, Dalian Commodity Exchange and International Energy Exchange, on various initiatives. It assists both PRC and international leading institutions with matters involving futures and OTC derivatives transactions, repo transactions, margin trading and securities lending, structured notes, and other complex and cutting-edge financial products.

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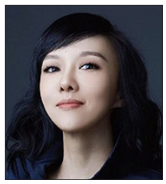

Yin Ge is a Shanghai-based partner in Han Kun's Investment Management & Finance Group and a globally renowned legal expert in this area. She sits on the management committee of Han Kun's Shanghai office and heads the firm's financial services practice. Yin is a board member of the Shanghai Asset Management Association. Before joining Han Kun, Yin led the financial services practice at Clifford Chance Shanghai. Yin graduated from Cornell University and is admitted to practice in the PRC and New York State. Yin's clients include leading global asset managers, trading firms, financial institutions, financial regulators, exchanges and trading platforms. Yin has also been deeply involved in advising on legislation for China's financial services sector.

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1. General

1.1 Overview of Derivatives Markets

General Regulatory Regime

China's derivatives market operates under a multi-sector regulatory regime, where both governmental authorities and self-regulatory organisations play roles in maintaining market order. Oversight is divided by factors such as participant type, product category, underlying asset and policy objectives.

Specifically, the main governmental authorities are the China Securities Regulatory Commission (CSRC), the People's Bank of China (PBoC), the National Financial Regulatory Administration (NFRA), the State Administration of Foreign Exchange (SAFE), the State-owned Assets Supervision and Administration Commission (SASAC) and the Ministry of Finance (MOF). Self-regulatory organisations include the National Association of Financial Market Institutional Investors (NAFMII), the Securities Association of China (SAC), the Asset Management Association of China (AMAC) and the China Futures Association (CFA). The specific allocation of duties and functions among these governmental authorities and self-regulatory organisations is discussed in detail in **3.1.1 National Regulators** and **3.3 Self-Regulatory Organisations, Independent Authorities, and Exchanges**. For purposes of this practice guide only, "China" and "the PRC" refer to Mainland China, which is exclusive of the Hong Kong Special Administrative Region, the Macao Special Administrative Region and Taiwan.

As will be further discussed in **3.3 Self-Regulatory Organisations, Independent Authorities, and Exchanges**, in China, the main onshore derivatives market infrastructure consists of exchanges (including six futures exchanges for most futures and two securities exchanges for exchange-traded fund (ETF) options, as discussed in detail in **2.1 Futures and Options**, and the Shanghai Gold Exchange (SGE) for certain over-the counter (OTC) products), OTC-centralised trading venues (ie, China Foreign Exchange Trade System (CFETS) and China Securities Internet System Co., Ltd. (CSIS)) and an OTC central counterparty (ie, Shanghai Clearing House (SHCH)). Where derivatives transactions involve any market infrastructure, such transactions are also subject to the relevant rules and regulations issued by that infrastructure, including those governing trading, settlement and clearing.

The PRC Futures and Derivatives Law (FDL) provides a foundational and comprehensive legal framework for the regulation of the futures and OTC derivatives markets in China. This is discussed in detail in **1.2 Historical Trends and Looking Forwards**. In China, establishing a futures exchange requires CSRC approval, and any standardised futures or options contracts must be registered with CSRC before listing and trading. As a result, on top of the FDL, futures and standardised options trading is primarily regulated by CSRC together with the relevant futures exchanges or two securities exchanges, while OTC derivatives are subject to regulation by multiple governmental authorities and self-regulatory organisations, depending on the specific product types, underlying assets and other elements.

Available Investment Channels for International Investors

Notably, due to restrictions on foreign equity participation in China's financial markets and foreign exchange control policies, international investors are subject to restrictions on participation in derivatives trading in China or with Chinese counterparties. Nevertheless, China is committed to promoting the high-level opening up of the financial market and, currently, international investors may access China's derivatives market through the following channels.

Foreign direct investment

International investors can establish foreign-invested enterprises in China and open institutional futures accounts to invest in onshore futures and options products by their renminbi (RMB) revenue. Since there is generally no licensing requirement for ordinary market participants to engage in OTC derivatives trading in China, international investors are also able to do so through their PRC foreign-invested enterprises, subject to certain investor suitability requirements.

Qualified Foreign Investor (QFI) regime

Under the QFI regime, eligible foreign institutional investors recognised by CSRC are allowed to trade specific derivatives products designated by the exchanges with the permission of CSRC. This will be discussed further in **2.1 Futures and Options**.

CIBM Direct

After pre-filing with PBoC, eligible foreign institutional investors and the products they issued may have direct access to the China Interbank Bond Market ("CIBM Direct"), while bond forwards, forward rate agreements and interest rate swaps are available to these international investors only for hedging their bond holding from CIBM Direct. International investors may open an account directly with onshore settlement agents or adopt a custodian model.

In addition, foreign institutional investors are permitted to trade onshore FX derivatives to manage FX risk exposure arising from their CIBM Direct investments. FX risk exposure consists of the principal, interest and market value fluctuations of bond investments, etc. Foreign institutional investors with actual CIBM Direct bond holdings can trade onshore FX forwards for hedging purposes.

Internationalised futures products

For specific futures contracts designated by CSRC ("Internationalised Futures Products"), international investors may trade through domestic or foreign brokerages as intermediaries, or trade directly on the exchanges, subject to certain criteria. To date, China has introduced 15 futures contracts and nine options contracts for trading by foreign investors, with general eligibility criteria set by the domestic futures exchanges.

Northbound Swap Connect

The eligibility for the Northbound Swap Connect is the same as that for CIBM Direct. Under the Swap Connect regime, international investors can leverage their familiar offshore trading platforms to trade interest rate swaps in the China interbank market without the need to open accounts or adopt complex custody arrangements onshore. This will be discussed further in **2.2 Swaps and Security-Based Swaps**.

1.2 Historical Trends and Looking Forwards

Introduction of the FDL

The FDL came into effect on 1 August 2022 and is an important milestone in the construction of the rule of law in China's capital markets. As the "basic law" for China's futures and derivatives markets, the FDL provides a legal basis for the high-quality development of the futures and derivatives markets.

The FDL applies to futures transactions, derivatives transactions and related activities conducted within China, and those conducted outside China that disrupt the domestic market order or damage the lawful interests of domestic traders. In terms of scope of application, the FDL focuses on regulating the futures market, while also considering the OTC derivatives market, and leaves room for future reform and innovation.

Notably, the FDL for the first time recognises in law the enforceability and effectiveness of a close-out netting regime and the single agreement concept, paving the way for China to become a clean close-out netting jurisdiction. The FDL effectively eliminates the concerns over bankruptcy administrator powers in derivatives transactions with respect to cherry-picking and clawback rights.

Meanwhile, it is worth noting that the FDL has extraterritorial effect on offshore entities under certain circumstances, in addition to purely offshore futures and derivatives transactions and related activities that disrupt the onshore markets. For example, offshore futures trading venues will generally need to register with CSRC and accept its supervision if they provide onshore entities or individuals with direct access to their trading system for trading services. Also, offshore futures, options or derivatives contracts listed in offshore futures trading venues that reference the prices of contracts listed onshore must comply with the relevant CSRC rules. In addition, marketing, promotion and solicitation activities in China conducted by offshore entities require CSRC approval and are subject to the relevant provisions of the FDL; onshore entities will also need to obtain CSRC's approval if they intend to engage in such activities for the benefit of offshore entities. This echoes the increasingly tightened regulatory position over marketing activities by offshore entities in China.

The Forthcoming Measures for Supervision and Administration of Derivatives Trading ("Draft Derivatives Trading Measures")

In 2023, CSRC conducted two rounds of consultation on the Draft Derivatives Trading Measures. The proposed rules will govern OTC derivatives transactions, with the exception of those conducted in the China interbank derivatives market or on platforms organised by banking and insurance financial institutions.

The Draft Derivatives Trading Measures propose the preliminary establishment of a trade repository framework in China and prohibit market participants from using OTC derivatives to circumvent regulatory requirements.

Notably, the Draft Derivatives Trading Measures are intended to apply extraterritorially, extending to derivatives transactions conducted overseas that relate to underlying assets within China and/or involve hedging transactions taking place within China. This proposal has generated considerable debate among market participants, and CSRC has yet to clarify both the scope of extraterritorial application and the possible methods of enforcement.

New Variation Margin and Initial Margin Rules

NFRA issued margin rules for non-centrally cleared derivatives transactions of financial institutions in December 2024 ("NFRA Margin Rules"). The NFRA Margin Rules are highly aligned with the framework published by the Basel Committee on Banking Supervision and the International Organization of Securities Commissions. This is discussed further in **4.1.2 Margins**.

Stringent Regulatory Requirements on Program Trading in the Futures Markets

In June 2025, CSRC issued the Administrative Provisions on Program Trading in the Futures Markets (for Trial Implementation) ("Futures Program Trading Provisions"), stipulating the reporting obligations for program traders. Meanwhile, participants in high-frequency trading (HFT) of futures via program trading are now subject to additional and stricter requirements under the Futures Program Trading Provisions, and the futures exchanges may adopt a differentiated transaction fee structure for HFT. In addition, with respect to technology system access and server co-location, CSRC in principle requires program traders to comply with the rules set by the exchanges. The exchanges are expected to impose more stringent requirements in these areas.

Prospect of Using RMB-Denominated Chinese Government Bonds as Margin

Permitting the use of RMB-denominated bonds as collateral in derivatives transactions can significantly enhance the utility and flexibility of RMB assets held by international investors. The widespread use of onshore RMB-denominated Chinese government bonds in international derivatives trading still faces obstacles, primarily due to foreign exchange controls and an underdeveloped cross-border custody system. However, significant progress has been made with offshore RMB bonds. In January and March 2025, Hong Kong Exchanges and Clearing Limited (HKEX) announced that it would accept Chinese government bonds and policy bank bonds held by international investors through Bond Connect as margin collateral for Swap Connect and all derivatives transactions cleared by OTC Clearing Hong Kong Limited ("OTC Clear"). This marks a major step forward in the use of RMB bonds as collateral.

2. Types of Derivatives

2.1 Futures and Options

Overview of Futures and Options in China

In China, exchange-traded futures and options primarily consist of commodity futures and options (covering energy, agricultural products and metals), financial futures and options, as well as one containerised-freight-index-linked future.

Commodity futures and options are listed and traded on five commodity futures exchanges, namely the Shanghai Futures Exchange (SHFE), the Shanghai International Energy Exchange (INE), the Dalian Commodity Exchange (DCE), the Zhengzhou Commodity Exchange (ZCE) and the Guangzhou Futures Exchange (GFE).

Financial futures are listed and traded on the China Financial Futures Exchange (CFFEX), which is the only financial futures exchange in China. Products traded on CFFEX include China government bond futures, stock index futures and options. In addition, two securities exchanges, the Shenzhen Stock Exchange (SZSE) and the Shanghai Stock Exchange (SSE) list ETF options, such as the CSI 50 ETF option and CSI 300 ETF option.

At present, more than 145 futures and options products have been listed in China's futures markets, among them, more than 125 referencing commodities, over 20 referencing financial instruments and one containerised-freight-index-linked future. Commodity-related futures and options account for the majority of exchange-traded futures and options in China, representing approximately 70% of the total notional trading volume, according to data from CFA.

Innovative Futures and Options Products

On 18 August 2023, the SCFIS (Europe) futures contract was officially listed for trading on the INE. The underlying index is the Shanghai (export) Containerized Freight Index based on Settled Rates (SCFIS) (Europe service), which is compiled and published by the Shanghai Shipping Exchange. This is the world's first shipping futures contract developed based on a Chinese containerised freight index. Given that China's port cargo and container throughput remains the world's highest, the launch of the SCFIS (Europe) futures meets the hedging and risk management needs of shipping companies and foreign trade enterprises.

In addition, GFE is positioned to list products related to green development and new energy industries. It has already listed three futures and options products linked to major new energy-related products – silicon metal, lithium carbonate and polysilicon. Meanwhile, CSRC is guiding GFE to develop other green products including futures referencing carbon emissions, climate-related factors and electricity.

Separately, in China, pursuant to the Notice on Further Preventing and Dealing with Speculation Risks in Virtual Currency Trading issued by PBoC, the Office of the Central Cyberspace Affairs Commission, the Supreme People's Court, the Supreme People's Procuratorate, the Ministry of Industry and Information Technology, the Ministry of Public Security, the State Administration for Market Regulation, the China Banking and Insurance Regulatory Commission (replaced by NAFR in May 2023), CSRC and SAFE on 15 September 2021, business activities related to virtual currencies, including derivatives trading, are considered illegal financial activities and are strictly prohibited. As such, there are currently no listed futures contracts linked to virtual currencies in China.

Foreign Institutional Investors

As mentioned in **1.1 Overview of Derivatives Markets**, foreign institutional investors may participate in the trading of CSRC-approved futures and options contracts by obtaining a QFI licence, or directly trade designated futures contracts and options without a licence.

Notably, the scope of futures and options available to QFIs has expanded this year. On 20 June 2025, 16 additional commodity derivatives were added to the QFI investment scope. Starting from 9 October 2025, QFIs will be permitted to participate in ETF options, including four ETF options listed on SZSE and five ETF options listed on SSE, totalling nine products. At time of writing, the number of futures and options available to QFIs has increased to 91, and on 9 October 2025, with the expansion to include additional ETF options, the total number will reach exactly 100.

It is noteworthy that under CSRC's rules, QFIs may trade financial futures or options for hedging purposes only.

2.2 Swaps and Security-Based Swaps

Regulatory Regimes for Swaps in China

All swap transactions in China are conducted OTC, and there are no exchange-traded swap products. The main types of swaps traded in China are, among others, interest rate swaps, FX swaps, credit default swaps (CDSs), commodity swaps and equity swaps.

In terms of regulation, as explained in more detail in **3.1.1 National Regulators**, China's financial system follows a sector-based regulatory mode. Therefore, the regulation of China's derivatives market is carried out by different authorities, mainly based on the type of market participants, the nature of the trading venue and the type of products involved. Building on the FDL as the overarching statutory foundation for derivatives regulation, swap transactions are subject to regulatory rules that apply to both market participants and products (including their trading platforms), which may be issued by one or more regulatory bodies.

Product-Specific Regulation for Swaps

From a product-based regulatory perspective, different types of swaps fall under the regulation of different authorities.

Interest rate swaps (IRSs) mainly consist of RMB IRSs and standardised IRSs. IRSs dominate China's interest-rate-linked derivatives market. IRSs on the seven-day fixed repo rate (FR007) are the products most traded by commercial banks, accounting for up to 70% of the total interest rate derivatives turnover, based on the data from PBoC. IRSs are primarily traded in the interbank market and generally regulated by PBoC, NFRA and NAFMII, depending on the specific product and counterparties involved.

Swaps linked to foreign exchange (FX) in China mainly include FX swaps, currency swaps and standardised currency swaps. These products are generally traded on the CFETS and regulated by SAFE and CFETS. Within the FX derivatives category, FX swaps (including currency swaps) are the most widely traded products, with USD/CNY swaps accounting for up to 99% of the notional number traded of all FX swaps, based on the data from CFETS.

Credit-linked swaps traded in China primarily include OTC CDS, which are regulated by PBoC and NAFMII. It is worth noting that in 2010, NAFMII launched two types of credit risk mitigation (CRM) tools: credit risk mitigation agreements (CRMAs) and credit risk mitigation warrants (CRMWs). While CRM instruments are regarded as China's domestic version of CDSs, they differ significantly from international CDS products. For instance, CDSs typically reference a series of bonds issued by the same issuer with common characteristics (eg, governing law, currency, seniority), whereas CRM products only reference one specific bond. A CRMA is a bilateral OTC contract and cannot be transferred in the market. A CRMW, by contrast, is a standardised instrument issued by qualified third-party institutions such as banks and may be traded in the secondary market.

Equity-linked swaps traded in China mainly include total return swaps (TRSs), which are traded OTC under the lead of securities firms or through China Securities Index Company. These are primarily regulated by CSRC.

Commodity-linked swaps traded in China may be traded through OTC platforms affiliated with exchanges such as DCE and SGE, or through other OTC arrangements. Depending on the underlying commodity, these swaps are regulated by CSRC, PBoC and/or the relevant trading platforms.

Interest Rate Swaps in China

IRSs, as the most widely-used OTC interest-rate derivatives, play a significant role in China's derivatives market. IRSs were first introduced in 2006 on a pilot basis in the interbank bond market and were fully launched in 2008. Currently, swaps in China may be subject to either bilateral or central clearing. Only certain standardised products are subject to mandatory central clearing. According to the PBoC's rule issued in 2014, SHCH provides a central clearing mechanism for IRS transactions, and certain types of IRS traded between financial institutions are required to be centrally cleared in SHCH. This will be discussed further in **3.1.2 Clearing**.

Swap Connect

The mutual access scheme of the Mainland China and Hong Kong interest rate swap markets (Swap Connect) was launched on 15 May 2023. It enables cross-border participation in Hong Kong and Mainland China's interest rate derivatives markets via a mutual access scheme between the financial market infrastructures in respect of trading, clearing and settlement in both places. Specifically, Swap Connect is run in partnership by onshore trading platform CFETS, central counterparty SHCH, and HKEX through its clearing subsidiary OTC Clear.

Swap Connect is divided into the Northbound and Southbound Swap Connects. The Northbound Swap Connect allows offshore investors in Hong Kong and other countries and regions to access IRSs in the

Mainland interbank market via Hong Kong infrastructure providers. The Southbound Swap Connect, in the opposite direction, will allow Mainland China investors to access the Hong Kong financial derivatives market through mutual access between infrastructure institutions in both places. Swap Connect started initially with the Northbound Swap Connect, while currently the Southbound Swap Connect is not yet available and will be explored in the future.

With regard to the Northbound Swap Connect, offshore investors that meet the requirements of PBoC, have completed filing for participation in CIBM Direct and have been granted permission by CFETS can participate in the Northbound Swap Connect. Swap Connect shares the same operational model with existing OTC Clear products. Even though the ultimate trading and clearing requests are confirmed and executed onshore via CFETS and SHCH, the offshore investors only face offshore electronic trading platforms (such as Bloomberg and Tradeweb) and OTC Clear without altering their existing trading and settlement practices.

As of the end of April 2025, a total of 20 onshore market makers and 79 offshore investors executed more than 12,000 IRS transactions through the Northbound Swap Connect, with total notional principal exceeding CNY6.5 trillion, according to a PBoC announcement.

Regulatory Considerations for Offshore TRSs on Chinese Securities and Futures

For many years, given that China's capital markets have not been fully accessible to foreign investors, overseas institutions need to utilise regimes like QFI, Stock Connect, Bond Connect, Internationalised Futures Products or CIBM Direct to access A shares, domestic futures and domestic bonds. As a result, many foreign investors engage in TRSs offshore to obtain economic exposure to Chinese securities and/or futures.

From a derivatives regulatory perspective, these offshore TRS transactions generally fall outside of the PRC regulators' jurisdiction. From a securities law and futures law standpoint, the total return receiver is not deemed to be the legal owner of the underlying securities or futures and thus is exempt from foreign ownership limits, duties of disclosure of interest, futures position limits and short-swing profit rules. However, for TRSs on Chinese securities, where the equity amount receiver in a TRS in fact controls voting rights or governance over the underlying securities during the swap's term, Chinese regulators may treat it as an indirect shareholder subject to applicable ownership and disclosure restrictions. Additionally, regardless of contractual structuring, both the TRS equity amount receiver and payer remain potentially subject to PRC insider trading and market manipulation laws.

Meanwhile, as mentioned in **1.2 Historical Trends and Looking Forwards**, the Draft Derivatives Trading Measures are intended to have extraterritorial scope, applying to derivatives transactions conducted overseas that concern underlying assets in China and/or hedging transactions executed within China. In this regard, where an offshore TRS with hedging transaction takes place with China, the onshore securities and futures exchanges may require the derivatives operating institutions (ie, brokers) to provide information related to such offshore TRS transaction, such as the details of the counterparty and the TRS transaction elements, based on the exchanges' monitoring needs. Besides this, where an offshore TRS transaction is in connection with domestic underlying assets, it remains subject to the futures position limit and large position reporting requirements, securities disclosures of interest rules, and the prohibitions on fraudulent, manipulative, insider-trading, short-swing and other unlawful activities. Considering such potential impacts of the Draft Derivatives Trading Measures when effective, it is worth keeping an eye on the finalisation of these measures.

2.3 Forwards

In China, forwards are regulated based on the type of underlying assets and the type of market participants involved. The principal forward products traded in China include interest rate forwards, FX forwards, bond forwards and commodity forwards.

FX forwards include currency forwards and standardised currency forwards. They are primarily traded on CFETS and are regulated by SAFE.

Interest rate forwards include bond forwards, forward rate agreements and standardised bond forwards, which are also traded on CFETS and are primarily regulated by PBoC and NFRA.

Commodity forwards include products linked to metals, agricultural products and energy. Depending on the types of products, commodity forwards may be traded OTC through OTC platforms affiliated with exchanges such as DCE, ZCE or SGE. The regulatory authorities typically are CSRC, PBoC and the relevant trading platforms.

2.4 Listed v Over-the-Counter

In China, exchange-traded derivatives include the futures and options described in **2.1 Futures and Options** and certain credit-related derivatives such as credit protection contracts and credit protection certificates, which are traded on SSE and SZSE. OTC derivatives, by contrast, involve a wide variety of products and markets.

Commodity derivatives dominate the exchange-traded market, while FX derivatives dominate the OTC market. Exchange-traded markets such as SSE, SZSE and the futures exchanges apply mature risk management mechanisms, including margining, daily mark-to-market and large position reporting requirements. The regulation of exchange-traded markets is discussed more fully in **3. Regulation of Derivatives**. New product listings require CSRC approval and are generally standardised in structure.

By contrast, OTC derivatives are mostly non-standardised and primarily trade under three master agreement frameworks: (1) the NAFMII framework for the interbank market; (2) the SAC framework for the securities and futures OTC market; and (3) the ISDA framework for the bilateral market used by foreign institutions.

Each framework features its own trading venues, primary products and market participants. The NAFMII market primarily covers interbank FX and interest rate derivatives and is generally traded on CFETS, SHCH and SGE for trading and/or clearing. The SAC framework governs the OTC derivatives markets for securities companies and futures companies, and includes both bilateral and quote-driven platforms. The ISDA framework generally governs bilateral trading between domestic financial institutions and foreign institutions.

In China's OTC derivatives market, trading venues and clearing and settlement infrastructures vary by underlying assets. All interbank derivatives transactions that reference interest rates, FX and credit are executed through CFETS. Most interest rate swaps are centrally cleared and settled at SHCH. Equity derivatives are executed via CSIS and are cleared and settled on a bilateral basis. Commodity derivatives are executed on various electronic platforms operated by exchanges such as DCE and SGE.

Notably, Chinese regulators generally discourage and restrict overly complex product structures in the domestic OTC markets.

2.5 Asset Classes

The primary underlying asset classes for derivatives in China are commodities for exchange-traded products and FX for OTC products.

Emerging asset classes include carbon-related products. Pilot markets in Shanghai, Hubei and Guangzhou have introduced carbon forward contracts, which are bilaterally cleared, with Shanghai utilising SHCH for clearing.

As mentioned in **2.1 Futures and Options**, derivatives linked to virtual currencies remain strictly prohibited in China as their trading is considered an illegal financial activity. Meanwhile, to prevent insider dealing and other illegal actions, controlling shareholders, directors and senior management personnel of listed companies are prohibited from trading derivatives linked to their own company's stock. In addition, listed companies and investors may not use derivatives to circumvent regulatory requirements.

2.6 Exemptions, Non-Derivative Products and Spot Transactions

Current Chinese regulations do not provide exemptions for specific derivatives products.

Spot commodities trading is regulated by the Ministry of Commerce, PBoC and CSRC. The Ministry of Commerce oversees national planning, information and statistical management for commodity spot markets to ensure healthy market development. PBoC supervises financial aspects and non-bank payment activities related to spot commodity trading. CSRC is responsible for rectifying any spot trading venues that conduct activities resembling illegal commodity futures trading. Local governments, under the guidance of the State Council, manage approximately 145 commodity spot trading centres, formulating local rules and exercising supervision. Spot commodities trading does not fall under the derivatives regulatory framework but is tightly supervised to prevent disguised illegal futures activity.

Foreign exchange in China is strictly regulated, and PBoC and SAFE oversee FX transactions. Individuals may conduct FX spot transactions primarily for legitimate current-account purposes, such as currency conversion and cross-border transfers. Capital-account FX transactions for individuals remain restricted and are permitted only under specific circumstances, such as cross-border equity incentives. Securities firms are prohibited from offering derivatives services to individual clients, and banks rarely offer FX derivatives to individuals, reflecting a highly cautious regulatory approach.

Leveraged spot commodity transactions, including products that may be categorised as contracts for difference, remain in a regulatory grey area. In practice, regulatory and judicial authorities may deem the trading and operation of such products to be illegal operations or unlicensed derivatives trading depending on their specific structure.

3. Regulation of Derivatives

3.1 National

3.1.1 National Regulators

China's financial system follows a sector-based regulatory model, resulting in a fragmented oversight structure for derivatives. Depending on the type of market participants, derivatives, underlying asset classes and policy objectives, regulatory responsibilities are distributed across multiple authorities, with potential overlaps in certain areas.

People's Bank of China (PBoC)

PBoC, as China's central bank, oversees monetary policy, macroprudential regulation, payment and clearing systems, and the interbank market. It regulates interbank OTC derivatives, including interest rate swaps, forward rate agreements, bond forwards and bullion OTC products on SGE, and is responsible for the oversight and development of key market infrastructures such as CFETS and SHCH.

China Securities Regulatory Commission (CSRC)

CSRC regulates exchange-traded derivatives such as futures and standardised options, as well as derivatives business conducted by CSRC-licensed entities, including securities and futures firms. It also supervises futures exchanges and is responsible for monitoring and addressing risks in the futures market.

National Financial Regulatory Administration (NFRA)

NFRA is China's regulator for the banking and insurance industries. It oversees derivatives activities conducted by its regulated institutions, with a focus on risk management and the prudential impact of derivatives trading on financial institutions.

State Administration of Foreign Exchange (SAFE)

SAFE is China's foreign exchange authority responsible for managing cross-border capital flows and foreign exchange transactions. It regulates the use of foreign exchange derivatives.

State-owned Assets Supervision and Administration Commission (SASAC)

SASAC, in its capacity as the capital contributor to central state-owned enterprises (SOEs), regulates the use of derivatives by such central SOEs under its ownership and imposes regulatory and risk management requirements on such activities.

Ministry of Finance (MOF)

MOF is responsible for taxation and formulating financial accounting standards related to derivatives and setting requirements for the use of derivatives by treasury-funded entities.

3.1.2 Clearing

Currently, exchange-traded derivatives are cleared and settled through the relevant futures exchanges via their internal clearing departments.

For OTC derivatives, SHCH provides central clearing services for a range of products, including interest rate, foreign exchange, certain credit and commodity derivatives. Currently, SHCH clearing is mandatory for IRS transactions traded between financial institutions referencing FR007, Shibor Overnight_O/N or Shibor 3M with a tenor of five years or less, where the counterparties and contract terms meet SHCH's eligibility criteria. Other standardised OTC derivatives are not yet subject to mandatory clearing.

3.1.3 Mandatory Trading

Under PRC law, futures and standardised options must be traded on futures exchanges established in accordance with the law, or on other trading venues for futures transactions approved by CSRC. Futures/standardised options trading outside of such authorised venues is strictly prohibited.

Certain interbank OTC derivatives are subject to mandatory execution venue requirements: all interbank RMB/FX transactions must be executed via CFETS. RMB IRS and bond forwards must also be executed via CFETS.

3.1.4 Position Limits

Position limits apply to exchange-traded derivatives. Under CSRC rules, futures exchanges are required to establish position limit regimes in accordance with regulatory requirements. Accordingly, each exchange has set differentiated position limits based on factors such as the type of contract, the type of participant and the nature of the position (eg, hedging, speculation or market-making). By contrast, there is currently no unified position limit framework applicable to OTC derivatives.

3.1.5 Reporting

For exchange-traded derivatives, the FDL and futures regulations require futures exchanges to establish reporting regimes covering actual control relationships, transactions, positions and margin usage. In accordance with these requirements, each futures exchange has developed its own reporting rules, which are binding on market participants.

Specifically, program trading is subject to additional disclosure obligations. Where a program trading participant on a stock exchange engages in return swaps or similar structured transactions with its clients and executes the related trades through its own account, it must report relevant client information in accordance with the rules of the stock exchange. Futures exchanges are likewise required to establish program trading reporting systems that specify the scope of reporting, reporting methods and verification procedures. Participants must submit the required information to the relevant futures exchange.

For OTC derivatives, regulated entities, such as banking and insurance institutions, securities firms and risk management subsidiaries of futures companies, are required to report OTC transaction information to their respective regulators or to designated reporting platforms, in accordance with applicable regulatory requirements. For instance, when conducting OTC gold derivatives transactions with onshore counterparties, banking financial institutions are required to report each transaction to SGE within the prescribed time, unless the transaction is executed through SGE's designated system.

3.1.6 Business Conduct

General Requirements

Under PRC law, the business conduct requirements applicable to futures and derivatives transactions are primarily aimed at maintaining market integrity, protecting investors and safeguarding systemic stability. The FDL establishes a high-level regulatory framework that prohibits manipulative, abusive or deceptive conduct in the derivatives market. Market participants – whether institutions or individuals – are required to act fairly, refrain from market manipulation and avoid trading based on undisclosed material non-public information. They are also prohibited from disseminating false or misleading information that may disrupt the orderly functioning of the futures or derivatives markets.

In addition to these core prohibitions, the FDL imposes conduct-based obligations relating to transparency, risk control and accountability. Exchange transactions are conducted on a real-name basis, where designated accounts cannot be used by others. Program trading must be carried out in a manner that does not compromise the security or stability of trading platforms. Furthermore, the misuse of credit or fiscal funds for trading in futures or derivatives is strictly prohibited.

Requirements for Financial Institutions

Specifically, financial institutions conducting derivatives business are subject to a dedicated set of business conduct requirements that emphasise regulatory approval, client protection and compliance with supervisory rules. Financial institutions must obtain prior approval or registration before engaging in derivatives activities and are obligated to implement suitable management procedures, including know-your-customer, verification of transaction authenticity and client risk assessment.

Furthermore, financial institutions are required to comply with conduct standards specific to their industry. For example, banks must not engage in misleading marketing or promise return guarantees when offering derivatives products. Securities firms are prohibited from improper solicitation, facilitating regulatory arbitrage or acting as a conduit to circumvent eligibility rules.

3.1.7 Commercial End Users

Under the FDL and the trading rules of PRC futures exchanges, there are generally no specific exemptions or reliefs for commercial end users. The core trading conduct rules apply uniformly to all market participants, such as those relating to market manipulation, insider trading and information disclosure.

However, due to the functionally segmented regulatory structure in China, most derivatives regulatory requirements are directed at regulated financial institutions such as banks, insurers, securities firms and futures companies, rather than commercial end users themselves. As a result, commercial end users are often indirectly regulated through the compliance obligations imposed on their financial counterparties.

3.2 Local

The local bureaus of China's national financial regulators are responsible for certain on-the-ground supervisory functions in relation to derivatives activities, handling both administrative approvals and regulatory enforcement within their respective jurisdictions.

- Provincial-level NFRA bureaus are responsible for approving derivatives business applications by city commercial banks, rural small and medium-sized banks, and certain foreign banks. NFRA's provincial and municipal bureaus are responsible for the ongoing supervision, inspection and disciplinary measures related to these banks' derivatives operations at the local level.
- Provincial-level CSRC bureaus are tasked with approving derivatives business qualifications for securities firms, as well as monitoring the conduct of securities and futures companies through on-site inspections and enforcement actions within their local jurisdictions.
- For foreign exchange derivatives, banks other than policy banks and nationwide commercial banks need to apply to their local SAFE branch for approval to conduct RMB/FX derivatives business. These local SAFE branches also perform compliance oversight and carry out regulatory enforcement concerning such foreign exchange derivatives activities.

3.3 Self-Regulatory Organisations, Independent Authorities, and Exchanges

Self-Regulatory Organisations

a) Securities Association of China (SAC)

SAC is a self-regulatory organisation established under the PRC Securities Law and operates under the guidance of CSRC, with all securities firms registered as its members. SAC is responsible for the self-regulation of the OTC markets and OTC derivatives business conducted by securities companies, fund management companies and their subsidiaries, as well as their associated personnel.

In this capacity, SAC formulates industry conduct standards, publishes standardised derivatives trading agreements for the securities and futures markets, and oversees risk management practices related to derivatives trading. It also conducts self-regulatory inspections of OTC activities and administers the filing and data reporting processes for in-scope OTC derivatives transactions.

b) China Futures Association (CFA)

CFA is the national self-regulatory organisation for the futures industry established under the FDL and operates under the guidance of CSRC. CFA is responsible for the self-regulation of derivatives activities carried out by futures companies and their risk management subsidiaries.

CFA formulates and implements industry rules related to futures business. It conducts supervision and inspections of futures companies and their subsidiaries, organises self-regulatory reviews, and promotes investor education and protection to support the sound and compliant development of the derivatives market.

c) Asset Management Association of China (AMAC)

AMAC, governed by laws under CSRC, serves as the self-regulatory organisation specifically for the fund industry. Its members are primarily publicly offered and private fund managers, as well as custodian banks for funds. AMAC regulates the use of derivatives by private investment funds.

d) National Association of Financial Market Institutional Investors (NAFMII)

NAFMII is the self-regulatory organisation for China's interbank market, operating under the supervision of PBoC. Its mandate covers a wide range of interbank markets, including the bond market, interbank lending market, foreign exchange market, bill market, gold market and derivatives market.

NAFMII is responsible for formulating standard documentation for financial derivatives transactions in the interbank market, overseeing the filing of executed master agreements, and administering the filing of internal operational procedures and risk management frameworks related to derivatives activities.

Independent Authorities

a) China Central Depository & Clearing Co., Ltd. (CCDC)

CCDC functions under MOF as the central securities depository for China's interbank bond market. CCDC plays a foundational role by registering, supervising and settling fixed income securities – such as government and corporate bonds. In the interbank market, certain bond trades executed via CFETS are settled through CCDC's systems.

b) Shanghai Clearing House (SHCH)

SHCH, established in 2009 under PBoC leadership, serves as the designated central clearing counterparty (CCP) and clearing house for a broad array of interbank derivatives – including interest rate, foreign exchange, bond forward, credit and commodity products. SHCH develops and enforces standardised clearing rules, margin methodologies, and default and risk management procedures, and it interfaces with both domestic and cross-border markets.

c) China Securities Depository & Clearing Corporation (CSDC)

For exchange-based bond and equity derivatives, CSDC acts as the central counterparty. CSDC is responsible for centralised registration, custody, clearing, settlement and netting of all exchange-based securities and derivatives.

Exchanges

CFFEX is China's dedicated venue for trading financial futures and options. Other commodity exchanges, including DCE, ZCE, SHF, INE and GFEX, provide centralised trading and clearing for futures and options linked to metals, energy, and agricultural and industrial products. SSE and SZSE are China's primary equity markets and also support the trading of listed ETF options. All futures and stock exchanges are regulated by CSRC.

Additionally, SGE, established with State Council approval and overseen by PBoC, serves as a specialised financial market for trading gold and other precious metals as well as the OTC trading platform for derivatives relating to them.

4. Documentation Issues

4.1 Trading Documentation

4.1.1 Industry Standards and Master Agreements

In China, the documentation for derivatives transactions generally follows three primary master agreement frameworks: those developed by NAFMII, SAC and ISDA.

As mandated by PBoC, participants in the interbank market are required to use the China Interbank Market

Financial Derivatives Transaction Master Agreement formulated by NAFMII to document their transactions of interest rate, foreign exchange, bond, credit and gold derivatives, as well as combinations thereof. NAFMII has also introduced an updated version of the master agreement to accommodate cross-border transactions.

For derivatives transactions conducted by securities firms, futures companies and fund management companies in the OTC market, the latest Master Agreement for Derivatives Transactions in the China Securities and Futures Markets jointly issued by SAC, CFA and AMAC is commonly adopted. However, the SAC master agreement is not mandatory, and counterparties may alternatively choose to adopt the ISDA Master Agreement depending on the nature of the transaction and the parties involved.

It is not uncommon for financial institutions to develop their own master confirmations in derivatives transactions.

4.1.2 Margins

To document margin arrangements, parties using the NAFMII Master Agreement typically adopt the Performance Assurance Documents formulated by NAFMII, which include both pledge and title transfer structures. For transactions documented under the ISDA Master Agreement, it is common to use the ISDA CSA. By contrast, the SAC Master Agreement currently does not have a set of standardised margin documentation.

As for regulatory requirements, initial margin (IM) and variation margin (VM) obligations for non-centrally cleared derivatives were not enforced in China until early 2025, when NFRA released the NFRA Margin Rules. The NFRA Margin Rules apply solely to non-centrally cleared derivatives where at least one counterparty is one of the following NFRA-regulated financial institutions or products: banking financial institutions (including foreign bank branches and subsidiary banks in China), insurance financial institutions, financial holding companies approved by PBoC, and asset management products issued by any of the foregoing institutions. The NFRA Margin Rules do not extend to non-centrally cleared derivatives transacted solely between non-NFRA-regulated financial institutions, such as those regulated by CSRC (including securities firms, futures companies, mutual fund managers and their asset management products), or between such entities and non-financial institutions. These rules introduce a phased implementation timeline for NFRA-regulated financial institutions: VM requirements will take effect from 1 September 2026, while IM requirements will be phased in over three stages from 1 September 2027 to 1 September 2029.

At present, there is no standardised set of contractual documents addressing the newly introduced PRC regulatory margin requirements. In-scope financial institutions are expected to revise or supplement their existing documentation frameworks to reflect and comply with the new margin regime.

4.1.3 Other Agreements

For bond repurchase transactions in the interbank market, PBoC requires market participants to adopt the Master Agreement for Bond Repurchase Transactions in the China Interbank Market, formulated by NAFMII. This agreement covers both pledged bond repurchase transactions and outright bond repurchase transactions. For bond lending activities in the interbank bond market, NAFMII has also developed a Master Agreement for Bond Lending Transactions in the China Interbank Market; however, the use of this agreement is not mandatory.

In cross-border transactions, depending on the specific transaction structure and counterparties involved, it is also common to adopt international documentation standards such as GMRA, MRA, MSFTA, GMSLA or MSLA.

4.2 Clearing Documentation

In China, clearing brokers (typically financial institutions acting as clearing members under SHCH) document clearing relationships using the CCP Clearing Agreement formulated by SHCH. This agreement defines the legal frameworks between clearing brokers and the CCP. General Clearing Members (GCMs) should also enter into a CCP Service Agreement for Client Clearing with Non-Clearing Members (NCMs) for NCMs to participate in one or more CCP clearing services. These documents do not directly depend on the derivative product class – be it interest rate, FX, bond forward or commodity swap – since clearing brokers operate under SHCH's unified central clearing framework.

To facilitate the central clearing of the Northbound Swap Connect transactions, NAFMII formulated the Swap Connect Cleared Derivatives Agreement, under which both parties agree to take reasonable steps to clear eligible Swap Connect transactions. The onshore parties to this agreement are market makers in the interbank derivatives market who are also clearing participants of SHCH.

In negotiating clearing documentation, the key issues typically concern account, margin arrangements, fees, effectiveness and termination of agreement, as well as default-related liabilities.

4.3 Opinions and Other Documentation Issues

Currently, there is no regulatory requirement in China that requires a legal opinion for conducting derivatives transactions.

5. Enforcement Trends

5.1 Regulator Priorities and Enforcement Trends

CSRC: Prevent Regulatory Evasion Through Derivatives to Strengthen Capital Market Governance

Over the past year, China's capital markets have experienced rapid growth. In 2024, China's major stock indices had seen significant gains, for example, the benchmark Shanghai Composite Index rising by 12.67%, and this growth momentum has continued into 2025. In line with this favourable trend and to maintain it, the central government, at its meeting on 30 July 2025, placed special emphasis on "consolidating the positive trend of stabilisation and recovery of capital markets" and "consolidating the positive trend of stabilisation and recovery of capital markets".

Against this backdrop, one of the major focuses of CSRC has been strict law enforcement to promote the development of the capital markets, particularly in preventing market participants from disrupting the financial order through derivatives. CSRC specifically disclosed two enforcement cases in 2024 involving derivatives: one concerning controlling shareholders circumventing restrictions on share reductions through securities lending and derivatives, and the other involving insider trading conducted via OTC options.

CSRC is expected to continue to strengthen the supervision of the derivatives market in 2025, as the Derivatives Trading Measures have already been included as a priority project targeted for release within the year.

PBoC: Foster the Regulation and Development of Financial Infrastructure

In August 2025, PBoC issued regulatory measures on financial infrastructures, which include provisions on, among other things, the registration and depository system, the clearing and settlement system, the payment system and trade repositories. The measures also allow overseas financial infrastructures to conduct business within China on the condition that their regulatory authorities have signed a memorandum of understanding with the relevant Chinese regulators. It is anticipated that PBoC will continue its focus on the compliance and development of financial infrastructure based on public comments made by PBoC officials, who have indicated PBoC's intent to establish trade repositories for the interbank market.

PBoC stated that, going forward, it will work with CSRC to continue strengthening the development and co-ordinated oversight of financial market infrastructures, with the aim of establishing an advanced and reliable financial infrastructure system.

Advancing the comprehensive development of financial market infrastructures will also mean that Chinese regulators will have greater authority and stronger enforcement capabilities over the operation of the financial and derivatives market. In this regard, we may expect that in the future, the PRC financial and derivatives market will operate in a more orderly manner and under closer regulatory supervision.

Trends and Developments

Contributed by:
Tao (Andy) Qin, Yanhua (Xavy) Xu, Ran (Addie) Cheng and Tianbing (Yasmin) Zhou
DeHeng Law Offices

DeHeng Law Offices is one of the leading Chinese law firms providing comprehensive legal services in the areas of capital markets, banking and finance, dispute resolution, M&A, cross-border investment and finance, construction and real estate, international construction and projects, antitrust and competition, intellectual property, international trade, employment and social security, bankruptcy and restructuring, government and public policy, healthcare, environment, maritime, tax, compliance, etc. DeHeng has over 5,000 legal service professionals in 63 global offices, including domestic offices in Beijing (headquarters), Shanghai, Guangzhou, Shenzhen, Changchun, Tianjin, Dalian, Changsha, Wuhan, Shenyang, Xi'an, Jinan, Hangzhou, Zhengzhou, Chongqing, Urumqi, Fuzhou, Nanjing, Chengdu, Kunming, Hefei, Taiyuan, Zhuhai, Suzhou, Wenzhou, Wuxi, Dongguan, Sanya, Ningbo, Shijiazhuang, Nanning, Nanchang, Yinchuan, Xiamen, Xixian New Area, Lanzhou, Guiyang, Qingdao, Haikou, Hengqin (Macao), Xiongan New Area, Yantai, Quanzhou, Changzhou and China Hong Kong SAR, and international offices in The Hague, New York, Paris, Dubai, Brussels, Silicon Valley, Almaty, Astana, Vientiane, Seoul, Tokyo, etc.

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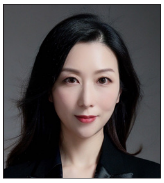

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Overview of Futures and Derivatives Markets

China's futures and derivatives markets have developed steadily amid a complex environment of global economic fluctuations, international tariff adjustments and geopolitical conflicts. According to statistics from the China Futures Market Monitoring Center (CFMMC), as of the end of July 2025, the total capital in the futures market had reached CNY1.82 trillion, an increase of 11.6% compared with the end of 2024. The market has been operating smoothly, and it continues to expand. The client equity of futures companies amounted to CNY1.71 trillion, representing a growth of 18.5% in the same period, among which the equity of industrial clients grew particularly prominently and the participation of real enterprises kept rising.

After over three decades of development, China's futures and derivatives markets have shown improvements across many dimensions, most importantly including the improvement of the product system, the enhanced ability to serve entities and the increased international participation of foreign capital.

The improvement of the futures and options product system

According to statistics from the CFMMC, China's futures and options product system has been steadily improving. As of 27 December 2024, the number of listed futures and options products had reached 146, making the industry more resilient by accurately matching the needs of each segment of the industry chain. Specifically:

- *Product coverage:* China's futures and options products have expanded rapidly, covering major sectors of the national economy such as agricultural products, metals, energy, chemicals, building materials, shipping and finance. This has resulted in a diverse pattern featuring the co-ordinated development of on-exchange and over-the-counter (OTC) commodities and finance markets, as well as futures and options.
- *National strategic development:* The product innovation of China's futures market is aligned with industrial transformation and upgrading. Futures in recently listed products, such as industrial silicon (a core material for new energy), lithium carbonate (a core material for lithium-ion batteries) and p-xylene (PX, a core raw material for the polyester industrial chain), have helped stabilise prices in high-end manufacturing and guided capital towards high-efficiency production capacity.
- *Environmental protection and low-carbon development:* Futures products in the electricity and new energy sectors provide full-chain risk management tools. The listing of futures products such as carbon emission rights, electricity futures, aluminium oxide futures, low-sulphur fuel oil futures and synthetic rubber futures in recent years has promoted the green upgrading of the industrial chain and guided production towards environmentally friendly manufacturing.

The enhanced ability to serve the real economy

From the perspective of serving the real economy, the futures market has expanded its service to small and medium-sized enterprises (SMEs) and extended coverage across the entire industrial chain. For example, by continually optimising the design of futures contracts – such as launching mini contracts for SMEs, adding futures delivery warehouses for regional industries, and adjusting contract settings for traders significantly affected by seasonal fluctuations – the market has turned futures into a practical tool that caters to enterprises' actual needs.

Internationalisation of futures and derivatives markets speeds up

CFMMC statistics show that the total number of tradable products available to the qualified foreign institutional investor (QFII) and renminbi qualified foreign institutional investor (RQFII) reached 91 in the first half of 2025. The number of foreign clients rose 17% year-on-year by the end of 2024, with their open interest increasing 28% simultaneously. The motivations for foreign investors to engage in deep participation in China's futures market include the following:

- With the two-way opening-up of China's capital market, foreign capital is encouraged to participate in more diversified and internationalised futures products, to achieve risk diversification and enrich investment portfolio allocation.
- China has advanced the institutional development of its futures market, including close supervision, the margin system, and adjustments to trading

hours and settlement methods to accommodate overseas investors. This not only improves risk management but also provides a better experience for overseas investors.
- China's financial derivatives are gaining pricing power alongside the rising international status of the renminbi.

To sum up, China's futures market is institution-based, deepening its role in serving the real economy and internationalisation through multidimensional enhancement, and steadily moving towards high-quality development.

Legislative Framework and Developments of Futures and Derivatives Markets in China

As the industry develops, China's futures and derivatives markets have seen a refinement of the legal framework. The Futures and Derivatives Law, enacted in 2022, serves as a fundamental law and establishes the overall regulatory framework for the futures and derivatives markets. Following the enactment of the Futures and Derivatives Law, a series of detailed rules, regulations and measures have been successively established.

The 2025 Annual Legislative Work Plan issued by the China Securities Regulatory Commission (CSRC) outlines the primary objectives for this year's legislative work: strengthening the supervision of capital market-related behaviours, regulating capital market-related entities and advancing law-based administration. Regarding strengthening capital market supervision, one of its "annual key projects" is the formulation of the Measures for the Supervision and Administration of Derivatives Trading. Regarding enhancing the regulation of capital market entities, its key project is the revision of the Measures for the Supervision and Administration of Futures Companies.

The Measures for the Supervision and Administration of Derivatives Trading and the Measures for the Supervision and Administration of Futures Companies are practical choices for the capital market

According to the Futures and Derivatives Law, the term "trading in futures" refers to trading activities that take futures contracts or standardised option contracts as their subject matter, while the term "trading in derivatives" refers to trading activities other than trading in futures that take swap contracts, forward contracts, non-standardised option contracts or portfolios thereof as their subject matter. Thus, trading in futures is characterised by standardisation, specific trading venues and statutory trading rules. Since the scale of the OTC market is far larger than that of the on-exchange market, trading in derivatives is characterised by flexibility and a high degree of contract freedom.

During the draft period, the Futures and Derivatives Law was known as the Futures Law and did not include "Derivatives" in its name, largely due to the fact that the derivatives OTC market is huge, with obvious individualised characteristics of transactions, which made it difficult to regulate trading behaviour while continuing to retain flexibility and innovativeness in the legislation. However, to recognise the distinct differences between the derivatives market and the on-exchange futures market, and the large size of the derivatives OTC market, derivatives were finally included in the name at the insistence of both academics and practitioners.

However, the Futures and Derivatives Law only provides basic principles for the derivatives market. This has led to frequent issues in the derivatives market, attributable to factors such as inconsistent regulatory standards, low hierarchical effectiveness of rules, urgent need for clarification on rule content, and lack of co-ordination in monitoring systems. Furthermore, under the overarching law of the Futures and Derivatives Law, the main rules governing the derivatives business are self-regulatory rules issued by the Securities Association of China (SAC) – such as the Administrative Measures for the OTC Option Business of Securities Companies and the Administrative Measures on Income Swap Business of Securities Companies – a situation that has resulted in a gap in legislation. Against this backdrop, the Measures for the Supervision and Administration of Derivatives Trading, as a refinement and supplement to the derivatives market's trading rules at the departmental regulation level, fulfil an urgent need and represent a practical choice for the capital market.

In addition to regulating trading activities, new compliance requirements have been put forward for futures companies regarding business expansion, enhanced supervision and standardised conduct amid the practical development of the futures market. In this context, the practical experience so far is due to be summarised and the Measures for the Supervision and Administration of Futures Companies are due to be revised.

The formulation of the Measures for the Supervision and Administration of Derivatives Trading and the revision of the Measures for the Supervision and Administration of Futures Companies are of great significance for regulating the derivatives trading market, enhancing the operational capabilities of futures companies and enabling their diversified development to adapt to economic growth and international competition, as well as stimulating the innovative vitality of the industry and promoting the internationalisation of China's futures and derivatives markets.

Observations on the formulation of the Measures for the Supervision and Administration of Derivatives Trading (Draft for Comment)

As mentioned above, the Futures and Derivatives Law only provides basic principles for derivatives trading, including the establishment of basic derivatives systems such as the single integrated agreement, net settlement and a trading report database. At the same time, it stipulates in Article 8 that: "The futures regulatory agency of the State Council and any other department authorised by the State Council shall carry out supervision and administration of the derivatives market according to their respective duties," authorising the CSRC to refine the trading rules for the derivatives market under its supervision. Subject to the scope of the derivatives market under the CSRC's supervision, the Measures for the Supervision and Administration of Derivatives Trading do not currently regulate the interbank derivatives market nor the OTC derivatives markets organised by banking financial institutions and insurance financial institutions.

The draft explanation of the Measures for the Supervision and Administration of Derivatives Trading (Draft for Comment) (the "Measures for Derivatives Trading") mentions that the formulation of these rules mainly adheres to four fundamental principles: functional supervision, co-ordinated supervision, strict risk prevention and reserving room for development. The Measures for Derivatives Trading contain a total of eight chapters and 52 articles, comprehensively covering General Provisions, Derivatives Trading and Settlement, Prohibited Trading Behaviours, Traders, Derivatives Business Institutions, Derivatives Market Infrastructure, Supervision and Administration, and Legal Liabilities, as well as Supplementary Provisions. The Measures for Derivatives Trading provide a more comprehensive regulation of trading behaviour in the derivatives market than previously, and some of their highlights are as follows:

- *Shift from institutional supervision to functional supervision:* To avoid systemic risks in the financial sector, China has long adopted a regulatory model dominated by institutional supervision, which has played an effective role under the segregated operation model. With the development of mixed business, operations have increasingly overlapped across markets. Functional supervision has emerged as an effective and progressive measure to prevent the cross-transmission of financial risks, mitigate conflicts in regulatory functions, eliminate regulatory vacuums and curb regulatory arbitrage.
- *Rules on trader access and suitability management are hierarchical:* Article 23 of the Measures for Derivatives Trading stipulates that entities engaged in risk management activities such as hedging may be exempted from all or part of the standards for professional traders, and this regulatory relaxation responds to the practical needs of enterprises in the real economy. However, how to define the scope of "hedging" and how to accommodate SMEs while serving the real economy may require verification and adjustment in practice. Furthermore, the deep verification of traders' identity and purpose not only requires traders to comply with regulatory requirements but also strengthens the due diligence obligations and compliance review requirements for derivatives business institutions.
- *Unprecedented efforts to combat illegal and irregular activities:* The Measures for Derivatives Trading first clarify that the development of overly complex derivative contracts is restricted, require highly standardised derivative transactions to be

conducted in designated derivative trading venues, and call on industry associations, trading venues and clearing institutions to enhance transaction standardisation. The rationale behind these provisions is to prevent regulatory failures caused by nested, complex or opaque products, which could create shortcuts for improper profit transfer. Chapter 3 of the Measures for Derivatives Trading is devoted to prohibited trading behaviours, including prohibition of illegal and irregular activities such as fraud, insider trading, market manipulation of securities, and evasion of supervision through derivatives trading. Among these provisions, the rules regarding "shareholders, actual controllers, directors, supervisors and senior executives of listed companies" are designed for the purpose of protecting the rights and interests of investors, preventing such parties from achieving disguised reduction of shareholdings through OTC derivative instruments (eg, the combination of equity swaps and securities lending hedging) to evade share sale restrictions.

- *Flexibilisation of the settlement system:* The Measures for Derivatives Trading expand the forms of margin to include marketable securities with strong liquidity such as cash, government bonds, stocks, fund units and standard warehouse receipts, while also leaving room for the CSRC to make additional supplements in the future. This is of great significance for traders to activate their existing assets, but a major challenge for derivatives clearing houses and registrars.

The Measures for Derivatives Trading further stipulate and refine provisions related to derivatives practitioners, business segregation and other matters – representing a key advancement in the laws and regulations governing derivatives trading. However, they may still face challenges from complex trading practices.

Observations on the revision of the Measures for the Supervision and Administration of Futures Companies (Draft for Comment)

The revision of the Measures for the Supervision and Administration of Futures Companies (Draft for Comment) (the "Measures for Futures Companies") is intended to align with the practical experience and development needs of the industry. It aims to improve the supervision and administration of futures companies on the principles of implementing the Futures and Derivatives Law, optimising and strengthening the supervision of futures companies, while temporarily refraining from specifying regulations on foreign-related matters. Specifically:

- *Comprehensive and professional transformation of futures companies' business:* In response to calls from industry professionals, following the revision, in addition to engaging in traditional brokerage business, futures companies will also be allowed to conduct business such as futures trading consulting, futures market-making transactions, futures margin financing, proprietary futures trading, derivatives trading and asset management. For different types of business, the requirements for access thresholds have been refined to effectively enhance the risk prevention and control capabilities of futures companies. These changes will help futures companies diversify their profit models and align more closely with the diverse needs of the real economy. However, given the raised business thresholds for futures companies, smaller-scale futures companies may gradually lose their market competitiveness for failing to meet the standards for certain businesses.
- *Strengthening supervision over the daily business operations of futures companies:* This includes improving corporate governance; strengthening multifaceted management of futures companies in areas such as shareholding control, fund management and internal control systems; clarifying that futures companies may provide financing and guarantees for their qualified subsidiaries; and improving the protection for Chief Risk Officers (CROs) in the normal performance of their duties. These revisions integrate external supervision with internal self-inspection. For futures companies, the focus is on establishing internal systems (including but not limited to those for protecting fund security), clarifying key systems such as related-party transactions and financing guarantees, and giving play to the independent functions and roles of CROs in abiding by legal supervision requirements and identifying potential risks.

The Measures for Futures Companies aim to promote the transformation of futures companies into comprehensive service providers, accelerate industry consolidation, and enhance their ability to serve the real economy and resist risks by relaxing restrictions on the scope of businesses such as overseas brokerage, proprietary trading and derivatives trading, while strengthening the requirements for net capital and shareholder qualifications. For futures companies, opportunities and challenges coexist. While being granted a broader business scope, they should further clarify their development strategies, improve their professional capabilities, pursue both horizontal and vertical expansion, strengthen their risk prevention capabilities and develop differentiated competitive advantages through building a pool of highly professional talents and improving corporate governance mechanisms. In this way, they can achieve a smooth ongoing adaptation to the ever-changing capital market environment.

Trends and Prospects

With the introduction of the Futures and Derivatives Law and the subsequent Measures for the Supervision and Administration of Derivatives Trading, as well as the revision of the Measures for the Supervision and Administration of Futures Companies, China's futures and derivatives markets have entered a stage of high-quality development with intensive supervision after more than three decades of exploration. For the capital market and the futures industry, seven major trends are expected to emerge.

Firstly, the comprehensive benefits enjoyed by the leading futures companies will become more prominent. The new business scope threshold will force futures companies to improve their capital strength and market competitiveness by enriching their business scope, and the strong regulatory requirements will prompt them to improve their compliance level in addition to their capital strength to meet all kinds of rating requirements and avoid marginalisation due to corporate governance issues. For these reasons, the futures market may face a "Matthew effect" whereby the strong become stronger and the weak become weaker.

Secondly, the demand for professional personnel will remain sustained. Whether for SMEs with insufficient experience in the financial investment field or for derivatives business institutions, the talents of such professionals should be well matched. They should include not only people with trading-oriented talents, but also personnel with professional capabilities in legal compliance, risk control, computer operations, etc. In the futures and derivatives trading markets, having a solid talent reserve and appropriate professional staffing will be particularly crucial.

Thirdly, the market functions of the futures and derivatives markets will be deepened, and their ability to serve the real economy will continually improve. The formulation of laws and measures including the Futures and Derivatives Law, the Measures for Derivatives Trading and the Measures for Futures Companies will effectively encourage futures companies and derivatives business institutions to continually enhance their professional capabilities and stimulate the industry's innovative vitality. This will further enable the futures market to exert important roles in various aspects such as risk management, price discovery, inventory management and financing, making it an important tool for enterprises in the real economy to hedge risks and optimise resource allocation in their development. Furthermore, the linkage between the futures and spot markets and the integration of industrial chains are also inevitable trends. By innovating futures and options products, enterprises can more flexibly manage inventory, conduct investment and financing, and realise the co-ordinated development of upstream and downstream in the industrial chain.

Fourthly, the futures and derivatives markets will become more transparent and standardised, and compliance requirements for market participants become unprecedentedly stringent. While regulations allow the development of customised derivatives, they also strengthen filing requirements. The Measures for Derivatives Trading prohibit excessively complex structured products and promote the precise alignment of OTC options, swaps and other instruments with the needs of the real economy. Among these provisions, rules such as prohibiting account lending and requiring deep verification are of great significance for improving market transparency, preventing insider trading and curbing market manipulation. Additionally, the clear prohibition of a series of market behaviours will serve as a powerful deterrent against illegal and irregular activities in the market.

Fifthly, the investor structure is undergoing professional upgrading, and classified and tiered management has become the core logic. The Measures for Futures Companies raise the access thresholds for professional investors and allows qualified institutions to participate in high-risk businesses. Beyond the existing market traders, listed companies, state-owned enterprises, overseas institutions and other entities will also gradually participate in the market in the future, becoming important participants in the market.

Sixthly, technology is empowering the transformation of market infrastructure. Compared with other sectors in the financial field, the futures and derivatives industry has relatively low technological content. In recent years, China has successively introduced policies such as the Development Plan for the New Generation of Artificial Intelligence and the Provisional Measures for the Administration of Generative Artificial Intelligence Services, which provide institutional frameworks and technical standards for the application of AI in the financial field and hold far-reaching significance for upgrading the operation and development model of the futures industry. For instance, AI can dynamically monitor market transaction information; when combined with blockchain technology to ensure transaction security, it can effectively prevent behaviours such as fraudulent transactions. Moreover, with the relaxation of the business scope of futures companies, AI and big data can promote the standardisation, popularisation and personalisation of futures companies' service models through methods such as analysing "transaction records" and "risk preferences". In the future, the application of digital technology and the reserve of technological talents may reshape the competitive landscape of the futures industry.

Lastly, the internationalisation process is moving towards institutional opening-up. In recent years, affected by factors such as international trade protectionism, local war conflicts and climate change, global economic volatility has intensified, leading to a significant increase in demand for risk management. Consequently, the global trading volume of derivatives has risen sharply, and their functions of price discovery, risk management and resource allocation have become an international consensus. On one hand, China's laws and regulations encourage foreign capital to participate in China's capital market while continually increasing efforts in product innovation and allowing futures companies to engage in more overseas businesses. On the other hand, due to the complexity of regulatory frameworks involved in foreign-related transaction procedures, existing laws and regulations still mostly remain limited to principled provisions regarding international transactions. China is still consistently improving futures systems and rules to further align with international standards.

To sum up, the institutional framework formed by the Futures and Derivatives Law and a series of regulatory measures is systematically reshaping the futures and derivatives markets ecosystem through strengthening leading competition, solidifying talent support, deepening services for the real economy, rigorously ensuring compliance and transparency, upgrading the investor structure, injecting technological impetus and advancing alignment with international standards. This process is not only the inevitable concomitant of the market's transition from "scale expansion" to "quality improvement", but also lays a solid foundation for it to better respond to global risks, empower industrial chain upgrading and support the high-quality development of the capital market. It will drive China's futures and derivatives markets towards a more mature stage of development while striking a balance between compliance and innovation.

JAPAN

Law and Practice

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Contents

Anderson Mōri & Tomotsune has a well-established derivatives practice and is adept at responding to the complex issues surrounding sophisticated derivatives transactions. Its expert lawyers regularly provide services for the negotiation and drafting of ISDA documents and other derivative contracts. They also provide support on a broad range of regulatory compliance issues regarding over-the-counter derivatives transactions including variation and initial margin requirements. They provide advice on all major categories of derivative, such as currency, interest rate, equity, credit and commodity derivatives. They also advise on earthquake, energy, carbon credit and crypto-asset derivatives, as well as structured finance transactions involving hybrid instruments such as structured deposits, synthetic collateralised debt obligations, credit-linked notes, credit-linked loans and repackaged notes. In addition, they advise on cross-border transactions with multi-jurisdictional elements and conduct research on foreign laws and regulations by working closely with leading overseas law firms.

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1. General

1.1 Overview of Derivatives Markets

The regulation of derivatives under Japanese law is divided into two major pieces of legislation, namely, the Financial Instruments and Exchange Act (Act No 25 of 1948, as amended, FIEA) and the Commodities Futures and Exchange Act (Act No 239 of 1950, as amended, CFEA).

The FIEA regulates over-the-counter (OTC) derivatives transactions falling under the definition of OTC Financial Derivatives Transactions, which include OTC derivatives referencing financial instruments such as interest rates, FX, equity, credit, electronic payment instruments or crypto-assets. The concept of OTC Financial Derivatives Transactions is further divided into the following three categories: (i) securities-related OTC Financial Derivatives Transactions (ie, OTC Financial Derivatives Transactions which refer to securities); (ii) non-securities-related OTC Financial Derivatives Transactions (ie, OTC Financial Derivatives Transactions which do not refer to securities) which do not reference crypto-assets etc; and (iii) non-securities-related OTC Financial Derivatives Transactions which refer to crypto-assets etc. As a result of an amendment to the FIEA in 2022, the term "crypto-assets etc" is defined to include not only crypto-assets but also certain electronic payment instruments defined under the Payment Services Act (which essentially means stablecoins). The scope of electronic payment instruments included in the definition of "crypto-assets etc" is to be designated by the Financial Services Agency of Japan (JFSA), but such designation has not yet been made.

Separately from the FIEA, the CFEA regulates OTC derivatives transactions falling under the definition of OTC Commodity Derivatives Transactions, which include OTC derivatives transactions referencing commodities such as oil, gas, electricity, precious metals and agricultural products.

OTC derivatives referencing underlying instruments which are related to neither financial instruments nor commodities will not trigger the licensing/registration requirement under the FIEA or the CFEA.

Exchange-traded derivatives referencing financial instruments and commodities are also regulated under the FIEA and CFEA.

1.2 Historical Trends and Looking Forwards

As a result of an amendment to the Foreign Exchange and Foreign Trade Act (Act No 228 of 1949, as amended) which came into force in 1980, Japanese parties are now able to enter into cross-border transactions without having to obtain any prior consents/approvals from the Japanese authorities under this Act in most cases. This event has had a significant impact on the development of the derivatives market in Japan.

In 1998, the Act on Close-Out Netting of Specified Financial Transactions Conducted by Financial Institutions (Act No 108 of 1998, as amended) was enacted, and the validity and enforceability of the close-out netting arrangement concerning certain OTC derivatives has been expressly confirmed by legislation. Further, as a result of amendments to insolvency laws (eg, Article 58 of the Bankruptcy Act), protection of the close-out netting arrangement has been expanded to cover a broader scope of derivatives. The legal certainty brought about by netting legislation has underpinned the growth of the derivatives market in Japan.

The development of the regulatory framework governing derivatives transactions has also influenced the way the derivatives markets have evolved. Before the Securities and Exchange Act was renamed as the Financial Instruments and Exchange Act by the amendments of 2006 (effective as of 2007), derivatives transactions were regulated as follows:

- Securities-related derivatives were regulated under the Securities and Exchange Act.
- Financial futures and options listed on the financial futures exchange were regulated under the Financial Futures Trading Act (Act No 77 of 1988, as amended).
- Commodities futures and options listed on the commodity futures exchange were regulated under the Commodity Exchange Act (Act No 239 of 1950, as amended).
- OTC derivatives referencing interest rates, FX or certain other financial instruments were not directly regulated by any specific legislation.

The Securities and Exchange Act and the Financial Futures Trading Act were merged into the FIEA, and the regulation of OTC Financial Derivatives Transactions was integrated under the FIEA.

Following the global financial crisis in 2008, the G20-initiated OTC derivative regulatory reforms (ie, mandatory clearing, mandatory trade execution, a trade data reporting requirement and a margin requirement for uncleared derivatives) were implemented under the FIEA.

As a result of an amendment to the CFEA in 2014, derivatives referencing electricity became regulated. In addition, as a result of an amendment to the FIEA in 2019, derivatives referencing crypto-assets became regulated. As described in **1.1 Overview of Derivatives Markets**, the amendment to the FIEA in 2022 defined the term "crypto-assets etc" to include not only crypto-assets but also a certain type of electronic payment instrument and as a result derivatives referencing "crypto-assets etc" became regulated as such. Derivatives referencing other types of electronic payment instruments also fall under the scope of derivatives regulated under the FIEA.

As regards the most recent developments in this area, the following amendments to the trade data reporting requirement came into force in April 2024:

- Although reporting dealers were previously allowed to report trade data to either the JFSA (ie, direct reporting) or the designated trade repository (ie, indirect reporting), they are now obligated to submit trade data to the trade repository, unless there is a natural disaster or any other due reason why they cannot report to the trade repository (in such a case, reporting dealers may submit trade data to the JFSA).
- For the purpose of implementing the data requirements specified by CPMI-IOSCO's CDE Technical Guidance, the use of an LEI (legal entity identifier), a UTI (unique transaction identifier) and improved CDE (critical data elements) is now required.
- In addition, effective from April 2025, reporting of unique product identifier (UPI) and delta has become mandatory.

The risk of rising interest rates in the future is having a major impact on the derivatives market. Specifically, the balance of outstanding JPY interest rate swap transactions cleared by the Japan Securities Clearing Corporation (JSCC) has reached record levels.

2. Types of Derivatives

2.1 Futures and Options

Futures and options are listed on regulated markets operated by the following four Japanese exchanges:

- Osaka Exchange, Inc. (OSE) (for both financial instruments and commodities derivatives);
- Tokyo Financial Exchange Inc. (TFX) (for financial instruments derivatives);
- Tokyo Commodity Exchange, Inc. (TOCOM) (for commodities derivatives); and
- Osaka Dojima Exchange, Inc. (ODEX) (for commodities derivatives).

No futures or options referencing crypto-assets are currently listed in Japan.

On 11 October 2023, the Tokyo Stock Exchange (TSE) established a carbon credit market for J-Credits. On this carbon credit market, carbon dioxide equivalent quotas and other similar products are traded.

In June 2024, the JFSA launched "Study Group on Financial Infrastructure Related to Carbon Credit Transactions" and, through hearings with market participants to ascertain the actual status of carbon credit transactions, has discussed issues to improve the transparency and soundness of carbon credit transactions. On 20 June 2025, the JFSA published "the Report of Study Group on Financial Infrastructure Related to Carbon Credit Transactions" (the "Report"). The Report pointed out that the carbon credit market is in its infancy, and that related systems and products are complex, diverse, and subject to change. Therefore, the Report referred to the importance of capacity building (improving literacy) among stakeholders, the importance of co-operation among stakeholders, the need to ensure appropriate explanations at the time of sales, the need to ensure transparency of transactions and markets through information disclosure, the need to sophisticate risk management, and the need to ensure consistency with international discussions. The Report also suggested that discussions on the emissions trading system are scheduled to begin in 2026 in Japan.

Emission allowance derivatives have generally been considered to not relate to either financial instruments or commodities. However, the legal status of carbon credits and how to regulate them is still under discussion, and therefore it is necessary to closely watch announcements of the JFSA or other Japanese authorities in the future.

2.2 Swaps and Security-Based Swaps

It is usual to conclude an ISDA Master Agreement for swap transactions. Voice trading is generally more common than electronic trading.

Swaps referencing financial instruments (including securities) are regulated as OTC Financial Derivatives Transactions under the FIEA, whereas swaps referencing commodities are regulated as OTC Commodity Derivatives Transactions under the CFEA.

Swaps cleared by the JSCC are subject to the JSCC's clearing rules. Uncleared swaps are subject to margin requirements, as described in **4.1.2 Margins**.

2.3 Forwards

Although cash-settled forward transactions are regulated as OTC Financial Derivatives Transactions or OTC Commodity Derivatives Transactions (depending on the underlying assets), spot or forward transactions which are settled only physically are considered sales and purchases of underlying assets, which do not fall under the definition of OTC Financial Derivatives Transactions or OTC Commodity Derivatives Transactions.

2.4 Listed v Over-the-Counter

OTC Derivatives

(1) Type I FIBO registration requirement under the FIEA

Engaging in the business of acting as a principal, intermediary, broker or agent in OTC Financial Derivatives Transactions falls under the definition of a Type I Financial Instruments Business. Under the FIEA, a person who conducts a Financial Instruments Business must be registered with the JFSA as a Type I Financial Instruments Business Operator ("Type I FIBO").

(2) Regulation of Foreign Securities Dealer under the FIEA

A Foreign Securities Dealer is defined as an entity which (i) engages in a business involving securities-related transactions in accordance with the law of a foreign jurisdiction, and (ii) is not registered as a Financial Instruments Business Operator (FIBO) or licensed as a Financial Institution in Japan. A Foreign Securities Dealer is generally prohibited from acting as a principal, intermediary, broker or agent in securities-related transactions with a customer in Japan, including securities-related OTC Financial Derivatives Transactions.

(3) Commodity Derivatives Business Operator licensing requirement under the CFEA

A person is considered to engage in the business of OTC Commodity Derivatives Transactions if such person acts as a principal, intermediary, broker or agent in such transactions as a business. Under the CFEA, depending on the type of commodities, a person who engages in such business must be licensed by the Ministry of Economy, Trade and Industry (METI) and/or the Ministry of Agriculture, Forestry and Fishery (MAFF) as a Commodity Derivatives Business Operator.

Exchange-Traded Derivatives

Type I or Type II FIBO registration requirement under the FIEA

A person who engages in the business of exchange-traded derivatives (ETDs) in Japan must be registered (i) as a Type I FIBO if the underlying instruments of such ETDs are certain highly liquid securities (eg, government bonds, municipal bonds, corporate bonds, corporate shares, share option certificates, units in investment trusts, commercial papers, mortgage securities, depositary receipts and negotiable deposit certificates) or if such ETDs are commodities futures listed on a financial instruments exchange licensed in Japan or (ii) as a Type II FIBO if such ETDs do not fall under the scope of (i) above but are still regulated under the FIEA.

Regulation of Foreign Securities Dealer under the FIEA

A Foreign Securities Dealer is generally prohibited from acting as a principal, intermediary, broker or agent in securities-related transactions with a customer in Japan, including securities-related ETDs.

In addition, a Foreign Securities Dealer is permitted to trade ETDs listed on a financial instruments exchange licensed in Japan without being registered as an FIBO if it has obtained permission from the JFSA.

Commodity Derivatives Business Operator licensing requirement under the CFEA

Under the CFEA, a person who engages in the business of acting as an intermediary, broker or agent in commodities ETDs listed on a commodities exchange licensed in Japan or on a commodities exchange outside Japan must be licensed as a Commodity Derivatives Business Operator. As distinct from OTC Commodity Derivatives Transactions discussed in (3) above regarding OTC derivatives, entering into commodities ETDs as a principal does not trigger this licensing requirement.

2.5 Asset Classes

The JFSA published the aggregated notional amounts of OTC derivatives reported to it as of March 2024. According to such published material, the underlying financial instruments of OTC derivatives predominantly traded in Japan are as follows in descending order on the basis of the aggregate notional amounts:

- interest rates (97.1%):
- FX (1.7%);
- credit (0.8%); and
- equity (0.4%).

In addition, commodity, electricity, earthquake and weather derivatives have been traded in Japan. As new asset classes, OTC crypto-asset derivatives have recently been emerging in Japan.

OTC derivatives referencing new asset classes may be caught by the prohibition of gambling under the Criminal Code (Act No 45 of 1907, as amended). Gambling means any provision or receipt of money or other economic value on a contingency basis. This definition is sufficiently broad to include virtually all derivatives transactions, including OTC Financial Derivatives Transactions and OTC Commodity Derivatives Transactions. Gambling is a criminal offence unless it is authorised by law or there is a legitimate reason. For a detailed description of the situations where OTC derivatives transactions are authorised by law, please see below.

FIEA Provisions

Any off-market act aimed at providing and/or receiving a monetary difference based on quotations or indices of stock exchanges or financial futures exchanges in Japan is illegal, unless it is an OTC Financial Derivatives Transaction to which an FIBO or Registered Financial Institution is a party, or an FIBO or Registered Financial Institution acts as an intermediary, broker or agent.

CFEA Provisions

The CFEA prohibits any off-market act aimed at providing and/or receiving a monetary difference based on quotations of domestic commodities exchanges, unless a licensed Commodity Derivatives Business Operator or a Specified OTC Commodity Derivatives Transactions Dealer that has made a notification to the MAFF or the METI is a party thereto. If a licensed Commodity Derivatives Business Operator or a notified Specified OTC Commodity Derivatives Transactions Dealer is a party, dealing in the relevant OTC Commodity Derivatives Transaction will be considered legal for the purpose of the Criminal Code.

Other Acts

The Banking Act (Act No 59 of 1981, as amended) and other legislation regulating Financial Institutions licensed in Japan provide that certain types of OTC derivatives transactions are included in the legitimate business of such Financial Institutions. OTC derivatives transactions that are entered into by such Financial Institutions pursuant to those statutes should also be considered not contrary to the Criminal Code.

If an OTC Financial Derivatives Transaction, an OTC Commodity Derivatives Transaction or any other derivatives transaction is not authorised by law and there is no legitimate reason for it, there is a theoretical risk that it could be deemed a form of gambling.

2.6 Exemptions, Non-Derivative Products and Spot Transactions

Exemptions for Transactions With Eligible Investors

1. OTC derivatives

Exemptions from the registration requirement under the FIEA or the licensing requirement under the CFEA are available, in cases where counterparties to OTC derivatives are limited to certain eligible investors. The scope of such eligible investors is different depending on the types of underlying assets (ie, securities, crypto-assets, other financial instruments and commodities) to which the relevant OTC derivatives refer.

(1) Exemption from the Type I FIBO registration requirement under the FIEA

As an exemption from the Type I FIBO registration requirement, the FIEA provides that for non-securities-related OTC Financial Derivatives Transactions that are not Specified OTC Financial Derivatives Transactions (as defined in **3.1.3 Mandatory Trading**) and do not refer to crypto-assets etc, a person will not be considered to be conducting a Financial Instruments Business by acting as a principal, intermediary, broker or agent in such transactions where the counterparties thereto are limited to the following entities ("Eligible Financial Derivatives Investors"):

- (i) Type I FIBOs;
- (ii) Registered Financial Institutions;
- (iii) qualified institutional investors (QIIs);
- (iv) stock corporations (*kabushiki kaisha*) with a paid-up capital of JPY1 billion or more; and
- (v) overseas persons equivalent to (i) to (iv) above.

In addition, a person conducting the business of OTC Financial Derivatives Transactions referencing crypto-assets etc solely outside Japan pursuant to the laws of the foreign jurisdiction will not be deemed to be conducting a Financial Instruments Business by entering into such transactions from outside Japan where the counterparties are limited to the following entities:

- the government of Japan or the Bank of Japan;
- FIBOs and Financial Institutions that engage in OTC Financial Derivatives Transactions referencing crypto-assets etc in the course of business;
- Financial Institutions, trust companies or foreign trust companies (only if they conduct OTC Financial Derivatives Transactions referencing crypto-assets etc for the purpose of investments or on the account of trustors under trust agreements); and
- FIBOs that engage in investment management business (only if such entities conduct any act related to investment management business).

(2) Exemption from the regulation of Foreign Securities Dealer under the FIEA

As mentioned in **2.4 Listed v Over-the-Counter**, a Foreign Securities Dealer is generally prohibited from acting as a principal, intermediary, broker or agent in securities-related OTC Financial Derivatives Transactions with an end user located in Japan. This general prohibition does not apply where the securities-related OTC Financial Derivatives Transactions are effected from outside of Japan:

- with FIBOs conducting securities-related businesses, government organisations, the Bank of Japan, FIBOs engaging in an investment management business and acting on behalf of their clients in the course of such business, banks, trust banks, insurance companies, co-operative banks, federations of co-operative banks, labour credit associations, federations of labour credit associations, The Norinchukin Bank, The Shoko Chukin Bank, credit associations, federations of credit associations (for their own investment purposes or for the account of a settlor (entrustor) pursuant to a trust agreement);
- with an Eligible Financial Derivatives Investor in Japan pursuant to an order of such investor without any solicitation on the part of the Foreign Securities Dealer; or
- with an Eligible Financial Derivatives Investor in Japan through a Type I FIBO acting as intermediary, broker or agent without any solicitation on the part of the Foreign Securities Dealer.

According to X-1-2 of the JFSA's "Comprehensive Guidelines for Supervision of Financial Instruments Business Operators, etc.", the posting by a Foreign Securities Dealer of advertisements regarding activities concerning securities-related businesses on its websites will, in principle, be deemed to constitute a solicitation. However, it may not be deemed to constitute a solicitation aimed at investors in Japan if reasonable measures (as illustrated below) are taken to prevent such advertisement from resulting in activities concerning securities-related business with investors in Japan as their transaction counterparties:

- Disclaimer: A disclaimer to the effect that the advertised service is not targeted at investors in Japan must be indicated.
- Measures to Prevent Transactions: Measures to prevent transactions with investors in Japan regarding activities concerning securities-related businesses must be put in place.

(3) Exemption from the Commodity Derivatives Business Operator licensing requirement under the CFEA

As an exemption from the licensing requirement as a Commodity Derivatives Business Operator, the CFEA provides that for OTC Commodity Derivatives Transactions, a person will not be considered to be engaging in the business of OTC Commodity Derivatives Transactions by acting as a principal, intermediary, broker or agent in such transactions where the counterparties to such transactions are limited to the following entities ("Eligible Commodity Derivatives Investors"):

- (i) Commodity Derivatives Business Operators;
- (ii) Commodity Investment Advisers;
- (iii) qualified institutional investors (QIIs);
- (iv) Type I FIBOs;
- (v) Registered Financial Institutions;
- (vi) stock corporations with a paid-up capital of JPY1 billion or more;
- (vii) overseas persons equivalent to (i) to (vi) above;
- (viii) special purpose companies (*tokutei mokuteki kaisha*) established under the Act on the Securitisation of Assets (Act No 105 of 1998, as amended) (i) whose specified share capital is JPY1 billion or more or (ii) whose specified share capital of JPY30 million or more and whose asset-backed securities are held by eligible investors only; and
- (ix) subsidiaries of any of the foregoing entities.

OTC Commodity Derivatives Transactions with Eligible Commodity Derivatives Investors are referred to as "Excluded OTC Commodity Derivatives Transactions". Under Article 349 of the CFEA, a person who engages in the business of Excluded OTC Commodity Derivatives Transactions is required to file a prior notification as a Specified OTC Commodity Derivatives Transaction Dealer if the underlying assets of such transactions are related to commodities or commodity indices which are designated by the relevant authority (currently, commodities and commodity indices referred to by exchange-traded commodities derivatives listed on commodities exchanges licensed in Japan are designated).

2. Exchange-traded derivatives

(1) Exemption from the FIBO registration requirement under the FIEA

The exemption from the FIBO registration requirement under the FIEA in cases where the counterparties are limited to certain sophisticated investors (see 1 (1) above) is not available for ETDs listed on a financial instruments exchange licensed in Japan.

(2) Exemption from the regulation of Foreign Securities Dealer under the FIEA

A Foreign Securities Dealer is permitted to trade ETDs listed on a financial instruments exchange licensed in Japan without being registered as an FIBO, if it has obtained permission from the JFSA.

In the case of securities-related ETDs listed on a foreign financial instruments exchange, a Foreign Securities Dealer is permitted to engage in such ETDs for Japanese customers under the regulatory framework for a Foreign Securities Dealer as described in 1 (2) above. Further, in the case of non-securities-related ETDs listed on a foreign financial instruments exchange, a foreign dealer is permitted to engage in such ETDs for Japanese customers under a regulatory framework similar to the regulatory framework for a Foreign Securities Dealer as described in 1 (2) above.

(3) Exemption from the Commodity Derivatives Business Operator licensing requirement under the CFEA

As distinct from OTC Commodity Derivatives Transactions discussed in 1 (3) above, entering into commodity ETDs as a principal does not trigger this licensing requirement. Further, a person who engages in the business of commodity ETDs listed on a foreign commodity exchange by acting as an intermediary, broker or agent in such foreign commodity ETDs need not be licensed as a Commodity Derivatives Business Operator, if customers and counterparties in Japan are limited to Eligible Commodity Derivatives Investors.

Non-derivative Products Including Spot Transactions

Regarding the definitions of the terms "OTC Financial Derivatives Transactions" and "OTC Commodity Derivatives Transactions", the following types of transactions are considered neither OTC Financial Derivatives Transactions nor OTC Commodity Derivatives Transactions:

- forward foreign exchange transactions (ie, physically-settled FX spot transactions, physically-settled FX forward transactions and physically-settled FX swap transactions); and
- derivatives transactions whose underlying asset are neither financial instruments nor commodities (eg, certain emissions allowances or freight).

In addition, physically settled securities forward transactions are generally not regulated as OTC Financial Derivatives Transactions but are regulated as sales and purchases of securities under the FIEA.

Physically settled FX spot/forward transactions are generally entered into as sale and purchase transactions of currencies. However, since foreign exchange margin transactions are rolled over, such FX transactions could be regulated as OTC Financial Derivatives Transactions. For more information about the regulation applicable to a provider of FX transactions (eg, for retail investors), please see **3.1.6 Business Conduct**.

3. Regulation of Derivatives

3.1 National

3.1.1 National Regulators

OTC Financial Derivatives Transactions are regulated by the JFSA pursuant to the FIEA, whereas OTC Commodity Derivatives Transactions are regulated by the METI and the MAFF pursuant to the CFEA.

3.1.2 Clearing

OTC Derivatives Subject to Mandatory Clearing Requirements

The following categories of OTC Financial Derivatives Transactions for which the JSCC offers clearing services are subject to the mandatory clearing requirement under the FIEA:

- credit derivatives transactions which refer to an index of iTraxx Japan ("Designated Cleared CDSs"); and
- interest rate swap transactions which refer to TONA compounded in arrears ("Designated Cleared IRSs", and together with Designated Cleared CDSs, "Designated Cleared Transactions").

Where the mandatory clearing requirement applies, parties must clear Designated Cleared Transactions through central counterparty clearing houses (CCPs) (including overseas CCPs) licensed in Japan.

Exemptions From Mandatory Clearing Requirements

Designated Cleared CDSs are exempt from the mandatory clearing requirement where:

- one counterparty to the transaction is not an FIBO or a Registered Financial Institution ("FIBO etc");
- the transaction is entered into by a trustee on behalf of the trust;
- the transaction is entered into by and between entities which belong to the same corporate group; or
- either (or both) of the counterparties to the transaction is an entity which is not a clearing member and whose parent companies or subsidiaries are not clearing members (limited to cases where there is a reasonable reason why none have or will become clearing members).

Designated Cleared IRSs are exempt from the mandatory clearing requirement where:

- one counterparty to the transaction is not an FIBO etc;
- the transactions are entered into by a trustee on behalf of the trust (excluding cases where the average aggregate notional amount of certain OTC derivatives of the trust is not less than JPY300 billion);
- the transactions are entered into by and between entities which belong to the same corporate group; or
- either (or both) of the counterparties to the transactions is an FIBO etc that meets either of the following criteria:
  - (a) it is (i) an FIBO which is not a Type I FIBO or (ii) a Registered Financial Institution that is neither a bank, The Shoko Chukin Bank, Development Bank of Japan Inc., Shinkin Central Bank, The Norinchukin Bank nor an insurance company; or
  - (b) it is an FIBO etc whose average aggregate notional amount of certain OTC derivatives is less than JPY300 billion.

3.1.3 Mandatory Trading

OTC Derivatives Subject to Mandatory Trade Execution Requirements

Mandatory trade execution requirements under the FIEA apply to Specified OTC Financial Derivatives Transactions, which are defined as JPY interest rate swap transactions involving the exchange of a floating rate and a fixed rate meeting the following conditions:

- The floating rate is TONA compounded in arrears.
- The notional amount remains unchanged during the term of the transaction.
- The effective date of the transaction is two business days after the trade date.
- The term of the transaction is either five, seven or ten years.
- As a business day convention, if a date designated by the parties is not a business day, that date will be taken to be the first following day that is a business day unless that day falls in the next calendar month, in which case the date will be taken to be the first preceding day that is a business day.
- The fixed rate is paid once every year and is calculated based on the actual number of days divided by 365.
- The floating rate is paid once every year and is calculated based on the actual number of days divided by 365.
- The JSCC offers clearing services for the transaction.

Specified OTC Financial Derivatives Transactions must be executed using an electronic trading platform (ETP) operated by an FIBO etc or by a foreign ETP operator which has obtained a licence in Japan.

Exemptions From Mandatory Trade Execution Requirements

Specified OTC Financial Derivatives Transactions are exempt from the mandatory trade execution requirement where:

- the transactions are entered into by a trustee on behalf of the trust;

- the transactions are entered into by and between entities which belong to the same corporate group;
- either (or both) of the counterparties to the transactions is an FIBO etc which meets either of the following criteria:
  - (a) it is (i) an FIBO which is not a Type I FIBO or (ii) a Registered Financial Institution that is neither a bank, The Shoko Chukin Bank, Development Bank of Japan Inc., Shinkin Central Bank nor The Norinchukin Bank; or
  - (b) it is an FIBO etc whose average aggregate notional amount of certain OTC derivatives as of each month-end during the last one-year period is less than JPY6 trillion.

3.1.4 Position Limits

Neither the FIEA nor the CFEA imposes any statutory position limit on the trading of derivatives, but registered FIBOs or licensed Commodity Derivatives Business Operators would impose a position limit on their customers for the purpose of their credit risk management. For ETDs, a position limit may also be imposed by the relevant financial exchange.

For completeness, under the Banking Act, banks licensed in Japan are subject to large exposure rules which set forth the upper limit on the total credit risk exposure (including derivatives exposure) for each counterparty. In addition, a loss cut rule must be established for certain retail derivatives, as we describe in **3.1.6 Business Conduct**.

3.1.5 Reporting

OTC Derivatives Subject to Trade Data Reporting Requirement

A trade data reporting requirement applies to the following OTC Financial Derivatives Transactions:

- forward transactions (except those settled within two business days);
- index forward transactions (except those settled within two business days);
- option transactions (except those whose exercise period is within two business days);
- index option transactions (except those whose exercise period is within two business days);
- swap transactions; and
- credit derivatives transactions.

The trade data reporting requirement applies to FIBOs etc (limited to (i) a Type I FIBO and (ii) a Registered Financial Institution that is a bank, The Shoko Chukin Bank, Development Bank of Japan Inc., Shinkin Central Bank, The Norinchukin Bank or an insurance company (any such entity in (i) and (ii), a “Reporting Dealer”)). Reporting Dealers must report the trade data to a trade repository designated by the JFSA, unless there is a natural disaster or any other due reason why the Reporting Dealers cannot report to the trade repository (in such case, Reporting Dealers may report the trade data to the JFSA).

Exemptions From Trade Data Reporting Requirements

If either or both of the counterparties to uncleared OTC Financial Derivatives Transactions are any of the following entities, the reporting requirements do not apply:

- national government;
- local public entities;
- Bank of Japan;
- foreign governments, local public entities and central banks;
- international organisations designated by the Commissioner of the JFSA; or
- an entity which belongs to the same corporate group as the other counterparty which is an FIBO etc.

In addition, if one party is a Reporting Dealer, the other party that is not a Reporting Dealer will be exempt from the reporting requirement.

Furthermore, if a Reporting Dealer of which its average aggregate notional amount of certain OTC derivatives is less than JPY300 billion has filed a notification to the JFSA and the designated trade repository, such Reporting Dealer is exempt from the reporting requirement on OTC Financial Derivatives Transactions other than those that refer to an interest rate, debt securities or FX.

3.1.6 Business Conduct

Specific Requirements for Business Operators Handling Derivatives

Leverage restrictions

FIBOs and Commodity Derivatives Business Operators are required to impose certain leverage restrictions when entering into certain derivatives with customers who are individuals. For example, for the leverage restriction imposed on certain FX transactions with individuals under the FIEA, the maximum notional amount is 25 times the amount of the margin posted by each customer. For the leverage restriction imposed on retail crypto-asset derivatives with individuals under the FIEA, the maximum notional amount is double the amount of the margin posted by each customer. For the leverage restriction on retail commodity derivatives with individuals, the maximum notional amount is 20 times the amount of the margin posted by each customer.

Loss cut rule

The FIEA provides that a Type I FIBO is required to establish a loss cut rule with respect to certain FX transactions offered to individual customers and with respect to OTC crypto-asset derivatives transactions (ie, if the loss incurred by a customer exceeds a certain level, the position of the customer must be compulsorily closed). The CFEA also provides that a Commodity Derivatives Business Operator is required to establish a loss cut rule.

Prohibition of solicitation without consent

The FIEA and CFEA prohibit visiting or making a phone call to a customer who has not consented to solicitation. Further, if a Type I FIBO engages in OTC crypto-asset derivatives, the following acts are also prohibited:

- entering into a crypto-asset-related agreement with or soliciting such, or advertising financial instruments transactions related to crypto-assets to customers without showing reasonable supporting evidence of certain prescribed facts; and
- soliciting the entering into of a crypto-asset-related agreement without representing certain matters to customers clearly and correctly.

General Requirements Applicable to FIBOs

Regulation of advertisement

Under the FIEA, any advertisement published by an FIBO etc must include the following information:

- (i) its company name;
- (ii) the fact that it is an FIBO etc and its registration number;
- (iii) the fee to be paid to the FIBO etc;
- (iv) the amount or calculation method of the required deposit;
- (v) the potential risk of the loss suffered by customers exceeding the deposits placed for derivatives transactions and the ratio of the deposit to the transaction amount;
- (vi) the potential risk of loss by customers and direct cause of such loss (eg, due to changes in the interest rate, value of currency or other relevant index);
- (vii) the potential risk of the loss suffered by customers in (vi) above exceeding the principal (if any) and direct cause of such loss;
- (viii) the spread between ordering price and executed price, if any;
- (ix) facts that might have significant adverse effect on customers; and
- (x) the self-regulatory organisation which the FIBO etc has joined (eg, JSDA)

Suitability principle

FIBOs etc have to follow the principle of suitability when marketing financial instruments to non-professional investors. The principle of suitability requires FIBOs etc to adjust their manner of solicitation as appropriate in light of the customer's sophistication (as determined from the customer's knowledge, experience, assets and purpose for purchasing the product, among other factors).

Requirement of written statutory disclosure to customers

Under the FIEA, when conducting transactions with customers, FIBOs etc had been required to deliver certain paper-based statutory disclosure documents containing the information relating to the transactions to the customers. As a result of the amendments to the FIEA which came into force on 1 April 2025, this requirement was modified to shift the focus from requiring FIBOs etc to deliver specific paper documents to requiring FIBOs etc to disclose important information regarding the substance of the transactions to the customers. In other words, while FIBOs are no longer required to disclose the information relating to the transactions to customers in paper form, they are required to ensure that they have provided sufficient explanations and information to the customers so that the customers are able to understand the substance of the transactions.

Prohibition of loss compensation

FIBOs etc are prohibited from providing loss compensation, additional profits or special benefits to a customer in connection with derivatives transactions in violation of the FIEA.

Regulations under the Act on Provision of Financial Services

Under the Act on Provision of Financial Services and Maintenance of Usage Environment (Act No 101 of 2000, as amended, APFSMUE), the seller of a financial instrument has a duty to explain important matters at the point of, or before, the sale of financial instruments. A breach of this duty gives rise to a private cause of action, with the burden of proof on the seller to prove the amount of damage (ie, the loss incurred by a customer is presumed to be the loss due to the failure of the duty). It is also prohibited to provide conclusive evaluation on uncertain matters or misleading information to customers. These regulations can be applied to derivatives transactions.

3.1.7 Commercial End Users

As we described in **2.6 Exemptions, Non-derivative Products and Spot Transactions**, exemptions from the registration requirement under the FIEA or from the licensing requirement under the CFEA are available in cases where counterparties are limited to certain eligible investors.

In addition, FIBOs are exempt from compliance with some of the key provisions on conduct in the FIEA (such as the principle of suitability, the requirement to deliver written statutory disclosure documents to customers, the prohibition of solicitation without consent, and the advertisement regulations) where the counterparties are professional investors. For this purpose, professional investors include qualified institutional investors (QIIs), listed stock corporations, stock corporations with stated capital of at least JPY500 million, special purpose companies established pursuant to the Act on Securitisation of Assets of Japan (known as TMKs) and foreign corporations. Individuals with trading experience of at least one year, and net and invested assets of at least JPY300 million, as well as other corporations, may apply to change their status from general investors to professional investors.

Further, the obligation under the APFSMUE to explain important matters as mentioned in **3.1.6 Business Conduct** would not be applicable where the counterparties are professional investors.

3.2 Local

Derivatives are regulated at the level of national laws, although certain supervisory functions are delegated by the national regulators (ie, the JFSA, METI and MAFF) to the Local Finance Bureau; the Regional Bureau of Economy, Trade and Industry; and the Regional Agricultural Administration Offices.

3.3 Self-Regulatory Organisations, Independent Authorities, and Exchanges

The following self-regulatory organisations operate in Japan:

- Japan Securities Dealers Association (JSDA) for Type I FIBOs and Registered Financial Institutions regulated under the FIEA;
- Financial Futures Association of Japan (FFAJ) for FX and interest rate derivatives (including OTC binary option derivatives) regulated under the FIEA;
- Japan Commodity Futures Industry Association (JCFIA) for commodity derivatives regulated under the CFEA; and
- Japan Virtual and Crypto assets Exchange Association (JVCEA) for crypto-asset derivatives regulated under the FIEA.

These self-regulatory organisations are subject to the national-level oversight by the JFSA, the METI and/or the MAFF (as applicable).

4. Documentation Issues

4.1 Trading Documentation

4.1.1 Industry Standards and Master Agreements

The industry standard for documentation of OTC derivatives is the ISDA documentation including but not limited to the ISDA Master Agreement, ISDA Credit Support Annex (CSA) and ISDA Definitions.

When using ISDA documentation, a short form confirmation is typically prepared by the dealer with reference to the relevant ISDA Definitions. Master confirmation agreements are sometimes prepared for certain equity derivatives transactions.

For ETDs, it is usual that the standard form terms and conditions are delivered by the dealer to customers. Such terms and conditions would govern the contractual relationship between the dealer and each customer (eg, settlement and custody arrangement) with reference to the relevant exchange rules and the CCP's clearing rules.

4.1.2 Margins

Before the introduction of the regulatory variation margin requirement for uncleared OTC derivatives under the FIEA, the typical documentation for the exchange of margin was (i) a Japanese law CSA (loan and pledge); (ii) an English law CSA (title transfer); or (iii) a New York law CSA (security interest).

Documentation for Variation Margin

The ISDA CSAs mentioned in **4.1.1 Industry Standards and Master Agreements** were updated in line with the regulatory variation margin requirement under the FIEA, and the parties now typically enter into (i) a Japanese law VM CSA (loan); (ii) an English law VM CSA (title transfer); or (iii) a New York law VM CSA (security interest). If a Japanese counterparty enters into (ii) or (iii), it is generally recommended that the Japanese Party Annex be incorporated in order to ensure that the close-out netting arrangement will be protected in Japanese insolvency proceedings.

Documentation for Initial Margin

Since the regulatory initial margin requirement for uncleared OTC derivatives was introduced under the FIEA, parties have typically entered into (i) an English law IM CSD or New York law IM CSA (including the Japanese Securities Provisions) and an Account Control Agreement; (ii) an ISDA Euroclear Collateral Transfer Agreement (including the Japanese Collateral Provisions) and an ISDA Euroclear Security Agreement; or (iii) an ISDA Clearstream Collateral Transfer Agreement and ISDA Clearstream Security Agreement (including the Recommended Amendment Provisions with respect to Japanese Collateral), depending on which global custodian is retained by the parties (eg, BNY Mellon, Euroclear or Clearstream).

In addition, for certain domestic transactions, the parties may also have entered into an ISDA 2016 Phase One Credit Support Annex for Initial Margin (IM) (Loan – Japanese Law) and a Trust Scheme Addendum. There are also domestic transactions in which a Japanese language trust agreement for initial margin is entered into by the parties.

Japanese parties may have also entered into a Japan Initial Margin Threshold Agreement, a template which enables parties to agree on a threshold amount applicable to each posting party in order to benefit from the documentation relief under the Japanese regulatory initial margin requirement in the case where the bilateral initial margin amount does not exceed JPY7 billion threshold on a group basis.

4.1.3 Other Agreements

Each Japanese bank may have its own standard form bespoke Japanese language derivative master agreement for its Japanese customers (eg, domestic Japanese corporations and individuals).

In addition, the JSDA publishes Japanese language master agreements for securities transactions such as the Master Agreement for Bond Transactions with Repurchase Agreement (Gensaki Transactions) and the Master Agreement for Bond Lending Transactions. These master agreements are widely used in Japan.

For cross-border repo and securities lending transactions, GMRAs, MRAs, MSFTAs, GMSLAs and MSLAs are often entered into by Japanese parties with overseas counterparties or global financial institutions.

4.2 Clearing Documentation

For Designated Cleared Transactions to which the JSCC as a CCP offers clearing services, the JSCC establishes a form of Clearing Brokerage Agreement which must be entered into between the clearing broker and its customer as part of the JSCC's clearing rule. The clearing broker and the customer may execute a side letter (or any other supplemental instrument) to the extent it does not conflict with the Clearing Brokerage Agreement.

In addition, the ISDA/FIA Cleared Derivatives Execution Agreement is widely used for cleared derivatives by market participants in Japan.

4.3 Opinions and Other Documentation Issues

In order to recognise the effect of the close-out netting arrangement for the purpose of calculation of the regulatory capital of Japanese banks, it is in practice required to obtain a legal opinion. More specifically, the relevant JFSA's Basel Q&A requires Japanese banks to confirm the existence of a reasonable written legal opinion, according to which the competent judicial court and authority would likely determine that the bank's exposure will be limited to the amount which is netted pursuant to the applicable netting agreement in light of the related laws upon occurrence of any legal dispute. In addition, Japanese banks may consider obtaining a legal opinion on the validity and enforceability of the collateral arrangement for the purpose of taking into account the credit risk mitigation effect of the collateral arrangement when calculating the regulatory capital.

5. Enforcement Trends

5.1 Regulator Priorities and Enforcement Trends

Under the FIEA, a person who conducts a Financial Instruments Business must be registered with the JFSA as an FIBO. Breach of such registration requirement could result in criminal penalties (ie, imprisonment and/or fine). In practice, it is common that the JFSA posts to its website the names of unregistered business operators and a summary of their unregistered business, as well as individually giving written warnings to such business operators. Notably, while a foreign business operator's act of soliciting Japanese investors to enter into derivatives transactions in principle constitutes a Financial Instruments Business (unless any relevant exemption applies), a number of such warnings have been made to such unregistered foreign business operators. Approximately 50 operators' names have been posted on the JFSA's website as unregistered operators over the latest 12 months. The trend towards enforcement is expected to continue as the JFSA's examination priority. The METI and the MAFF have also made similar warnings in the past.

Trends and Developments

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Anderson Mōri & Tomotsune (AMT) has an established derivatives practice and is recognised for its ability to handle complex issues surrounding sophisticated derivatives transactions. Its attorneys are regularly engaged to draft and negotiate ISDA documents and other derivative contracts, in addition to providing support in a broad range of regulatory compliance issues involving over-the-counter derivative transactions, including variation and initial margin requirements. AMT advises on all major categories of derivatives transactions, such as currency, interest rate, equity, credit and commodity derivatives, besides earthquake, energy, carbon credit and crypto-asset derivatives. AMT's attorneys are often also instructed to act in structured finance transactions involving hybrid instruments such as structured deposit, synthetic collateralised debt obligations (CDOs), credit-linked notes (CLNs), credit-linked loans (CLLs) and repackaged notes. In addition, AMT advises on cross-border transactions with multi-jurisdictional elements, including conducting research on foreign laws and regulations in collaboration with leading overseas law firms.

Authors

Daisuke Tanimoto has extensive experience in the areas of derivatives, securitisation and structured finance. He is often sought for his advice on derivatives transactions involving ISDA documentation and is well-versed in all aspects of derivatives documentation practice. Clients also look to him for the handling of complex transactions with multi-jurisdictional elements that require close collaboration with leading overseas law firms. Daisuke is also familiar with a wide range of financial regulatory and cross-border legal issues, taking advantage of his work experience at the Financial Services Agency of Japan and at the Financial Markets Law Committee in London.

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Close-Out Netting of OTC Derivative Transactions Referencing Digital Assets Under the Laws of Japan

The growing prevalence of OTC derivative transactions referencing digital assets ("OTC digital asset derivative transactions") has led to extensive discussions about whether and to what extent close-out netting arrangements for such transactions would be valid and enforceable in events of insolvency under Japanese law.

Article 2, Paragraph 14 of the Payment Services Act (Act No 59 of 2009, as amended; the PSA) provides the definition of crypto-assets. However, the legal nature of crypto-assets (such as Bitcoin and Ether) and other digital assets is still a fluid concept under Japanese law. Moreover, every digital asset has its own distinct characteristics. Accordingly, in a discussion of the validity and enforceability of netting arrangements in respect of OTC digital asset derivative transactions, product-by-product analysis is required. It is this context that this article summarises the basic legal framework relating to the validity and enforceability of close-out netting arrangements under Japanese law.

Close-out netting under the Netting Act

Close-out netting arrangements in respect of OTC digital asset derivative transactions would be valid and enforceable if the relevant requirements of the Act on Close-out Netting of Specified Financial Transactions entered into by Financial Institutions, etc. (Act No 108 of 1998, as amended; the "Netting Act") are satisfied.

More specifically, close-out netting will be enforceable under the Netting Act if:

- at least one of the parties is a Financial Institution;
- the parties have entered into Specified Financial Transactions;
- the Specified Financial Transactions are governed by a Master Agreement;
- the Master Agreement contains provisions on Eligible Close-out Netting; and
- one of the parties has become subject to a Japanese insolvency event.

In respect of the above, the concepts of "Financial Institution", "Specified Financial Transactions" and "Master Agreement" are particularly relevant. Accordingly, we now turn to each of these concepts.

Financial Institution

The term "Financial Institution" encompasses the following entities:

- banks;
- Type I Financial Instruments Business Operators (ie, broker-dealers);
- insurance companies;
- federation of co-operative banks (*shinnyo kinko rengou kai*);
- Norinchukin Bank;
- Shoko Chukin Bank;
- Japan Bank for International Cooperation;
- securities financing companies;
- call loan dealers; and
- Commodities Futures Transaction Dealers.

A dealer that engages in the business of OTC derivative transactions referencing crypto-assets as a principal, agent, intermediary or broker is generally required to undergo registration as a Type I Financial Instruments Business Operator under the Financial Instruments and Exchange Act (Act No 25 of 1948, as amended; FIEA). On the other hand, a dealer that engages in the business of trading crypto-assets as a principal, agent, intermediary or broker, providing custody services for customers' fiat currency in connection with such trading, or managing crypto-assets for the benefit of others is generally required to undergo registration as a crypto-asset Exchange Services Provider under the PSA. Type I Financial Instruments Business Operators fall within the scope of Financial Institutions for the purpose of the Netting Act. Crypto-Asset Exchange Services Providers, however, do not constitute Financial Institutions under the Netting Act.

Specified Financial Transactions

The term "Specified Financial Transactions" includes the following transactions:

- (i) OTC Derivative Transactions (as such term is defined under the FIEA);

- (ii) financial derivative transactions under Article 10, Paragraph 2, Item 14 of the Banking Act (Act No 59 of 1981, as amended);
- (iii) conditional sale and purchase of securities;
- (iv) securities lending;
- (v) sale and purchase of securities with options;
- (vi) forward foreign exchange transactions;
- (vii) OTC commodity derivative transactions defined under the Commodity Derivatives Transaction Act (Act No 239 of 1950, as amended); and
- (viii) loans for consumption or deposits for consumption of cash or securities as collateral for the purpose of securing any of the transactions listed in (i) through (vii) above.

It should be noted, with respect to item (i) above, that OTC derivative transactions referencing crypto-assets fall within the scope of OTC Derivative Transactions. This is because crypto-assets fall within the definition of Financial Instruments under the FIEA. In this regard, it is also worth noting that the Financial Services Agency of Japan (FSA) has discretion in designating any given Electronic Payment Instruments (based on its definition in the PSA, Electronic Payment Instruments essentially means stablecoins) as a Financial Instrument, although the FSA has not exercised such discretion to date. In view of the foregoing, it is important to determine whether the digital assets referenced by a specific OTC digital asset derivative transaction constitute crypto-assets under the PSA, for purposes of ascertaining whether the Netting Act applies to such OTC digital asset derivative transaction.

Master Agreement

The term “Master Agreement” is broadly defined in Article 2, Paragraph 5 of the Netting Act as “an agreement intended to govern two or more Specified Financial Transactions to be entered into on a continuing basis between a Financial Institution and a counterparty, stipulating the terms of such transactions and other basic matters relating thereto.”

The master agreement governing two or more other master agreements (ie, the ultimate master agreement) is generally understood as constituting the Master Agreement under the Netting Act.

Although the ISDA Master Agreement is a prime example of such “Master Agreement”, it may be necessary to analyse whether other master agreements tailored for OTC digital asset derivative transactions fall within the definition of the Master Agreement. In certain cases, such tailored master agreements may require revision to ensure that they fall within the ambit of the Netting Act.

Close-out netting under the Bankruptcy Act

An OTC digital asset derivative transaction that does not fall within the ambit of the Netting Act may nevertheless fall within the ambit of close-out netting under Article 58 of the Bankruptcy Act (Act No 75 of 2004, as amended), which provides as follows:

“(1) If an agreement with respect to transaction in instruments having quotations on organized exchanges or other markets may not achieve its objectives unless it is settled at a particular time and date and if the settlement time and date is scheduled after the commencement of bankruptcy proceedings, then the contract is deemed to be terminated upon the commencement of bankruptcy proceedings.

(2) In the case mentioned in paragraph (1) above, the amount of damages arising from termination of the agreement should be the difference between the market quotation prevailing at the relevant place and time and the contract price.

(3) (Omitted)

(4) In relation to matters set forth in paragraphs (1) and (2) above, if the relevant exchange or market provides otherwise, then paragraphs (1) and (2) should be interpreted in accordance with and give effect to such provision of the relevant exchange or market, as applicable.

(5) If a master agreement for repeated transactions of those set forth in paragraph (1) above provides that all such transactions should be settled by netting the amount of damages set forth in paragraph (2) above, then the amount of damages that a party owes to the other should be determined pursuant to that provision.”

With respect to paragraph (1) above, it is necessary to determine whether the digital assets referenced by an OTC digital asset derivative transaction have “quotations on organized exchanges or other markets”. Furthermore, in order to ensure that “the contract is deemed to be terminated upon the commencement of the bankruptcy proceeding”, as is the case with other derivative transactions, it may be advisable to insert an automatic early termination provision in the contract.

Article 58 of the Bankruptcy Act will apply mutatis mutandis to a party with respect to which a civil rehabilitation or corporate reorganisation proceeding is commenced (Article 51 of the Civil Rehabilitation Act (Act No. 225 of 1999, as amended), Article 63 of the Corporate Reorganization Act (Act No 154 of 2002, as amended) and Article 41, Paragraph 3 and Article 206, Paragraph 3 of the Act on Special Measures for the Reorganization Proceedings of Financial Institutions (Act No 95 of 1996, as amended), respectively).

Close-out netting by way of set-off

Even if an OTC digital asset derivative transaction does not fall within the ambit of the Netting Act or Article 58 of the Bankruptcy Act, the non-defaulting party in such a transaction may still be able to exercise its statutory or contractual set-off rights. In this regard, the contractual set-off rights would be enforceable if the requirements of Article 505, Paragraph 1 of the Civil Code (Act No 89 of 1896, as amended), which are set forth as follows, are met:

- all the receivables and payables to be set off are held by parties bound to each other;
- the parties are bound by obligations the nature of which are of the same kind; and
- the obligations of both parties under the agreement are due and payable.

Whether an OTC digital asset derivative transaction meets all of the requirements of Article 505, Paragraph 1 needs to be analysed on a case-by-case basis, and the type and nature of the specific OTC digital asset derivative transactions may be relevant to such analysis.

Conclusion

Although there is currently no standard practice in Japan regarding close-out netting arrangements for OTC digital asset derivative transactions, it is hoped that with the increasing prevalence of such transactions, and the corresponding need to analyse them, standardised practice for such close-out netting will soon emerge.

NIGERIA

Law and Practice

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Contents

G Elias is one of Nigeria's leading business law firms. With more than 70 lawyers, the firm has an international outlook and an outstanding record of carrying out critical, innovative and complex work to the highest standards. Headquartered in Lagos, the financial capital of Nigeria, and with an office in Abuja, the capital city, G Elias is active on the "cutting edge" of Nigerian law and legal practice. The derivatives team of about 17 lawyers (two partners and 15 associates/senior associates) has extensive experience of advising leading global banks such as ICBC Standard Bank, Goldman Sachs, Citi and Barclays on various derivatives (swaps, forwards), repurchase and securities-lending transactions involving Nigerian counterparties. The team advises on an estimated 80% of all major OTC derivatives transactions (and repurchase transactions) in the Nigerian market. G Elias has also authored standard legal opinions (including a netting opinion) for Nigeria for the International Swaps and Derivatives Association (ISDA) and other entities.

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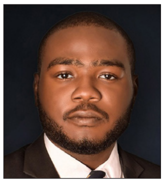

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1. General

1.1 Overview of Derivatives Markets

The Nigerian derivatives market is nascent and not as developed as the derivatives markets of Europe and North America. However, in recent times, the Nigerian market has received attention from leading global banks and mid-sized financial institutions from Europe and Asia. This has led to the structural growth and development of the market, products, regulations, and regulatory infrastructure.

The Nigerian Securities and Exchange Commission (SEC) performs a major role in the regulation of exchange-traded derivatives transactions in the Nigerian financial market. The SEC Rules and Regulations 2013 (as amended) (the "SEC Rules") contain provisions on derivatives transactions, including commodities and futures trading. In 2019, the SEC published the Rules on Regulation of Derivatives Trading (the "Derivatives Trading Rules"). The Derivatives Trading Rules provide for rules to regulate derivatives trading on an exchange, including registration requirements for derivatives contracts and market participants. The Derivative Trading Rules will apply to OTC derivatives trade when specifically mentioned in the relevant derivative contract.

The SEC also introduced the Rules on Regulation of Derivatives and Central Counterparties 2019 (the "CCP Rules") in 2019, which – among other things – outlines the requirements for registration as a central counterparty (CCP).

Most recently, the enactment of the Investments and Securities Act, 2025 ("ISA 2025") has further strengthened the statutory foundation for derivatives regulation in Nigeria. Section 355 of the ISA 2025 empowers the SEC to make rules and regulations specifically directed at derivatives, including matters relating to derivatives markets and business, derivatives exchanges, market infrastructure, business operators, and trade associations. It also authorises the SEC to take measures aimed at preventing unfair derivatives trading practices. This legislative development affirms Nigeria's commitment to deepening its derivatives framework in line with international best practices and is expected to guide the evolution of more comprehensive regulatory interventions by the SEC across both exchange-traded and over-the-counter derivatives products. The ISA 2025 (s. 356 (3)) preserves all prior regulations and orders issued by the SEC prior to its enactment.

The Central Bank of Nigeria (CBN) also plays a major role in the regulation of the Nigerian derivatives market, especially in relation to FX trades. In March 2011, the CBN introduced the Guidelines for FX Derivatives in the Nigerian Financial Markets (the "FX Derivatives Guidelines"), which set out the approved FX derivatives products that can be offered by authorised dealers (ie, banks authorised by the CBN to trade in FX) in the Nigerian financial markets. The CBN also released the Revised Guidelines for the Nigeria Foreign Exchange Market, 2024 ("Revised FX Guidelines"), and Revised Guidelines for the Operation of the Nigerian Interbank Foreign Exchange Market 2016 (the "Interbank FX Market Guidelines"), which provide that – in addition to the approved hedging products provided under the CBN Guidelines for FX Derivatives and Modalities for CBN FX Forwards 2011 (the "FX Derivatives and Modalities for CBN FX Forwards Guidelines") – authorised dealers are permitted to offer naira-settled non-deliverable OTC FX

Futures. The approved hedging products under the FX Derivatives and Modalities for CBN FX Forwards Guidelines are FX options, forwards (outright and non-deliverable), FX swaps, and cross-currency interest rate swaps. The FX Derivatives Guidelines supersede the FX Derivatives and Modalities for CBN FX Forwards Guidelines where there is a conflict between the former and the latter.

Self-regulatory organisations, such as securities exchanges, also play a crucial role in the regulation of the Nigerian derivatives markets. The Nigerian Exchange Limited or NGX (formerly the Nigerian Stock Exchange) and the FMDQ (Financial Market Dealers Quotation) Securities Exchange (FMDQ) both provide platforms for the trading and settlement of derivatives contracts. The NGX, in 2019, introduced its Rulebook on the Derivatives Market (the "NGX Rulebook"). The NGX Rulebook has sundry provisions for the regulation of derivatives trading and settlement on the NGX trading platform. FMDQ introduced similar rules for the trading of derivatives on its platform in 2021. Both the NGX Rulebook and FMDQ's Derivative Market Rules were approved by the SEC. Amendments to FMDQ's Derivates Market Rules were approved by the SEC on 7 May 2024.

Similar to securities exchanges, commodity exchanges in Nigeria (such as the Nigeria Commodity Exchange and Africa Exchange (AFEX)) also have rules that regulate the trading and settlement of commodities derivatives on their respective platforms.

Notably, legislation enacted by the National Assembly (Nigeria's federal Parliament) contains provisions that feature frequently in derivatives transactions and directly impact the trading and settlement of derivatives. For example, the Companies and Allied Matters Act 2020 (as amended) (CAMA) and the Banks and Other Financial Institutions Act 2020 (BOFIA) both contain provisions on netting of payments, which directly affect how derivatives transactions involving Nigerian counterparties are settled.

1.2 Historical Trends and Looking Forwards

Although Nigeria exports crude oil, it is a net importer of food, machinery, goods and services. Considerable FX is required to satisfy these needs. In recent times, low crude oil production output and falling FX revenues from crude oil exports created a volatile FX market. This state of affairs necessitated the development of derivatives markets and products for financial institutions and other corporates to hedge foreign exchange risks and improve access to FX. The uncertainty regarding the enforceability or otherwise in Nigeria of netting provisions in derivatives contracts led to the enactment of netting provisions in both CAMA and BOFIA in 2020. Per FMDQ's financial markets monthly report for May 2025, the total turnover in the FX derivatives segment of FMDQ was NGN2.85 trillion (approximately USD1.8 billion), representing a 12% increase from June 2024.

One of the most significant catalysts for the development of the Nigerian derivatives market in recent times was the floating of the Nigerian naira by the CBN in June 2023 and the consequent meteoric rise of the exchange rate between the Nigerian naira and other major currencies. This resulted in substantial FX losses for many companies with FX obligations. In response, these companies increasingly turned to derivatives contracts (primarily FX forwards and swaps) as a means of hedging against the volatility of FX rates.

There has been a marked increase in the use of FX forwards contracts and currency swaps by Nigerian companies. These instruments allow businesses to lock in exchange (and interest) rates for future transactions, thereby mitigating the risk associated with fluctuating FX rates.

Although the exchange rate of the Naira to major currencies appears to have achieved some level of stability, the upward trend in the use of derivatives in Nigeria is expected to continue, given the Naira's track record of volatility and the need to manage FX risk more effectively in the changing economic environment. As companies increasingly recognise the benefits of these financial instruments, the derivatives market is likely to expand both in size and sophistication.

Moreover, regulatory support and market infrastructure improvements will play a crucial role in fostering this development. The increased activity in the Nigerian derivatives market is expected to lead to a corresponding development of regulatory frameworks and structures. The increased focus on derivatives regulation in the ISA 2025 is a strong indication of the regulatory commitment to deepening and formalising the derivatives ecosystem in Nigeria.

2. Types of Derivatives

2.1 Futures and Options

As mentioned in **1.1 Overview of Derivatives Markets**, the Nigerian derivatives market is still in its nascent years. This is reflected in the limited derivatives product offerings available in the Nigerian market. With regard to futures, the major securities exchanges in Nigeria – the NGX and FMDQ – have different offerings. The NGX currently has four offerings of cash-settled index futures, which track the NGX 30 Index (a capitalisation-weighted index that tracks the performance of the 30 largest and most liquid companies listed on the NGX) and the NGX Pension Index. For its part, FMDQ offers federal government of Nigeria (FGN) bond futures and naira-settled exchange-traded FX futures, which primarily track the exchange rate of the US dollar to the Nigerian naira.

The various commodity exchanges (the Nigeria Commodity Exchange, AFEX, and the Lagos Commodities and Futures Exchange (LCFE)) are also set up to offer standardised futures contracts that track the prices of particular commodities such as crude oil, paddy rice, and wheat.

There are currently no options on futures being traded on any of the exchanges.

The Nigerian derivatives market is yet to see the emergence of unconventional or innovative futures products such as cryptocurrency futures. However, the ISA 2025 already anticipates this and has put in place a framework for the regulation of virtual and digital assets and any related services. Given the upward trend in the use of derivatives, it is very much possible that in the medium to long term, Nigeria will see the development of a robust market infrastructure for derivatives and increased and expanded participation of stakeholders. This will create the requisite conditions for the emergence of innovative derivatives products, including diverse futures products.

2.2 Swaps and Security-Based Swaps

In Nigeria, swaps are traded OTC – that is, directly between the contracting parties rather than on a centralised exchange such as the NGX or FMDQ. Parties will usually agree on the terms of the swap and will document those terms under a standard International Swaps and Derivatives Association (ISDA) Master Agreement, making the necessary changes in the schedule to the ISDA Master Agreement and entering into Confirmations for specific transaction terms, as needed.

Swap transactions in Nigeria are primarily interest rate swaps and currency swaps (including cross-currency interest rate swaps). No law prohibits the trading of other types of swap transactions (including commodity swaps). Although there is no streamlined framework for the regulation of swaps in Nigeria, swap transactions that involve a Nigerian counterparty are governed in more than one respect by Nigerian statutes and regulations. CAMA and BOFIA, for example, have extensive provisions on netting of payments under a qualified financial contract (such as a swap) to which a Nigerian company (and, in the case of the BOFIA, bank or financial institution) is a party. CAMA also contains general provisions on the ways in which a company can validly take corporate actions, including the due execution of transaction documents.

Importantly, the Derivatives Trading Rules (paragraph 15) requires all participants (dealing members or entities performing clearing services) and other registered capital market operators to report all OTC derivatives transactions to a trade repository or an exchange (as the case may be) in accordance with guidelines to be issued by the SEC from time to time. The report must contain:

- the entry into of an agreement or contract for the sale or purchase of a derivatives contract or product, however concluded by the parties and however described;
- a change in the beneficial ownership of derivatives contracts between parties, one of whom is a participant;

- the modification, assignment or termination of an agreement or contract for the sale or purchase of a derivatives contract or product, however described; and
- the legal entity identifier code (a 20-character, alpha-numeric code issued by accredited issuing organisations that are duly endorsed by the Global Legal Entity Identifier Foundation).

Further, in the case of a currency swap involving a Nigerian counterparty, the parties must adhere to the Foreign Exchange (Monitoring and Miscellaneous Provisions) Act 1995 (FEMMPA) and the CBN Foreign Exchange Manual 2018 (the “Forex Manual”). The FEMMPA and the Forex Manual contain extensive provisions regulating dealings in FX in the Nigerian FX market. Specifically, the FEMMPA and Forex Manual provide that where a person imports foreign currency into Nigeria that is intended to be converted into naira, such person must obtain an electronic certificate of capital importation (eCCI). An eCCI is a dematerialised certificate issued by an authorised dealer to a person who imports foreign capital into Nigeria, where such foreign capital is converted into naira. The purpose of an eCCI is to guarantee the holder of the eCCI unrestricted transferability of funds through an authorised dealer in freely convertible currency.

2.3 Forwards

Additional requirements may apply where an exchange such as FMDQ Clear is engaged as a CCP for the forward transaction or where the forward contract is standardised and traded on the exchange. The Derivatives Trading Rules provide that all standardised OTC derivatives contracts shall be traded on an exchange and further state that the SEC must issue guidelines on standardised OTC derivatives contracts from time to time (paragraph 6 (2)(3)). By way of example, FMDQ has a set of rules that apply to cleared naira-settled non-deliverable forwards, including the requirement of adequate eCCIs for the transaction and contingent eCCIs to deal with any contingent FX risks.

Also, as noted in **1.1 Overview of Derivatives Markets**, the Interbank FX Market Guidelines permit authorised dealers to offer naira-settled non-deliverable OTC FX futures. This is also provided for under the FX Derivatives and Modalities for CBN FX Forwards Guidelines and the FX Derivatives Guidelines, which both provide that the maximum tenor allowed for FX forwards (and by implication FX swaps and cross-currency interest rate swaps) is five years but authorised dealers may seek specific approval for longer tenors. Naira-settled non-deliverable forwards (OTC FX futures) are traded on FMDQ. Naira-settled non-deliverable FX forwards have been used as tools to hedge against the volatility in the exchange rate of the naira with other major currencies.

2.4 Listed v Over-the-Counter

In Nigeria, there are different requirements for exchange-traded derivatives and OTC derivatives. The requirements for exchange-traded derivatives are primarily set out in the Derivatives Trading Rules and the respective derivatives rules introduced by various exchanges such as the NGX and FMDQ. The Derivatives Trading Rules (paragraph 3 (1)) provide that the approval of the SEC must be sought and obtained prior to the introduction of any exchange-traded derivatives contract. All exchange-traded derivatives contracts are required to be registered with the SEC. An application for registration of a contract must be filed with the SEC by or on behalf of an exchange, along with the relevant SEC form and an information memorandum detailing the specifications of the contract.

The Derivatives Trading Rules provide that exchange-traded derivatives can only be traded on exchanges registered or recognised by the SEC. These exchanges are required to develop rules for the derivatives market such as the NGX’s Rulebook and FMDQ’s Derivatives Market Rules. Furthermore, the Derivatives Trading Rules require that all exchange-traded derivatives contracts must be cleared by a CCP registered or recognised by the SEC. The rules also contain requirements for market participants and provisions on position limits to prevent participants and clients from holding positions large enough to control and/or manipulate the underlying asset.

In Nigeria, there is no robust legal framework regulating OTC derivatives contracts. The OTC derivatives contracts are usually governed by the terms of the contracts themselves. However, as earlier stated, the Derivatives Trading Rules require standardised OTC derivatives contracts to be traded on an exchange.

As mentioned in **2.2 Swaps and Security-Based Swaps**, the Derivatives Trading Rules (paragraph 15) also require all participants (dealing members or entities performing clearing services) and other registered capital market operators to report all OTC derivatives transactions to a trade repository or an exchange (as the case may be) in accordance with guidelines to be issued by the SEC from time to time.

Additional requirements may apply where an exchange such as FMDQ is engaged as a CCP for the OTC derivatives contract or where the OTC contract is standardised and traded on the exchange.

2.5 Asset Classes

The most common assets that underlie derivatives products in Nigeria are securities (primarily stocks, government bonds, treasury bills and open market operation (OMO) bills), currency exchange rate, interest rates, and commodities (such as paddy rice, crude oil, wheat, cotton and maize). Notably, the FX Derivatives Guidelines recognise FX options, forwards (outright and non-deliverable), FX swaps and cross-currency interest rate swaps as approved hedging products for authorised dealers.

There are no outright restrictions on asset classes on which derivatives products can be based. In principle, parties to an OTC derivatives contract can base the derivatives product on any asset class and the contract will be valid. This is because Nigerian law and courts will enforce an agreement voluntarily entered into by parties, subject to unlawfulness, public policy considerations or other vitiating concerns. As regards exchange-traded derivatives, however, even though there is no outright prohibition or restriction on any asset class, the SEC reserves the right to approve every exchange-traded derivatives contract before that contract is introduced on an exchange. As a result, the SEC can exercise this discretion in favour of or against the approval of a derivatives product based on a particular asset class. The ISA 2025 now mandates the SEC to register derivative products and regulate the derivatives market.

As mentioned in **1.1 Overview of Derivatives Markets**, the Nigerian derivatives market is still nascent. Unconventional or innovative futures products such as cryptocurrency futures have not yet been introduced into the market even though the existing legal framework contemplates such innovative products. The asset classes underlying derivatives products in the Nigerian market are fairly conventional.

In terms of liquidity, the limited offerings in the Nigerian derivatives markets make it difficult to properly estimate liquidity across all asset classes. However, most liquidity can be seen in the currency asset class, with the recent rise in the use of currency swaps and FX forwards by Nigerian companies to hedge against the falling value of the naira. As referenced earlier, the FMDQ reported a total turnover in its FX derivatives segment of about NGN2.85 trillion (approximately USD1.8 billion) in May 2025.

2.6 Exemptions, Non-Derivative Products and Spot Transactions

There are no derivatives products that are exempt from regulation in Nigeria. The ISA 2025 gives the SEC power to regulate the Nigerian derivatives market. As mentioned in **2.2 Swaps and Security-Based Swaps**, while the regulatory framework for OTC derivatives products is not as robust as that for exchange-traded derivatives, the Derivatives Trading Rules still require that standardised OTC derivatives contracts be traded on an exchange and require market participants to report all OTC derivatives transactions to a trade repository or an exchange (as the case may be) in accordance with guidelines to be issued by the SEC from time to time. There are more extensive regulations applicable to exchange-traded derivatives contracts, including a requirement that every such contract must be approved by the SEC.

Spot commodities transactions are regulated in accordance with the regulations put in place by the relevant exchange or self-regulatory organisation that acts as a CCP in such transactions – for example, the Nigeria Commodity Exchange, AFEX, or LCFE. Such regulations are made in accordance with applicable laws regulating commodities trading, which are generally non-discriminatory with regard to spot commodities trading.

FX trading in Nigeria is regulated by the FEMMPA, the Forex Manual and the Revised FX Guidelines. The

FEMMPA establishes an autonomous FX market and provides for the appointment of authorised dealers. With the CBN's abolition of exchange rate segmentation and the re-introduction of the "willing buyer–willing seller" model in June 2023, transactions in the FX market are completed with the rate mutually agreed between the purchaser and the authorised dealer concerned.

For its part, the Revised FX Guidelines recognise the Electronic Foreign Exchange Matching System (EFEMS) introduced by the CBN in October 2024 and mandate that all interbank FX transactions are to be completed on the EFEMS. The Revised FX Guidelines further provide that the pricing of foreign exchange transactions shall be undertaken on the EFEMS. All foreign exchange transactions completed by authorised dealers must be recorded by the dealers on a processing system and reported to the CBN within ten minutes of the transaction.

Except for those that may be imposed by the respective commodities exchanges, there are no unique rules applicable to leveraged retail spot commodities transactions. However, the Derivatives Trading Rules (paragraph 10) require the exchange to liaise with the CCP to determine the applicable leverage relevant to each type of derivatives contract and the same should be disclosed to the SEC within 24 hours.

3. Regulation of Derivatives

3.1 National

3.1.1 National Regulators

As stated in **1.1 Overview of Derivatives Markets**, the primary federal government agencies involved in the regulation of derivatives transactions and the derivatives market are the SEC and the CBN. These national agencies regulate derivatives transactions by providing rules and regulations on general requirements, reporting requirements and membership requirements, among other things.

The SEC has the legislative mandate under the ISA 2025 to register derivatives and regulate the derivatives markets. The SEC is authorised to issue regulations concerning derivatives, derivatives markets or business, derivatives exchanges, derivatives market infrastructure, derivatives business operators, trade association of derivatives business operators, and preventing unfair derivatives trading practices. In practice, the SEC's regulatory focus is on exchange-traded derivatives contracts. The SEC prescribes rules and guidelines to regulate dealings in such exchange-traded derivatives contracts (even though some reporting requirements exist for OTC contracts). The CBN, on the other hand, particularly regulates dealings in derivatives contracts by financial institutions, which, when entered into by these financial institutions in their capacity as principal are typically OTC derivatives contracts. The statutory and regulatory jurisdictions of these primary regulators are clear-cut, except where the derivatives transaction involves financial institutions and exchange-traded derivatives contracts. In circumstances where both regulators have jurisdiction over derivatives market participants, the stipulated guidelines issued by both regulators will – to the extent applicable – regulate such transaction.

3.1.2 Clearing

The Derivatives Trading Rules (paragraph 6) provide that all standardised OTC derivatives contracts must be traded on an exchange and all exchange-traded derivatives contracts must be cleared by a CCP registered with the SEC.

The CCP Rules further provide a detailed framework for the clearing of standardised and exchange-traded derivatives, including comprehensive risk management, collateral requirements and margin requirements, among other things. Derivatives traded on exchanges are generally centrally cleared and the clearing and settlement arms of the exchange (eg, FMDQ Clear and NG Clearing) act as CCPs for derivatives traded on its platforms. As a result, clearing requirements are particular to exchange-traded derivative contracts (including standardised OTC derivatives contracts).

3.1.3 Mandatory Trading

The Derivatives Trading Rules require that all standardised OTC derivatives contracts be traded on an exchange. The Derivatives Trading Rules make no exceptions in this regard.

3.1.4 Position Limits

The Derivatives Trading Rules (paragraph 9) mandate all exchanges to set position limits in order to prevent participants and clients from holding positions large enough to control and/or manipulate the underlying asset. Exchanges are also required to set stringent position limits on participants and clients related to issuers whose securities represent the underlying asset or determine the price of the underlying asset. Additionally, exchanges are required to notify the SEC of prescribed position limits - as well as methodologies and rationale used for determining the limits - and are to monitor compliance with position limits and sanction any defaulting participants. Where a participant or client owns up to 5% or more of total open interest in a particular contract, the exchange is mandated to report such participant or client to the SEC.

Further, the FX Derivatives Guidelines (paragraph 3.0) provide that the CBN's financial policy and regulation and banking supervision departments will develop detailed prudential guidelines that will include - among other things – spot-hedge position limits in the absence of a developed interbank options market. Also, the CBN Prudential Guidelines for Deposit Money Banks 2010 (paragraph 3.18) (and a later 2019 exposure draft of revised guidelines) provide that all banks must comply with FX trading position limits as advised by the CBN from time to time. This requirement is reiterated in the Revised FX Guidelines (paragraph 5.0 (e)).

3.1.5 Reporting

First, all exchange-traded derivatives contracts must be pre-approved by the SEC. Additionally, every exchange has reporting obligations to the SEC. Also, participants in the derivatives market (that is, every dealing member and clearing member) are required to disclose their outstanding derivatives exposures to the SEC on a quarterly basis (paragraph 11 of the Derivatives Trading Rules), including such matters as the estimated maximum loss that could be incurred from proprietary outstanding positions and its effect on the financial position of the participant. There are also reporting obligations required to be made by participants in their financial statements as well as disclosures to their clients.

However, as mentioned in **2.2 Swaps and Security-Based Swaps**, with regard to OTC derivatives, the Derivatives Trading Rules (paragraph 15) require all participants (dealing members or entities performing clearing services) and other registered capital market operators to report all OTC derivatives transactions to a trade repository or an exchange (as the case may be) in accordance with guidelines to be issued by the SEC from time to time. The report shall contain – among other things - details of the entry into of an agreement or contract for the sale or purchase of a derivatives contract or product, however concluded by the parties and however described.

There are also reporting obligations imposed on financial institutions by the CBN. For example, the CBN Guidelines on Liquidity Monitoring Tools 2021 - one of the six guidelines the CBN issued in its adoption of Basel III - provide that reporting banks should include in their reports information on possible cash flows arising from derivatives such as interest rate swaps and options to the extent that their contractual maturities are relevant to the understanding of the cash flow (paragraph 3 (9)). Also, the CBN Guidelines on Leverage Ratio 2021 (another of such guidelines) provide that the total exposure measure for the leverage ratio shall be computed as the sum of on-balance sheet exposures, derivatives exposures, securities financing transactions exposures and off-balance sheet exposures (paragraph 10).

Furthermore, the Revised FX Guidelines provide that all foreign exchange transactions completed by authorised dealers must be recorded by the dealers on a processing system and reported to the CBN within ten minutes of the transaction.

3.1.6 Business Conduct

In addition to the reporting obligations of the participants in the Nigerian derivatives market, the Derivatives Trading Rules (paragraph 12) require participants to have risk management units within their organisations, include a risk management report in their annual financial statements, and have comprehensive risk management frameworks and investment policies for managing derivatives-related risks. The framework must include, at a minimum:

- the officer responsible for co-ordinating risk function;
- reporting line;
- risk appetite and risk tolerance for all classes of risks;
- risk register; and
- roles and responsibilities of all staff (including board members) with regard to risk management.

Accompanying sanctions are also provided where a participant defaults in complying with any of these requirements.

Also, the SEC Rules (rule 259) mandate that every exchange must have a code of conduct - approved by the SEC - for its staff and members. The SEC Rules also mandate separation of client funds by traders and record maintenance requirements for market operators and self-regulatory bodies.

The derivatives trading rules of the respective exchanges also impose business conduct requirements on the participants trading on those exchanges, including such obligations as to management of accounts and client funds and client trade and allocation. Accompanying sanctions for default are also stipulated.

In addition to all of the foregoing, all companies in Nigeria are subject to generally applicable AML laws and the Nigerian Code of Corporate Governance 2018. Companies that operate in specific sectors, such as banks, are additionally subject to sector-specific business conduct requirements imposed by their regulators.

3.1.7 Commercial End Users

Commercial end users encounter distinct challenges when utilising derivatives for risk management. Such problems include the relative novelty and complexity of derivative instruments, counterparty risk - especially where there is no CCP - and regulatory compliance burdens. Notably, entities can (and usually do) engage registered trading members (usually a bank) to enter into derivatives transactions on their behalf. Although this reduces some of the risks of trading as a commercial end user (such as complexity of documentation and perhaps counterparty risk), it imposes new obligations on such entity in the form of agency fees due to the trading member.

Even though commercial end users in Nigeria that utilise OTC derivatives are exempted from some of the reporting and registration requirements that apply to dealing members and clearing members, some other requirements (such as the requirement for eCCIs) will apply to commercial end users in the same way as they would apply to a registered trading member.

The limited domestic market liquidity and narrow product range further constrain the ability of commercial end users to access effective hedging solutions. Many commercial users rely on cross-border transactions to manage exposures, particularly in relation to foreign currency, interest rates, and commodity prices. However, these transactions are often subject to foreign exchange controls and capital importation documentation requirements imposed by the CBN, which can potentially delay execution and settlement. As the market continues to evolve, improving product diversity, market depth, and legal certainty will be critical to promoting efficiency and encouraging commercial end users to actually participate in Nigeria's derivatives ecosystem.

3.2 Local

In Nigeria, derivatives are regulated only at the national level under the framework and by the regulators highlighted in **1.1 Overview of Derivatives Markets** and **3.1.1 National Regulators**. There is no framework for regulating derivatives transactions at the state or local level.

3.3 Self-Regulatory Organisations, Independent Authorities, and Exchanges

Some self-regulatory organisations or entities that operate in Nigeria are:

- FMDQ;
- NGX;
- Nigeria Commodity Exchange (NCX);
- AFEX; and
- LCFE.

These self-regulatory organisations are important stakeholders in the Nigerian financial markets and are generally licensed and regulated at the national level by the SEC.

4. Documentation Issues

4.1 Trading Documentation

4.1.1 Industry Standards and Master Agreements

In Nigeria, the documentation of derivatives transactions typically follows international standards, with significant influence from globally recognised frameworks. The most widely used documentation for derivatives transactions in Nigeria (especially OTC contracts), as in many other jurisdictions, is the ISDA Master Agreement. This is particularly the case where a foreign counterparty is involved. This framework is favoured for its comprehensive and standardised approach, providing legal certainty and operational efficiency.

The ISDA Master Agreement - along with the schedule thereto, the Confirmations and (where applicable) the Credit Support Annexes - constitutes the suite of documents under which most cross-border derivatives transactions involving a Nigerian counterparty are documented. FX spot and forward contracts are also documented under the Nigerian Master FX Agreement and relevant confirmations. Parties may also execute Long-Form Confirmations where they have not executed a formal ISDA Master Agreement.

Parties to OTC derivatives contracts can exercise discretion with regard to documentation of the contracts. However, master confirmation agreements are not used very often in the Nigerian derivatives market. Parties would usually opt to document all the terms of each individual transaction separately in distinct confirmations.

4.1.2 Margins

Generally, the exchange of variation margin in respect of exchange-traded derivatives is completed in accordance with the rules of the relevant exchange. For OTC derivatives transactions, however, the documentation of arrangements for the exchange of variation margin involving a Nigerian counterparty is primarily handled through the ISDA framework - in particular, by utilising the ISDA 2016 Credit Support Annex for Variation Margin (CSA VM). The Derivatives Trading Rules (Rule 13 (1)(b)) require CCPs to pay to or receive from participants and clients, variation margins for gains or losses resulting from mark to market of positions.

There has been no change in the documentation of the exchange of variation margins, especially as the Nigerian derivatives market is a developing one.

The authors are not in scope for initial margin under regulatory initial margin requirements. With regard to the authors' clients who are participants in the Nigerian derivatives market, the Derivatives Trading Rules (Rule 13 (1)(a)) mandate that a CCP shall receive and maintain initial margin from participants before accepting to clear contracts from them. This places the participants in scope for initial margin where an SEC-regulated CCP is involved in the transaction.

4.1.3 Other Agreements

Other trading agreements used in the Nigerian financial markets include:

- the Global Master Repurchase Agreement (GMRA) (1995, 2000, and 2011) and the various annexes and confirmation;
- the Global Master Securities Lending Agreement (GMSLA) (2000, 2009, 2010, and 2018); and
- the Nigerian Master Repurchase Agreement.

4.2 Clearing Documentation

Clearing brokers in Nigeria rely on a range of documentation to facilitate their clearing activities, which may vary depending on the type of cleared derivative and the specific requirements of counterparties and the clearing house. Common types of documentation include clearing agreements, the foundational derivatives contract (whether the ISDA Master Agreements, the Nigerian FX Master Agreement, or some other agreement), clearing house documentation outlining rules and procedures, customer account documentation for KYC compliance, and product-specific documentation tailored to the type of cleared derivative.

Issues of greatest concern to clearing brokers and their customers when negotiating clearing documentation typically revolve around margin requirements, netting, default procedures, operational efficiency, legal and regulatory compliance, and risk management. Negotiations often focus on determining acceptable margin calculation methodologies, streamlining confirmation processes, ensuring compliance with applicable laws and regulations, and addressing risk mitigation strategies.

4.3 Opinions and Other Documentation Issues

In Nigeria, there is generally no statutory or regulatory requirement that a legal opinion be provided in respect of trading agreements. However, it is usual for parties to a trading agreement to request legal opinions on trading agreements and the transactions entered into under these agreements. As a result, clients most often require opinions to be provided when they enter into swap or forward transactions documented under the ISDA Master Agreement and its relevant annexes. Clients also require opinions when entering into repurchase agreements under GMRAs or a securities lending transaction under the GMSLA, as well as other transactions documented under other trading agreements.

These legal opinions usually address a broad range of matters ranging from the validity of the agreements (which involve Nigerian counterparties) under the laws of Nigeria to the enforceability of collateral or security arrangements under these trading contracts. Opinions are also provided on specific questions asked by clients, including questions concerning recharacterisation risks and counterparties' netting of payment obligations.

5. Enforcement Trends

5.1 Regulator Priorities and Enforcement Trends

During the past year, there have been no notable enforcement activities and trends in Nigeria's derivatives market. This might be because the market is still in the early stage of its development and there is close co-operation between the participants, the exchanges and the regulators to ensure that the market operates in a transparent, efficient and orderly manner.

That is not to say that there have been no infractions committed by participants - only that such infractions are either not particularly significant or the details thereof are not publicly available. It is worth noting, however, that exchanges in Nigeria such as FMDQ closely monitor trades on their platforms to ensure compliance with their trading rules and consequently assume enforcement roles where applicable.

The SEC exercises significant discretion in determining the areas of priority for examination and surveillance in the financial market. The SEC may choose to outline its examination priorities or make its observations on surveillance and compliance issues public, but it has no obligation to do so.

SPAIN

Law and Practice

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Contents

Cases & Lacambra is a client-focused international law firm with a cornerstone financial services practice consisting of six partners, one of counsel, two senior associates and six associates. Key practice areas are banking and finance, capital markets, derivatives and structured finance. The firm's corporate and banking and finance group has extensive experience in all types of bilateral, syndicated, national and cross-border financing and debt-restructuring transactions, including structured finance and corporate and acquisition finance, as well as project finance (real estate, energy and infrastructure) along with the structuring of scheme guarantees. With a presence in Europe and America, the firm has a significant track record in complex transactions involving the financial sector, special situations, financial markets regulation and cross-border disputes, particularly in sensitive tax transactions. Cases & Lacambra offers expert legal advice, reconciling the concerns of all the parties involved and providing solutions that enable the execution of solid transactions for the benefit of clients on both sides of the table.

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CASES & LACAMBRA

1. General

1.1 Overview of Derivatives Markets

All financial derivatives are characterised as financial instruments under Section 4.1.15 of Directive 2014/65/EU on markets in financial instruments, as amended by Directive (EU) 2024/790 of 28 February 2024 (MiFID III). Consequently, these products are subject to securities legislation, the main components of which in Spain are as follows.

- The Spanish Securities Market and Investment Services Act 6/2023 (SMA): As the cornerstone of the regulatory regime, the SMA should fully transpose MiFID III not later than 29 September 2025. The SMA is of paramount importance in relation to derivatives trade, investment firms' roles and administrative sanctions.
- Regulation (EU) 600/2014 on markets in financial instruments, as amended by Regulation (EU) 2024/791 of 28 February 2024 (MiFIR II).
- Regulation (EU) 648/2012 on OTC derivatives, central counterparties and trade repositories (EMIR). EMIR's scope is limited to OTC derivatives and is directed towards creating robust market structures, such as central counterparties (CCPs), margin practices (ie, initial and variation margin), timely confirmation, conciliation and compression of portfolios, and transactions reporting to trade repositories. On 4 December 2024 the EU's Official Gazette published Regulation (EU) 2024/2987 of the European Parliament and of the Council of 27 November 2024 (EMIR 3) amending the EMIR and other European regulations related to measures for the mitigation of excessive exposure to third-country central counterparties (CCPs) and improve the efficiency of Union clearing markets. In general, EMIR 3 entered into force on 24 December 2024.
- Royal Decree-Law (RDL) 5/2005 (RDL 5/2005), which transposes into Spanish Law Directive 2002/47/EC on financial collateral arrangements and regulates close-out netting in Spain.

1.2 Historical Trends and Looking Forwards

The key recent legal developments in this field are as follows.

- The enactment of the SMA, which is of special interest in respect of transactions with crypto-assets as the underlying assets.
- The transposition into Spanish Law of Directive (EU) 2019/1023 by means of the enactment of Act 16/2022, which amended Spanish insolvency legislation by adding a new restructuring process and entered into force on 1 January 2023. Unfortunately, this piece of legislation did not broaden the list of qualified entities covered by the Spanish close-out netting regime, as allowed by the directive. The inclusion of commodity brokers in such list would have been a positive step due to the increasing market activity and the key role brokers play in managing the related market risks, but the decision was left to the member states. However, Act 16/2022 empowered Spanish commercial judges to order the early resolution of derivative transactions in restructuring proceedings, as well as in insolvency proceedings.
- The enactment of MiFID III and MiFIR II.
- The enactment of EMIR 3 by the European Parliament in November 2024.
- The enactment of Regulation (EU) 2025/914 of the European Parliament and of the Council of 7 May 2025, amending Regulation (EU) 2016/1011 in respect of the scope of the rules for benchmarks, the use in the EU of benchmarks provided by an administrator located in a third country and certain reporting requirements. This Regulation shall apply from 1 January 2026.
- The enactment of Directive (EU) 2024/2811 of the European Parliament and of the Council of 23 October 2024 amending Directive 2014/65/EU to make public capital markets in the Union more attractive for companies and to facilitate access to capital for small and medium-sized enterprises and repealing Directive 2001/34/EC.

In the authors' opinion, the main drivers of the market in the near future will be:

- the transposition and implementation of the new set of EU legislation mentioned above;
- the trading of derivatives over crypto-assets and derivatives with ESG features, spurred by the entry into force of Regulation (EU) 2023/1114 (MICA) and

the implementation of EU climate-related legislation;
- the implementation of Regulation (EU) 2022/2554 of the European Parliament and of the Council of 14 December 2022, on digital operational resilience for the financial sector and amending Regulations (EC) No 1060/2009, (EU) No 648/2012, (EU) No 600/2014, (EU) No 909/2014 and (EU) 2016/1011 (DORA), which applies from 17 January 2025; and
- digitalisation and artificial intelligence.

2. Types of Derivatives

2.1 Futures and Options

Spanish Stock Exchanges and Markets (*Bolsas y Mercados Españoles* (BME)) operates the only official Spanish market specialised in derivatives: *Mercado de Derivados* (MEFF). Although an OTC segment exists, the bulk of MEFF's activities are focused on futures, options and swaps traded on a trading venue. The current products and their underlying assets are as follows:

- futures and options (European style) over the IBEX35 index;
- futures (settled by differences or physically) and options (American and European style) over Spanish shares;
- futures over dividend benchmarks and single-share dividends;
- rollovers of equity futures;
- rollovers of foreign exchange (FX) futures; and
- swaps and futures over the Iberian Electricity Market (MIBEL).

MEFF has recently improved the functionalities available to retail investors. In this vein, it is worth mentioning that such investors can directly hold segregated derivatives accounts, and all retail investors' transactions are now marked with the so-called red flag to fully comply with all regulations applicable to retail investors, especially those related to pricing. In addition to these improvements, MEFF is adding new underlying shares after each relevant IPO in Spain.

In respect of OTC options, major banks regularly offer a broad range of FX options to their clients, including retail clients, actively engaged in cross-border activities. The huge interest in these products is normally a consequence of the high volatility in FX markets, although these hedging structures can be extremely costly in practice. OTC options over underlying assets other than exchange rates are generally negotiated on a case-by-case basis and as part of structured investments.

2.2 Swaps and Security-Based Swaps

Before the emergence of specialised trading venues, these instruments were exclusively closed by banks voluntarily acting as market makers vis-à-vis end users. Two Spanish banks (BBVA and Santander) that – on an organised, frequent, systematic and substantial basis – dealt on their own account by executing OTC derivative client orders outside a regulated market (RM), multilateral trade facility (MTF) or organised trade facility (OTF), became systematic internalisers (SIs) after meeting the applicable quantitative criteria under MiFID II. Although the current situation may change in the near future since SI status is no longer mandatory in respect of derivatives under MiFID III, at present it is very common that large end users, even non-financial counterparties (NFCs), close OTC derivatives on OTFs, since such trading venues act as online price aggregators and improve transparency.

The most relevant regulatory developments in interbank derivatives transactions are outlined in this chapter of the guide. These developments aim to enhance market resiliency and pricing transparency. In terms of transparency, the entire regulatory development has been influenced by the absence of collusive practices; however, no specific transparency standards have been established in this respect. Recent Spanish case law has focused on alleged collusion in the project finance lending market among the four largest Spanish banks, which were investigated and sanctioned by the Spanish National Markets and Competition Commission (*Comisión Nacional de los Mercados y la Competencia* (CNMC)). However, this sanction was ultimately dismissed by the National High Court since the CNMC was unable to prove the existence of collusion among banks to mislead their clients on swap pricing.

2.3 Forwards

There is no specific regulation on forwards other than the exceptions mentioned in **2.6 Exemptions, Non-Derivative Products and Spot Transactions**.

2.4 Listed v Over-the-Counter

The key difference between derivatives that trade on the counter versus OTC is the fact that OTC derivatives, although generally documented on the basis of standard models, are bespoke, tailor-made products as opposed to the derivatives traded on futures and options markets, which have fully standardised terms and conditions. Since there is no room left for negotiation in relation to these derivatives, they can be listed as negotiable securities.

It is worth noting that trading on a trading venue is one of the criteria used to characterise products as derivatives, especially when the contract can – or has been – physically settled, as mentioned in **2.6 Exemptions, Non-Derivative Products and Spot Transactions**. Moreover, the National Securities Market Commission (C *omisión Nacional del Mercado de Valores* (CNMV)) considers some securities (ie, warrants with embedded options) as derivatives.

2.5 Asset Classes

According to the 2023 European Securities and Markets Authority (ESMA) Market Report on EU Derivatives Markets, based on the data provided by the trade repositories regulated by EMIR, the most common derivative products in the EU are those related to the following:

- interest rates (78%);
- exchange rates (14%);
- equity (5%);
- credit (4%); and
- commodities (1%).

In its 2024 Activity Report, the CNMV summarises the number of transactions and the related notional amounts of derivatives traded on Spanish trading venues. The gross notional amount of derivatives traded on MEFF experienced a sharp decline (5.3%), although this negative trend was smaller than for Spanish equity product-related segments (6%); these comprise the bulk of MEFF's business, which is mainly concentrated on the trading of two shares (Santander and Telefónica, accounting for up to 97% of the whole segment). The growth in the number of contracts for different types of futures (particularly dividends) partially offset the decline in the volume of stock options contracts (down 14.1%), which were more affected by competition. Likewise, trading in both futures and stock options remained concentrated in a very small number of underlying assets (Iberdrola, Banco Santander, Telefónica, Repsol and BBVA).

The number of derivative transactions contracted in OTFs continued to increase in 2024, although this increase was not accompanied by a higher amount of cash traded. Thus, the number of transactions traded grew by 27.1%, but their cash value fell by 7.2%, mainly due to the decline in cash contracted in currency derivatives (down 25%).

There are no limits on asset classes beyond the position limits for commodity derivatives pursuant to Article 57 of MiFID III. Notwithstanding the foregoing, the CNMV restricted the distribution of contracts for difference (CFDs) with high leverage ratios, setting limits on the provision of initial margin (higher than one-thirtieth for major currency pairs, one-twentieth for all other currency pairs, gold and relevant stock benchmarks, one-tenth for commodities and non-relevant stock benchmarks, one-half for crypto-assets and one-fifth for all other underlying assets) and banning the offering of binary options among retail investors from 2017 onwards, in line with previous ESMA decisions. Such restrictions also affect the publicity related to these products (the distributor must warn potential clients of the actual risks and their likely lack of suitability) and entail other protective measures:

- a margin close-out rule on a per account basis (at 50% of the minimum required margin);
- negative balance protection on a per account basis as an overall guaranteed limit on retail client losses; and
- a restriction on the incentives offered to trade CFDs. On 11 July 2023, the CNMV issued additional restrictions on CFD publicity and promotion practices, specifically banning several marketing techniques and broadening the scope of the protective measures to encompass all products

whose potential losses are not limited at the time of closing.

In the last four years, derivatives on emission allowances have been steadily growing in Spain, spurred by the impending discontinuation of the emission allowances that are currently freely assigned to major emitters of greenhouse gases. At present, forwards are the most common type of OTC product in this market.

Sustainability-linked derivatives (SLDs) – ie, OTC derivatives whose pricing and/or payment obligations rely on meeting certain climate-related key performance indicators (KPIs), sustainable performance targets (SPTs) or ESG scores, are also well known in Spain. For the time being, when based on the framework contract for financial operations (*contrato marco de operaciones financieras* (CMOF)) model, the related provisions are typically bespoke (tailor-made). It is quite likely that, assuming the standardised clauses for SLDs of the International Swaps and Derivatives Association (ISDA) win favour among derivatives practitioners, such clauses will become the standard in Spanish practice.

In connection with derivatives on crypto-assets, after being fully authorised by the CNMV in 2023, MEFF published a set of terms and conditions for futures on crypto indexes in May 2024 and is about to trade futures in Bitcoin and Ethereum. This market segment is restricted to institutional investors, with all products settled by differences. MEFF does not clear any transactions involving custody arrangements. In addition to this authorisation, the CNMV released a set of rules on publicity related to crypto-assets, whose scope embraces all assets other than financial instruments and consequently should not be deemed applicable to derivative transactions. It is quite likely that the ISDA digital asset derivatives definitions will win favour in Spain in the near future, although this is a matter not yet covered by the SMA (for the time being, this piece of legislation is exclusively focused on tokens, and cryptocurrencies such as Bitcoin and Ethereum are far beyond its current scope), and there are deep concerns related to the legal nature of cryptocurrencies under Spanish law that may delay further developments in the trading of such products in Spain.

In addition, it should be noted that EMIR 3 has set out for the first time a prior authorisation regime for Initial Margin (IM) models used as a risk-mitigation technique for OTC derivative contracts not cleared by a CCP. Such authorisation shall be applied to the relevant competent authorities (in Spain, CNMV) before using, or adopting a change to, a model for initial margin calculation.

In this regard, the European Banking Authority (EBA) has issued an opinion on 17 December 2024.

The CNMV has indicated that until the RTS or guidelines developing the details of the authorisation and validation process for IM exchange models are adopted, the CNMV, following EBA's recommendations, believes that entities may continue to make use of the existing models and, if any modifications are made to such extent, they must notify such circumstance as an update to the initial application by submitting the information specified in EBA's statement.

2.6 Exemptions, Non-Derivative Products and Spot Transactions

Forwards are deemed OTC derivatives except when used for commercial purposes under the terms set forth in Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU. The most relevant exception is the use of FX forwards as means of payment when the following conditions are met.

- They are settled physically other than by reason of a default or other termination event.
- At least one of the parties is not a financial counterparty (FC) as defined by EMIR.
- Their purpose is to facilitate payment for identifiable goods, services or direct investment.
- They are not traded on a trading venue.

On 28 September 2020, the CNMV issued a set of guidelines to prevent such conditions being used as a "way out" of MiFID. In particular, these guidelines set out the operational procedures needed to check the existence of actual transactions related to goods, services and investments before closing the contract, coupled with a post-closing review of the commercial character of the related hedged activities.

In addition to the above-mentioned exception, the following criteria are laid out to prevent the characterisation of other types of transactions as derivatives.

- Wholesale energy forwards (power, gas, oil and coal) are not deemed derivatives when they are – or may be – physically settled and are used for commercial purposes. However, the following agreements are deemed derivatives even when settled physically: (i) agreements traded on a trading venue (except physically settled wholesale energy products traded on an OTF) and (ii) physically settled agreements not used for commercial purposes that have characteristics akin to other derivative instruments (ie, derivatives traded on a trading venue).
- Commodity spot transactions are not deemed derivatives provided that they fit the definition of a spot transaction. These transactions are defined in Article 7 of Regulation (EU) 2017/565 as agreements for the sale of a commodity, asset or right, under the terms of which delivery is scheduled to be made within the longer of the following periods: (i) two trading days or (ii) the period generally accepted in the market for that commodity, asset or right as the standard delivery period.
- FX spot transactions are not deemed derivatives provided that they fit the definition of an FX spot transaction. These transactions are defined in Article 10 of Regulation (EU) 2017/565 as agreements for the exchange of one currency against another currency, under the terms of which delivery is scheduled to be made within:
  - (a) two trading days in respect of any pair of major currencies (US dollar, euro, Japanese yen, pounds sterling, Australian dollar, Swiss franc, Canadian dollar, Hong Kong dollar, Swedish krona, New Zealand dollar, Singapore dollar, Norwegian krone, Mexican peso, Croatian kuna, Bulgarian lev, Czech koruna, Danish krone, Hungarian forint, Polish zloty and Romanian leu);
  - (b) the longer of two trading days or the period generally accepted in the market for a given currency pair as the standard delivery period for that pair of currencies, where at least one currency is not a major currency; or
  - (c) the period generally accepted in the market for the settlement of a given transferable security or unit in a collective investment undertaking as the standard delivery period – where the contract for the exchange of those currencies is used mainly for the sale or purchase of a transferable security or a unit in a collective investment undertaking – or five trading days, whichever is shorter.
- Since there are other products that can be deemed derivatives due to being settled in cash – or that may be settled in cash at the request of one of the parties other than by reason of default or other termination event, or due to having the characteristics of other derivative products – Section 3.10 of Annex I of MiFID III, and Articles 6 and 8, include a long list of potential underlying assets.

3. Regulation of Derivatives

3.1 National

3.1.1 National Regulators

CNMV is the regulator of reference for derivatives and derivatives transactions as defined in the SMA. However, other regulators may also oversee certain types of derivatives transactions. For instance, the Bank of Spain (*Banco de España* (BdE)) is the primary regulator for a broad range of banking issues related to derivatives, such as lending practices, accounting and solvency, inter alia. Additionally, other sector-specific regulators may be involved, such as those overseeing energy, insurance or other industry-specific areas.

3.1.2 Clearing

EMIR, as amended from time to time, and its implementing legislation are the high-level regulations on derivatives clearing. Since all these rules are deemed regulations pursuant to the Treaty on the Functioning of the EU, they are mandatory over the whole territory of the EU, including Spain, in accordance with its own terms.

Derivatives clearing is mandatory for those OTC agreements that are deemed liquid and sufficiently standard according to the regulatory technical standards (RTS) laid down by ESMA and adopted by the European Commission. Pursuant to Articles 4 and 5.2 of EMIR, such regulations will list the agreements subjected to mandatory clearing and the date when such obligation will enter into force. These agreements will be properly recorded on ESMA's registry, together with the relevant dates mentioned in the foregoing and the recognised CCPs. At present, the affected agreements are rates derivatives for certain classes of interest rate derivatives (basis swaps, forward rate agreements (FRAs), interest rate swaps (IRS) and overnight indexed swaps (OIS)) and two credit default swaps (CDS) for iTraxx indices.

Not all counterparties are subject to mandatory clearing. For this purpose, based on the business thresholds over the outstanding gross notional volume of five classes of derivatives (at present, the thresholds are EUR1 billion for credit derivatives, EUR1 billion for equity derivatives, EUR3 billion for interest rate derivatives, EUR3 billion for FX derivatives and EUR4 billion for commodity derivatives and other derivatives classes, excluding intra-group transactions), all counterparties are classified into four categories: FCs, FCs minus (FC-s), NFCs and NFCs plus (NFC+s). Only FCs and NFC+s are affected (although NFC+s must exclude from this calculation all hedging transactions and clear only those OTC agreements pertaining to the class whose threshold has been exceeded) after serving a notice on ESMA once this status has been checked.

It should be noted that, following EMIR 3 enactment, the quantitative thresholds currently in force may be amended due to the Consultation Paper issued by ESMA on 8 April 2025 on Draft technical standards amending Regulation (EU) 149/2013 to further detail the new EMIR clearing thresholds regime.

When this status ceases to be applicable, a non-subjection notice is to be served as well. This test is to be carried out at monthly intervals over the previous 12 months. Intra-group transactions are exempt from any clearing obligations when both counterparties are established in the EU and previously notified their respective competent authorities in writing that they intend to make use of this exemption. Within the 30 calendar days following the receipt of that notification, the competent authority may object to the use of this exemption if the transactions between the counterparties do not meet the conditions laid down in Article 3 of EMIR. If there is a disagreement between two competent authorities, ESMA may assist those authorities in reaching an agreement. If only one group entity is in the EU, the regulator of such party will check whether all conditions are met and will adopt the corresponding decision.

It is worth noting that EMIR 3 is more favourable to NFCs, since cleared derivatives are not considered when calculating the thresholds and group-level calculations will be replaced by single-entity-level ones. Finally, EMIR exempted transactions with certain EU pension schemes from any clearing obligations, but this exemption will not extend to transactions with third-country schemes. EMIR 3 introduces a permanent exemption from clearing for EU counterparties closing transactions with third-country pension schemes where those schemes are authorised, supervised and recognised under national law and are within the scope of a clearing exemption in their home jurisdiction.

Finally, EMIR 3 introduces the obligation to maintain an active account for systemically relevant products with an EU CCP (ie, OTC interest rates derivatives in euros and zlotys as well as short-term interest rate derivatives in euros), and MiFID III removes the mandatory provision by trading venues of open and non-discriminatory access to a CCP, with a reciprocal requirement for CCPs to provide access for trading venues, when clearing exchange-traded derivatives (ETDs).

Regarding the requirement to maintain an active account, ESMA published on 19 June 2025 the Final Report on the Conditions of the Active Account Requirement. This Final Report provides the draft RTS further specifying the requirements under Article 7a of EMIR, the conditions for stress testing such conditions, the details of the representativeness obligation under Article 7a of EMIR, as well as the details of the reporting in accordance with Article 7b of EMIR.

3.1.3 Mandatory Trading
As per Articles 28 and 32 of MiFIR II, all counterparties subjected to mandatory clearing must close the corresponding transactions with another entity also subject to such obligation on a trading venue (including equiv-

alent third-country trading venues). Investment firms acting as an SI are excluded from the scope of this regulation. For such cases, ESMA was authorised to draft regulatory technical standards (RTS), later adopted by the European Commission as Commission Delegated Regulation (EU) 2017/2417. Despite the similarities with the clearing obligation, their scopes are different, albeit aligned, since derivatives subjected to mandatory trading must fulfil two specific tests: (i) the trading venue test, where the affected derivatives must be traded at least on one trading venue; and (ii) the liquidity test, which is exclusively based on the requirements of the relevant benchmarks instead of the notional amount of the transactions.

3.1.4 Position Limits

This matter is regulated by MiFID III and is transposed into Spanish law by Article 78 of the SMA and Articles 129 to 141 of Royal Decree 814/2023, of 8 November 2023, on financial instruments, listing, negotiable securities records and market infrastructures. The CNMV, acting through its steering committee (*comité ejecutivo*), is the national competent authority in Spain that calculates and enforces position limits in respect of Spanish trading venues, while its president as well as its vice-president are authorised to grant exemptions to such limits, as per the CNMV Resolution dated 5 March 2025. Notwithstanding the decisions that trading venues may take in the event that position limits are exceeded, the CNMV may impose sanctions corresponding to those in the SMA. As per the SMA, position limits – and updates thereof – on Spanish trading venues are made public by the CMNV on its website, with the currently applicable resolution dated 18 March 2021. At present, the scope of EU position limits regulation is limited to agricultural – and other critical and relevant – commodities and is calculated over net positions, excluding positions closed for hedging or liquidity purposes.

The relevant ESMA legislation covers three areas:

- the RTS for the calculation and application of position limits to commodity derivatives and procedures for applying for exemption from position limits – Commission Delegated Regulation (EU) 2022/1302, which derogated Commission Delegated Regulation (EU) 2017/591;
- the RTS on the format of position reports by investment firms and market operators – Implementing Regulation (EU) 2017/1093 as amended by Implementing Regulation (EU) 2022/1300; and
- the RTS on the content of position management controls by trading venues – Delegated Regulation (EU) 2022/1299.

Notwithstanding the foregoing, ESMA is reviewing margin call levels and position limits.

3.1.5 Reporting

The two most relevant reporting duties are those required by EMIR (reporting of transactions to trade repositories) and by MiFID III and MiFIR II (pre- and post-trade transparency and post-trade reporting duties). It is worth noting that ESMA was expressly mandated to enhance the co-ordination of these two reporting regimes, since their co-existence can easily lead to duplications, as well as to align transparency and transaction reporting obligations. Moreover, both reporting regimes are amended by MiFIR II and EMIR 3, which will result in the temporal disapplication of some new provisions until the currently applicable RTS has been amended. In general, it should be noted that ESMA shall strengthen the regulation on transaction reporting through RTS.

EMIR reporting covers all derivatives transactions (both OTC and exchange-traded) and was originally mandatory for all counterparties. However, this situation proved to be extremely burdensome for NFCs, and the duplicated regime caused several reporting mistakes. The amendment of Article 9 of EMIR by Regulation (EU) 2019/834 (EMIR Refit) made FCs and FC-s solely responsible, and legally liable, for reporting on behalf of NFCs other than NFC+s, as well as for ensuring the correctness of the details reported. Nevertheless, NFCs may voluntarily choose to report the corresponding transactions and, if feasible, to enter into delegation agreements to fulfil such duties. The data subjected to these reporting obligations is to be provided to the trade repositories regulated by EMIR on a trading day plus one business day (T+1) basis. If at least one of the counterparties is an NFC, provided that (i) both parties are included in the same consolidation group on a full-time basis, (ii) both parties are subject to appropriate centralised risk evaluation, measurement and control procedures, and (iii) the parent undertaking is not an FC, both parties may apply for an exemption to the local regulators. Counterparties shall notify their competent authorities of their intention to apply for this exemption, which will be applicable except if the regulator disagrees within the three months following the receipt of such proposal.

Among the changes introduced by MiFIR II and EMIR 3, it is worth noting the following.

- The exclusion of derivatives from MiFIR II transparency and transactions reporting obligations, except those traded on a trading venue and the OTC derivatives mentioned in Article 8.2.(b) of MiFIR II (ie, the IRS and CDS OTC derivatives denominated in euros, Japanese yen, US dollars or pounds sterling and subject to EMIR's clearing obligation). Formerly, all OTC transactions whose underlying assets were traded on a trade venue were subject to this obligation.
- Derivatives closed with the intention to reduce post-trade risks are exempted from MiFID III trading obligations, best execution obligations and transparency requirements. Likewise, EMIR 3 excludes these derivatives from clearing obligations. It is worth noting that this exemption was formerly limited to portfolio compression, but its scope has been extended to any activity related to post-trade risk reduction. However, the firms offering these types of services are subject to strict governance duties.
- EMIR 3 contains new requirements in relation to data quality and penalties for transaction reporting. In this vein, national competent authorities will impose administrative or periodic penalty payments on entities whose reports repeatedly contain manifest errors. The periodic penalties will be set at an amount up to 1% of the average daily turnover for the preceding business year per day of breach.
- EMIR 3 also introduces a new transaction reporting requirement for NFC+s in the event that the parent entity is located in the EU, even when exempted from transaction reporting requirements in respect of intragroup transactions. The parent will have to report to its competent authority the net aggregate positions of the group's NFC+s per class of derivatives on a weekly basis.

EMIR 3 also requires EU clearing members and clearing clients who clear in recognised third-country CCPs to report details of their clearing activity in those CCPs to their competent authorities.

3.1.6 Business Conduct

Business conduct requirements for parties engaged in derivatives trading are primarily regulated under the MiFID and MiFIR frameworks. These regulations have an extensive scope and require a thorough analysis. The following is a summary of the key business conduct requirements applicable to such parties.

The business conduct requirements covered are as follows:

- conflicts of interest;
- remuneration;
- communications – must be fair, clear and not misleading;
- dealings with eligible counterparties;
- inducements – there is a ban on inducements paid from manufacturers to distributors in relation to the reception and transmission of orders, or the execution of orders to or on the behalf of retail clients, in addition to the existing ban on inducements concerning independent advice and portfolio management;
- investment advice – definition and independence;
- product intervention;
- product governance and sales processes;
- best execution;
- client order handling;
- client categorisation;
- suitability;
- appropriateness and execution-only business;
- reporting to clients;
- providing information to clients;
- record-keeping;
- recording of telephone conversations and electronic communications;
- complaints handling; and
- safeguarding of client assets.

3.1.7 Commercial End Users

The CNMV enacted specific regulations to enhance the protection of end users in respect of the distribution of derivatives, as follows.

- Circular 1/2018, of 12 March 2018, on warnings related to the distribution of financial products (as amended by Circular 2/2025, of 26 March 2025): This regulation is applicable to, when addressed to retail investors, eligible minimum requirement for own funds and eligible liabilities (MREL) financial products, credit-linked and structured indexed products with potential losses equal to or higher than 10% of the gross investment, CFDs, binary options and other complex OTC structured products. These products must satisfy a prior risk warning to be expressly accepted by the clients, with a handwritten signature being required (or a recorded message for telephone closing or a "permanent message" in respect of products closed on an electronic platform). In the event that the product was eligible for MREL calculations, an additional warning is to be made in connection with the bail-in risk. In the event that the gap between the market price of the product and the client's pricing exceeds some specific thresholds, an additional warning is required.
- Circular 2/2020, of 28 October 2020, on the publicity of products and investment services: This regulation is applicable to all types of publicity on derivatives products aimed at commercial end users, regardless of their classification as retail or professional investors. Its main features are as follows:
  - (a) the issuance of general rules on publicity;
  - (b) the obligation to create inner procedures to enforce the principles of this Circular, with the board of directors ultimately being responsible;
  - (c) a general duty to record all publicity activities for a minimum of five years; and
  - (d) the powers granted to the CNMV to cease or adjust on-going advertising campaigns.
- CNMV Resolutions on intervention measures for highly leveraged financial instruments, dated 27 June 2019 and 11 July 2023: To clarify the scope and structure of these Resolutions, the CNMV issued – and regularly updates – a list of FAQs, of which the most recent version is available on the CNMV's website. Publicity and promotional activities, as well as the management of margins, are the main issues dealt with by these Resolutions.

3.2 Local

There are no local regulators in the securities market. However, territorial consumer agencies are involved in claims related to the distribution of financial instruments relatively frequently, although their activities are exclusively based on the Spanish General Consumers Protection Act.

3.3 Self-Regulatory Organisations, Independent Authorities, and Exchanges

Although they are not self-regulatory entities, the Spanish Banking Association (*Asociación Española de Banca* (AEB)) and the Spanish Confederation of Saving Banks (*Confederación Española de Cajas de Ahorro* (CECA)) have co-operated to draft framework agreements under Spanish Law since 1997 (CMOF). To date, four versions of the CMOF have been made public, all of which are easily available on AEB's website. At present, both entities are associations. There are no other similar initiatives in Spain.

4. Documentation Issues

4.1 Trading Documentation

4.1.1 Industry Standards and Master Agreements

As mentioned above, the CMOF is the standard documentation for OTC derivatives in Spain. This contractual standard is adapted to Spanish Law and drafted in Spanish, albeit that the parties are free to choose the governing law and the disputes resolution mechanism. In this vein, the CMOF has alternative clauses to assist the parties in choosing the competent jurisdiction or tribunals, or alternatively in submitting the contract to arbitration. It is worth noting that the choice-of-court, arbitration and governing law clauses were amended in the 2020 version to ensure that such elections embraced all transactions covered by the CMOF, and that all relevant causes of action fell within their scope regardless of their characterisation as contractual or tort claims. The use of CMOF models is quite common in Spain, mostly because the vast majority of end users' transactions are not international and hedged positions are based on agreements also drafted in Spanish. However, the CMOF standard has no definitions beyond its Annex II and must be adapted to document transactions other than interest rates transactions. Although this standard may be used in any Spanish-speaking country, it is mainly used in Spain as a domestic documentation standard.

Although framework agreements are the most commonly used option in Spain, forward transactions represent a notable exception. Two factors can fully explain this situation. First, when such transactions are not characterised as derivatives, and this is the only type of contract negotiated between the parties, the use of framework agreements may be controversial because the scope of close-out netting provisions is limited to qualified transactions. Second, some forwards, such as energy forwards, are usually entered into between non-qualified entities, which excludes these transactions from the scope of Spanish close-out netting provisions. The current version of the CMOF standard, made public in 2020, was adapted to EMIR and Regulation (EU) 2016/1011 (Benchmark Regulation). Accordingly, this version has two forms of Annex III pertaining to the posting of collateral by means of property transfers: (i) one adapted to the regulation on variation margin and (ii) a simplified model for all other cases.

In Spain, ISDA standard documentation is commonly used for international agreements, including:

- the 1995 ISDA Credit Support Annex (Transfer – English Law, amended when used with the 2002 ISDA Master Agreement);
- the 2016 ISDA Credit Support Annex for Variation Margin (VM) (Title Transfer – English Law); and
- the Master Agreement for Financial Transactions or European Master Agreement (EMA).

EMIR 3 permanently exempts all uncleared single-stock equity options and equity index options from the mandatory exchange of initial and variation margin. This new exemption is to be reviewed by ESMA every three years and is removable by the European Commission, but the market will have at least two years' notice should the Commission decide to remove it. However, although this development may spur the use of single documents to document these types of derivatives, as far as the authors know, there is no interest in changing current practice.

4.1.2 Margins

As mentioned in **4.1.1 Industry Standards and Master Agreements**, the current version of the CMOF standard, made public in 2020, was adapted to EMIR and Regulation (EU) 2016/1011 (Benchmark Regulation). Accordingly, this version has two forms of Annex III pertaining to the posting of collateral by means of property transfers: (i) one adapted to the regulation on variation margin to be used between FCs and FC-s and (ii) a simplified model to be used in transactions with commercial end users. In connection with international agreements, the authors have used ISDA standard documentation: 1995 ISDA Credit Support Annex (Transfer – English Law, amended when used with the 2002 ISDA Master Agreement) and 2016 ISDA Credit Support Annex for Variation Margin (VM) (Title Transfer – English Law).

In connection with initial margin, a new Annex V was added to the CMOF to document such margin exchange based on the creation of pledges governed by Spanish law pursuant to Royal Decree-Law (RDL) 5/2005. Since the pledged assets should be deposited in accounts opened at an insolvency-remote entity, the BME is offering a deposits management service to its clients. In connection with international agreements complying with initial margin provisions, professionals belonging to this law firm have been involved in the negotiation and documentation of this regulatory requirement. In all cases, the collateral was held in accounts opened at Euroclear and Clearstream. The following ISDA documentation standards are used: the ISDA 2019 Clearstream Collateral Transfer Agreement, ISDA 2019 Clearstream Security Agreements (Luxembourg Law), ISDA 2019 Euroclear Collateral Transfer Agreement and ISDA 2019 Euroclear Security Agreements, coupled with the corresponding tripartymargining services agreements.

4.1.3 Other Agreements

International standards such as Global Master Repurchase Agreements (GMRAs), Master Repurchase Agreements (MRAs), Master Securities Forward Transaction Agreements (MSFTAs), Global Master Securities Lending Agreements (GMSLAs) and Master Securities Lending Agreements (MSLAs) are exclusively used in connection with international repo and securities lending transactions. In Spain, it was quite common to use the EMA, sponsored by the European Banking Federation (EBF), the European Savings Bank Group and the European Association of Co-operative Banks, to document repos and securities lending agreements. Only the 2001 version of the EMA was drafted in Spanish, and the updated versions have therefore never been used for such purposes. It is worth noting that the parties commonly elect to use Spanish law to govern the EMA when applied in domestic transactions.

4.2 Clearing Documentation

In connection with ISDA master agreements, the standards sponsored by the Futures Industry Association (FIA; formerly the Futures and Options Association (FOA)) and ISDA are generally used in connection with peer-to-peer (P2P) transactions to be cleared in a CCP. When the services of a clearing member are needed, it is customary in Spain to sign and execute a bespoke tailor-made agency agreement, coupled with an ISDA Master Agreement between the client and the clearing member, with an addendum to deal with cleared transactions governed by the CCP's rulebook and the opening of a segregated account. In Spain, the 2020 CMOF includes an Annex IV, in line with ISDA/FIA-sponsored standards for P2P transactions within the EU. In respect of derivatives traded on a trading venue, CCPs use the agency model instead of the principal model used in Europe.

The most common concerns arising from the negotiations between brokers and clients to clear standard derivatives are as follows:

- the use of electronic platforms to enter orders;
- collateral posting and its transformation when margin obligations are funded with non-eligible assets in the event the clearing member provides this service; and
- portability and default provisions.

4.3 Opinions and Other Documentation Issues

At the level of the EU, Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms, and amending Regulation (EU) No 648/2012 (Capital Requirements Regulation (CRR)), require that credit entities obtain legal opinions in respect of regulatory capital obligations on OTC derivatives, as follows.

- Article 194 (1) and (2) subject the recognition of credit-risk-mitigation techniques to reduce the consumption of regulatory capital to the prior obtention of legal opinions on the legal effectiveness and enforceability in all relevant jurisdictions of such techniques. Consequently, close-out netting (covering both the applicable law and the counterparty's residence jurisdiction) and collateral opinions (covering the legal status of collateral takers and givers) are needed.
- Article 305 (2) also requires that the client of a clearing member has the legal opinion that it would bear "no losses" on account of the insolvency of its clearing member, or any of the clearing member's clients, under the laws of the jurisdiction of various related entities. This is the reason why ISDA's legal opinions on these subjects have an architecture based on three modules.

5. Enforcement Trends

5.1 Regulator Priorities and Enforcement Trends

According to the CNMV's 2025 Activity Plan, its main enforcing actions are to be focused on the following areas.

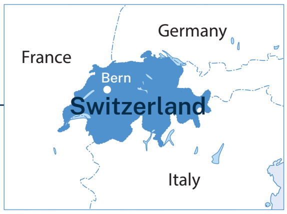
- Effective supervision as the key to ensuring the smooth operation of capital markets and protecting investors: the CNMV is in the process of developing supervisory technology (SupTech) tools to improve these efforts and sharing them across various supervisory bodies. Likewise, the CNMV plans to gradually increase the sanctions imposed for infringements that severely undermine any of its three core objectives, ie, investor protection, transparency of information, and orderly functioning of the market. In this area:
  (a) the supervisory model is to be aligned with ESMA's principles for risk-based and data-

based supervision and CNMV is to adopt ESMA's strategic supervisory priorities – CNMV is to strengthen its supervision of the strategies for marketing investment products and services to retail investors;
(b) CNMV will bolster its mechanisms for supervising systemic risk and enhance its readiness to handle potential market shocks;
(c) CNMV will continue to promote sustainable finance to support the transition towards a more sustainable and inclusive economy;
(d) the supervision of the issuance of crypto-assets, excluding stablecoins, and the activities of crypto-asset service providers; and
(e) the supervision under the DORA Regulation and of AI.

- The development of capital markets.
- Adapting the institution for a new environment.

Likewise, the 2025 working plan, with 44 specific goals, was also published on its website. Although none of the goals is directly connected to derivatives, some of them will positively affect the whole financial system, especially those aimed at fostering cybersecurity, digitalisation, governance, transparency and investor protection (in particular, ensuring that financial influencers comply with rules on investment recommendations).

SWITZERLAND



Law and Practice

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Contents

Schellenberg Wittmer Ltd is one of the leading Swiss business law firms with over 150 specialised lawyers in Zurich, Geneva and Singapore. The capital markets group consists of a core team of more than 15 lawyers with in-depth knowledge of debt and equity capital markets, along with the practical and technical expertise to advise on derivatives and structured finance transactions of any type (including OTC derivatives transactions documented under ISDA terms or under Swiss law, exchange-traded derivatives transactions (ETDs) and the issuance of structured products) and to answer any regulatory questions that arise in connection thereto. The team has significant experience in shaping the legal and regulatory environment in the Swiss derivatives and structured finance sector and also takes part in initiatives with trade associations (such as ISDA and the Swiss Bankers Association).

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1. General

1.1 Overview of Derivatives Markets

Segments of the Swiss Derivatives Market

The Swiss derivatives market can be divided into the following segments:

- OTC derivatives – the OTC derivatives market consists of Swiss derivatives dealers trading OTC derivatives with other Swiss or international dealers in the inter-dealer market as well as transactions entered into between a Swiss dealer and end-users. The end-users may be corporations using derivatives for their hedging, investment or treasury management purposes or investors using derivatives for hedging or investment purposes. OTC derivatives may be cleared or uncleared products. However, there is no Swiss clearing house providing clearing services for OTC derivatives.
- Exchange-traded derivatives (ETDs) – the Swiss ETD market involves Swiss banks acting as clearing brokers or clients of clearing brokers providing Swiss end-users with access to the clearing services of a central counterparty (CCP) of the relevant exchange where the ETDs are traded. There is no Swiss ETD exchange or Swiss CCP for ETDs. For this reason, the Swiss parties involved in the clearing chains always access the clearing services provided by foreign CCPs.
- Structured products – these are usually issued under a programme for such products. To the extent that the products may be sold to retail investors, they must be issued or guaranteed by a regulated issuer (ie, a bank, a securities house or an insurer) or the products must be fully collateralised. The products have an international securities identification number (ISIN) and are issued as securities. The pay-out of the products references an underlying asset and such products therefore have the economics of a derivative, but they are issued in securitised form. Such structured products may be listed on a Swiss regulated exchange (eg, SIX Swiss Exchange). Structured products may be used, for instance, to have exposure to a new asset class of underlyings such as digital assets, but in the form of traditional securities (eg, through exchange-traded products (ETPs), which are products listed on a Swiss regulated exchange that are secured by liquid assets or through tracker certificates on such underlyings that may or may not be secured by collateral).

Applicable Regulatory Requirements

OTC derivatives

OTC derivatives are subject to the Swiss regulation of derivatives under the Swiss Financial Market Infrastructure Act of 19 June 2015 ("FinMIA"). These regulatory requirements are the Swiss equivalent of the European Market Infrastructure Regulation (EMIR) and include:

- a reporting obligation for all such derivatives transactions other than transactions entered into between small non-financial counterparties;
- a clearing obligation for certain types of OTC derivatives (including some interest-rate derivatives and credit derivatives on indices as underlyings), except if they are entered into with a small financial or a small non-financial counterparty; and
- risk mitigation obligations for uncleared derivatives – including:
  (a) variation margin requirements for any transactions other than those entered into with a small non-financial counterparty;
  (b) initial margin requirements for financial counterparties and large non-financial counterparties crossing a threshold of CHF8 billion in aggregated average notional amounts;
  (c) the obligation to agree to portfolio reconciliation and dispute resolution (PRDR) processes and, to the extent the transaction is entered into with a counterparty other than a small non-financial counterparty, perform portfolio reconciliations;
  (d) the obligation to perform portfolio compressions in trading relationships that include more than 500 transactions; and
  (e) the obligation for any counterparty other than a small financial or small non-financial counterparty to value transactions.

Under the rules of the FinMIA, financial counterparties are regulated banks, securities firms, insurance and reinsurance companies, holding companies of financial or insurance groups, managers of collective investment schemes, fund management companies, collective investment schemes and pension funds. All other counterparties are deemed to be non-financial counterparties.

Similar to EMIR, small non-financial counterparties are distinguished from large non-financial counterparties by reference to the nominal amounts of the outstanding OTC derivatives (average gross positions, calculated over 30 working days). A non-financial counterparty is deemed to be large if it exceeds at least one of the following threshold values with all of its trading activity with any counterparties:

- credit derivatives – CHF1.1 billion;
- equity derivatives – CHF1.1 billion;
- interest rate derivatives – CHF3.3 billion;
- FX derivatives – CHF3.3 billion; and
- commodity derivatives and other derivatives – CHF3.3 billion.

The calculation is done by aggregating the positions of all group companies that are non-financial counterparties (worldwide), without counting the positions of financial counterparties (of the same group). Hedging transactions and physically settled FX forwards and swaps are not counted for the calculation.

The Swiss calculation includes cleared and uncleared OTC derivatives transactions and, in this respect, will differ from the determination as it is made under EMIR when the rules of EMIR 3.0 come into force, as for the purposes of EMIR 3.0, only uncleared OTC derivatives will be counted (but with lower thresholds).

The FinMIA distinguishes small and large financial counterparties by reference to a threshold of CHF8 billion, including the entire derivatives portfolio (counting also hedging transactions and including cleared and uncleared OTC derivatives transaction, but without counting ETDs) except for physically settled FX forwards and swaps. Except for funds, collective investment schemes and fund managers, the calculation is made by aggregating the positions of all group companies that are financial counterparties (worldwide), without counting the positions of non-financial counterparties (of the same group). As regards funds, collective investment schemes and fund/asset managers, there is no aggregation of their positions. The calculation is made in respect of each fund and collective investment scheme separately (even if the assets are managed by the same manager).

As opposed to the rules of EMIR 3.0 as they are intended to be implemented, the FinMIA does not require a separate calculation for cleared and uncleared OTC derivatives.

Under the current framework of the FinMIA, the determination of a party qualifying as a small or large financial or non-financial counterparty is an ongoing calculation. To the extent that a small financial or non-financial counterparty becomes a large one, it must notify the counterparty and it has four months to comply with the further obligations resulting from the change to its status (eg, compliance with the clearing obligation).

To the extent that the transactions are entered into on a cross-border basis, these regulatory requirements may also be complied with by applying the rules of a jurisdiction recognised by the Swiss Financial Market Supervisory Authority ("FINMA") as being equivalent to the rules of the FinMIA by applying such foreign rules on a substituted compliance basis. This is at present possible for EMIR, UK EMIR and the US rules of the Commodity Futures Trading Commission (CFTC).

ETDs

ETDs are also subject to some regulatory obligations under the FinMIA, including a reporting obligation for all such derivatives transactions. However, the other regulatory obligations of the FinMIA do not apply to ETDs.

Structured products

Structured products are not subject to the regulatory obligations of the FinMIA. However, if they are issued to any retail investors, they must either be issued or guaranteed by a regulated firm or, as an alternative, they must be fully collateralised. In addition, they must be issued under a programme or prospectus that complies with the disclosure requirements of the Swiss Financial Services Act of 15 June 2018 ("FinSA") and any products that are offered to retail investors other than in the context of a discretionary asset management mandate or an advisory mandate entered into with a bank or securities firm must be documented with a key information document (KID) that complies with the requirements of the FinSA or those of the EU packaged retail and insurance-based investment products (PRIIPs).

1.2 Historical Trends and Looking Forwards

As regards the offer of products available in the Swiss market, a key driver is the demand for products requested by the buy-side in the asset management and private banking sectors. In the past 12 months, on the supply side, the disappearance of Credit Suisse has left a gap that was filled on the sell-side by other derivatives dealers.

As regards the regulatory environment, Switzerland has, so far, been closely aligned with the regulation of derivatives as it applies in the EU by following the rules of EMIR. The rules of the FinMIA were put in place after those of EMIR and, in some respects, the Swiss rules are more liberal than those of EMIR. This has allowed Swiss derivatives regulation to remain aligned with EMIR after the EMIR Refit. However, in the context of the adoption of EMIR 3.0, the EU rules will diverge from those of the FinMIA in some material respects, particularly as regards the determination of status as a small or large financial or non-financial counterparty.

The Swiss Federal Department of Finances (FDF), in consultation with the financial industry, recently prepared a reform package for the FinMIA that was adopted by the Swiss Federal Council and released as a consultation report (the "FinMIA Refit Report"), together with a proposed draft of the revised FinMIA, on 19 June 2024. The consultation ran until 11 October 2024. Under such revised rules, the Swiss derivatives regulation for OTC derivatives has been liberalised further, with the key proposals being the following:

- The determination of the status of a counterparty as a small or large financial or non-financial counterparty will become an annual determination.
- To the extent that a jurisdiction is eligible to be applied instead of the FinMIA, on a substituted compliance basis, this will also allow the application of such rules to determine counterparty status (ie, the question of the counterparty classification will not remain subject to a Swiss law analysis).
- The new rules will provide that small non-financial counterparties will not come into the scope of the reporting obligation at any point in time.
- As regards the content of the reporting fields, the financial data feed (FDF) further proposes to amend the content of reports to the trade repository by harmonising such content with international standards on ordinance level (eg, with regard to the legal entity identifier (LEI), unique transaction identifier (UTI) and other critical data points). In this way, the quality of the reported data will be improved, which should make it possible to determine financial stability risks more easily.

As regards substituted compliance, note that Switzerland signed the Berne Financial Services Agreement (BFSA) with the UK on 21 December 2023 as a bilateral treaty regarding the mutual recognition of certain areas of financial services and insurance regulation. As regards the regulation of OTC derivatives, the BFSA also covers the risk mitigation obligations for uncleared OTC derivatives (eg, margin rules, portfolio reconciliation and dispute resolution processes, timely exchange of confirmations, valuation of transactions, and portfolio compression). As a result, between Switzerland and the UK, applying the rules of the other jurisdiction by way of substituted compliance will also become possible on the basis of the BFSA when it goes live. However, as regards the application of the rules of the UK EMIR on a substituted compliance basis under Swiss law, this is already possible on the basis of domestic Swiss law.

2. Types of Derivatives

2.1 Futures and Options

Futures are traded as ETDs. Options may be traded either as ETDs or as OTC derivatives.

As regards the market for ETDs, Switzerland does not have a trading venue for such products. Therefore, the products traded are those available in markets outside Switzerland. In terms of the demand for ETDs, Swiss investors have recently requested ETDs on cryptocurrencies as underlyings. These products may also be sold in Switzerland to retail investors. However, as such ETDs are qualified as "securities" for the purposes of Swiss regulation, any firm offering such products from Switzerland or using a Swiss intermediary to access the Swiss market, may become subject to licensing requirements as a securities firm or may have to obtain the authorisation of a Swiss branch or Swiss representative office of a foreign securities firm.

As regards options traded as OTC derivatives, the authors see innovative products used in the Swiss market, for instance, in the context of equity financing transactions. An example of such products are collar transactions, which may be used for the purpose of hedging a long position in an equity investment with a put option by protecting the shareholder against a decline in the share price below a put strike price, while at the same time giving away the upside in the event of a development of the share price above the call strike price.

At present, options on single names or baskets of equities as underlyings and equity index options benefit from a temporary exemption from the variation and initial margin requirements that is currently in place until 1 January 2026. In the context of the FinMIA Refit, the temporary exemption is intended to become a permanent one.

2.2 Swaps and Security-Based Swaps

Swaps are typically traded as OTC derivatives with the involvement of a swap dealer using an International Swaps and Derivatives Association (ISDA) Master Agreement or a Swiss Master Agreement (SMA) as the relevant documentation. Under Swiss law, no distinction is made between security-based swaps and other swaps.

Exemptions from the derivatives regulation apply in respect of physically settled FX swaps (in addition to physically settled FX forwards) and in respect of physically settled OTC derivatives (including swaps) with commodities as underlyings. The exempted FX swaps are only subject to a reporting obligation, but not the other regulatory requirements resulting from the FinMIA. Exempted swaps with commodities as underlyings are not subject to the derivatives regulation under the FinMIA at all.

Certain interest-rate swap transactions, as well as certain index-credit default swaps, are subject to a mandatory clearing obligation, except if they are traded with a small financial counterparty or a small non-financial counterparty. Other swap transactions may be subject to a voluntary clearing. Any such clearing occurs with a central counterparty outside Switzerland. To the extent that the clearing occurs through Swiss clearing brokers as direct participants of such CCPs, the CCPs must be authorised by FINMA to provide such clearing services in Switzerland (CCPs such as Eurex Clearing, ICE Clear, LCH, LME Clear and Cboe Clear have such authorisation).

2.3 Forwards

Forwards are traded as OTC derivatives. Forwards may be traded in respect of any asset classes as underlyings. From a Swiss perspective, a derivative is defined as a financial contract: (i) with a value depending on one or more underlying; and (ii) that is not a spot transaction.

As long as a forward contract references the value of an underlying asset and it is not settled as a spot transaction (see **2.6 Exemptions, Non-Derivative Products and Spot Transactions**), it will fall within the definition of a derivative for the purposes of Swiss law. This would also include, for instance, FX forward transactions.

Exemptions from the derivatives regulation apply in respect of physically settled FX forwards (in addition to physically settled FX swaps) and in respect of physically settled OTC derivatives (including forwards) with commodities as underlyings. The exempted FX forwards are only subject to a reporting obligation, but not the other regulatory requirements resulting from the FinMIA. The exempted forwards with commodities as underlyings are not subject to the derivatives regulation under the FinMIA at all.

2.4 Listed v Over-the-Counter

Listed Derivatives/ETDs

At present, there are no Swiss exchanges where derivatives in the form of exchange-traded derivatives (ETDs) are listed. Any such ETDs are traded on foreign exchanges. Swiss investors are able to access such foreign exchanges through a clearing chain, involving a clearing broker providing clearing services and, possibly, a client of such clearing broker providing indirect clearing services. For investors other than small non-financial counterparties in the sense of the FinMIA and for Swiss parties involved in the clearing chain, ETDs are subject to a reporting requirement from the perspective of Swiss derivatives regulation under the FinMIA, but not to other regulatory requirements.

For Swiss banks or securities firms providing clearing services in the clearing chain for clients, the positions resulting from ETDs are not subject to regulatory capital requirements, except where they indemnify the client for any losses incurred due to changes in the value of the transaction in the event of default by the qualifying CCP, or they guarantee to the clients that the qualifying CCPs or clearing services provider perform their obligations. However, to the extent that banks or securities firms hold ETDs for their own account, or in the event that they were to guarantee the exposures resulting from the ETDs to their clients, the banks or securities firms must take into account the positions resulting from the ETDs for the purposes of their own regulatory capital analysis.

For the purposes of such analysis, a risk weight of 2% applies, to the extent that the ETDs are cleared with a qualifying CCP and legal opinions of the relevant jurisdictions involved confirm the following:

- the ETD transactions are identified as "client transactions";
- margin assets held through the clearing chain with the qualifying CCP will be segregated for the benefit of indirect clients, that is, the indirect clients will not incur any losses in the event of:
  - (a) the insolvency of the clearing services provider through whom the bank or securities firm acts;
  - (b) an insolvency of other indirect clients of such clearing services provider; or
  - (c) an insolvency of the clearing services provider and other indirect clients; and
- in the event of an insolvency of the clearing services provider through whom the bank or securities firm acts as direct client of a clearing broker, the applicable laws and regulations lead to the conclusion that the positions and margin would either be upheld directly with the qualifying CCP or they could be transferred at the market value to another clearing broker (porting) or, upon request of the client, they could be closed out.

OTC Derivatives

OTC derivatives are traded as bilateral contracts between two parties under the market standard documentation for such transactions. This is typically an ISDA Master Agreement, together with the relevant supporting documents, or an SMA for OTC derivatives transactions, as published by the Swiss Bankers Association.

Such OTC derivatives are subject to the regulatory requirements of the FinMIA, which are closely aligned with EMIR (see **1.1 Overview of Derivatives Markets**).

As regards their regulatory capital analysis, derivatives dealers trading OTC derivatives may account for OTC derivatives traded under netting set on a net basis if the following requirements, as implemented in Switzerland on the basis of the Basel rules, are met:

- A master agreement customarily used in the OTC derivatives market (a "Master Agreement"), including a close-out netting arrangement, is in place that provides for a single lump sum termination amount including all the relevant derivatives transactions, provided that the Master Agreement includes termination events for the possible default or insolvency of the counterparty.
- Reasoned legal opinions confirm that the contractual provisions of the Master Agreement (as described above) are legally binding and enforceable:
  - (a) according to the place of incorporation of the counterparty, including in the event of a default or insolvency of the relevant counterparty;
  - (b) according to the law governing the individual transactions forming part of the netting arrangement; and
  - (c) according to the agreement governing the netting arrangement.
- The bank has processes in place to monitor ongoing changes to the applicable laws that are relevant for the enforceability of the netting arrangement.

2.5 Asset Classes

Swiss law does not restrict any particular asset class as an underlying of a derivatives transaction.

However, certain exemptions from regulatory requirements apply with respect to some types of asset classes (see **2.6 Exemptions, Non-Derivative Products and Spot Transactions**).

To the extent that derivatives transactions are not traded as transactions in the inter-dealer market, but are traded with a client as a financial service like any other financial instrument, the relevant point-of-sale obligations resulting from the FinSA must be complied with.

As regards such point-of-sale obligations, FINMA introduced additional risk disclosure requirements in connection with complex products offered to retail clients such as contracts for differences (CFDs). When disclosing the risks associated with financial instruments, the provider must inform its clients of:

- the proportion of clients who lose money in connection with CFDs;
- the potential obligation to make additional payments and the risk of unlimited losses; and
- leverage and margin rules, as well as counterparty and market risk.

New types of asset classes that are emerging in Switzerland include derivatives on cryptocurrencies and other digital assets as underlyings, derivatives on verified carbon credits (VCCs) and equity derivatives used in the context of complex equity financing transactions (eg, in the context of an accelerated share buy-back).

2.6 Exemptions, Non-Derivative Products and Spot Transactions

Non-Derivative Products and Spot Transactions

From a Swiss perspective, a derivative is defined as a financial contract (i) with a value depending on one or more underlying; and (ii) that is not a spot transaction.

With regards to (i) having a value depending on an underlying:

Swiss law does not provide for an exhaustive list of underlying assets or values of a derivative. While the Ordinance to the FinMIA (the "FinMIO") mentions shares, bonds, commodities and bullion as underlying assets as well as currencies, and interest rates and indices as underlying values, these are only examples. A contract referencing other assets or values that will be used to determine the value of the contract (eg, economic statistics, inflation rates or climatic variables) is also considered a derivative for the purposes of the FinMIA.

For the purposes of classifying a contract as a derivative under the FinMIA, it is a requirement that the value of the contract directly or indirectly depends on the price of the underlying asset. Therefore, the reference to the value of the underlying must result from the terms and conditions of the financial contract. It is not sufficient that the value is derived from an asset pool. As a result, asset-backed securities or collateralised loan obligations do not qualify as derivatives for the purposes of the FinMIA. In addition, shares in an investment company investing in underlying assets are also not classified as derivatives for the purposes of the FinMIA.

Any instrument issued in the form of a certified or uncertified security would not be classified as a derivative in the sense of the FinMIA, even if its value is directly or indirectly dependent on the price of an underlying asset. For instance, any structured products issued in securitised form would not be viewed as a derivative.

Moreover, the definition of derivatives for the purposes of Swiss law does not include instruments, where a derivative is only an embedded element, but the primary purpose of the contract is different (eg, stock options forming part of a stock option plan paid as compensation under an employment agreement or put/call options embedded in a shareholders' agreement). To be classified as a derivative for the purposes of the FinMIA, the main contractual obligations of the parties must depend on the value of the underlying assets or values.

With regards to (ii) not being a spot transaction:

A spot transaction is a transaction that is settled within two trading days (T+2) of the trade date or within the longer settlement period that is customary for such transaction. A transaction does not qualify as a spot transaction where the parties provide for a postponement of the delivery of the underlying asset that is longer than two days or, if longer, the customary settlement period for the assets concerned (one settlement cycle). However, if there is no customary settlement period for a specific product, the question may arise how to distinguish a spot transaction from a forward contract. In the event that the parties determine a settlement date that is not the shortest possible settlement date, the transaction is likely not to be qualified as a spot transaction but as a forward transaction (ie, a derivative for the purposes of the FinMIA).

A transaction for the sale and purchase of securities in any currency that settles within one settlement cycle of the securities transaction (securities conversion transaction) is also viewed as a spot transaction. This raises the questions: (i) whether this also applies to foreign exchange transactions entered into separately from the securities transaction and, if so; (ii) whether there is a maximum time limit for the settlement cycle that would have to be complied with to fall into the scope of this exemption.

On the basis that securities conversion transactions qualify as spot transactions in the sense of Article 10 (2)(c) MiFID II Delegated Regulation (ie, they are settled within the customary settlement cycle for the underlying securities transactions, which is not longer than T+5), the Swiss analysis should be that such transactions should also be classified as spot transactions for the purposes of the FinMIA. Regarding the cap of five trading days, while this is not addressed in the Swiss rules, the authors believe it is advisable to stay within the limit set by the EU regulation as a "safe harbour" in order for the transactions not to be classified as derivatives for the purposes of the FinMIA.

Rolling spot transactions are permitted in Switzerland and qualify, depending on their structure, either as spot transactions or as derivatives for the purposes of the FinMIA. To the extent spot transactions do not include an enforceable obligation to extend the transaction (ie, if the parties can decide freely whether or not they wish to roll over the economic terms of a spot transaction) and provided further that such extension of the spot transaction is not the normal market practice between the parties, such transaction would be treated as a spot transaction. However, if the parties are obliged to roll a spot transaction or if such extension of a spot transaction is the normal market practice, such transaction would be qualified as a derivative for the purposes of the FinMIA.

Exempted Transactions

Under the Swiss rules, the following types of transactions are exempt from the derivatives regulation:

- physically settled commodity derivatives, except if they are traded on a regulated exchange, on a multilateral trading facility or on an organised trading facility;
- physically settled commodity derivatives on power or natural gas as underlyings traded on an organised trading facility; and
- derivatives regarding freight, inflation rates, climatic variables or official economic statistics that are cash-settled only upon default or termination.

Other transactions are only exempt from certain obligations, as follows:

- ETDs are only subject to a reporting obligation, but not to other obligations of the derivatives regulation resulting from the FinMIA.
- Physically settled FX forwards and swaps, where the confirmation specifies that the transactions will be physically settled (however, the calculation should include cash-settled FX forwards (ie, NDFs) and swaps, FX options and currency swaps), are only subject to a reporting obligation, but not to other obligations of the derivatives regulation resulting from the FinMIA.
- Currency swaps, which combine a swap of currencies and an interest rate derivative, are not subject to the initial margin requirement for the FX component.
- Options on single names or baskets of equities as underlyings and equity index options benefit from a temporary exemption from the variation and initial margin requirements that is currently in place until

1 January 2026. In the context of the FinMIA Refit, the temporary exemption is intended to become a permanent one.

3. Regulation of Derivatives

3.1 National

3.1.1 National Regulators

FINMA is the Swiss regulatory authority in charge of applying the rules of the Swiss derivatives regulation. Such rules are specified in the FinMIA and the FinMIO and the FINMA Ordinance on Financial Market Infrastructures and Derivatives Trading of 3 December 2015 (the "FinMIO-FINMA").

As regards financial counterparties, the internal and external auditors of a regulated firm are, in the context of the annual regulatory audit process, in charge of confirming compliance with such rules. As regards non-financial counterparties, financial auditors are mandated to confirm whether, and how, the firm complies with such rules.

3.1.2 Clearing

The clearing obligation applies under the rules of the FinMIA to certain interest rate derivatives and certain credit default swaps on indices, except if they are entered into with a small financial or a small non-financial counterparty.

These clearing requirements apply to some of the derivatives that are currently subject to a clearing obligation under EMIR.

The following interest rate products are subject to the clearing obligation:

- basis swaps and fixed-to-floating rate swaps on the euro interbank offered rate (Euribor) as underlying, EUR as settlement currency and a maturity between 28 days and 50 years;
- forward rate agreements (FRAs) on Euribor as underlying, EUR as settlement currency and a maturity between three days and three years;
- overnight index swaps (OIS) on the secured overnight financing rate (SOFR) as underlying, USD as settlement currency and a maturity between seven days and three years;
- OIS with federal funds (FedFunds) as underlying, USD as settlement currency and a maturity between seven days and three years;
- OIS with the euro short-term rate (EuroSTR) as underlying, EUR as settlement currency and a maturity between seven days and three years;
- OIS with the sterling overnight indexed average rate (SONIA) as underlying, GBP as settlement currency and a maturity between seven days and 50 years; and
- OIS with the Tokyo overnight average rate (TONA) as underlying, JPY as settlement currency and a maturity between seven days and 30 years.

The following credit default swaps are subject to the clearing obligation:

- credit default swaps (index, not tranched) on iTraxx Europe Main as the underlying, EUR as settlement currency and a maturity of five years; and
- credit default swaps (index, not tranched) on iTraxx Europe Crossover as the underlying, EUR as settlement currency and a maturity of five years.

No other derivatives transactions (eg, FX derivatives, commodity derivatives or equity derivatives) are subject to a clearing obligation.

3.1.3 Mandatory Trading

FINMA has the competence to resolve that certain derivatives will become subject to a mandatory trading obligation. However, FINMA has not exercised such competence to date.

The mandatory trading obligation would be subject to the following:

- FINMA must take into account the degree of standardisation of the relevant derivatives transactions both from a legal and operational perspective, the liquidity of the relevant products, the traded volumes, the availability of information for determining market prices, and the counterparty risks involved with the relevant products;

- FINMA must apply the trading obligation in line with international standards and international developments;
- the trading obligation will not be applicable to transactions that are not available for trading on a trading venue; and
- physically settled FX forwards and swaps may not be subject to a trading obligation.

To the extent that FINMA will declare such trading obligation to be applicable, it is unlikely that this would, in any event, go beyond the obligations applicable under EMIR.

3.1.4 Position Limits

The rules of the FinMIA provide for the competence of the Swiss Federal Council to put in place obligations on position limits for commodity derivatives. However, the Swiss Federal Council has not made use of such competence and there are no indications that such competence will be exercised in the near future.

3.1.5 Reporting

Reporting of OTC Derivatives and ETDs

The Swiss regulatory requirements of the FinMIA provide for reporting obligations regarding OTC derivatives and ETDs. Note that it is currently not possible to satisfy such reporting obligations under foreign rules that have been recognised as equivalent by FINMA (eg, those of EMIR), because no foreign trade repositories are recognised by FINMA for the purposes of reporting under a jurisdiction other than the FinMIA.

For OTC derivatives

The reporting obligation depends on the status of the counterparties involved. In any event, a small non-financial counterparty never has a reporting obligation.

The Swiss rules provide for a one-sided reporting regime that imposes a reporting obligation under the rules of the FinMIA on one of the parties to a transaction, as follows:

In transactions between two Swiss counterparties –

- where one is a financial counterparty and the other is a non-financial counterparty, the financial counterparty reports;
- where one is a large and the other is a small financial counterparty, the large financial counterparty reports;
- where one is a large and the other is a small non-financial counterparty, the large non-financial counterparty reports;
- where both are large financial counterparties or both are small financial counterparties or both are large non-financial counterparties, the seller reports (if there is a seller) or, if not, the party as determined by the ISDA tie-breaker rules reports; and
- where both are small non-financial counterparties, no party reports.

Further to the above rules, note that there is no intragroup exemption. Therefore, unless the transaction is entered into between two small non-financial counterparties, it is subject to a reporting obligation.

In transactions between a Swiss and a foreign counterparty –

- the Swiss party reports, unless it is a small non-financial counterparty; and
- if the Swiss party is a small non-financial counterparty, there is currently an exemption in place until 1 January 2028, however, with the proposed FinMIA Refit, such obligation will generally be waived for small non-financial counterparties.

For ETDs

The reporting obligation falls on the Swiss party in the clearing chain that is closer to the foreign CCP.

To the extent that it is a clearing arrangement between a Swiss and a foreign clearing services provider, the obligation falls on the Swiss party. If the Swiss party at the end of the clearing chain is a small non-financial counterparty, there is currently an exemption in place until 1 January 2028, however, with the proposed FinMIA Refit, such obligation will generally be waived for small non-financial counterparties.

Transaction Reporting

Separately from the above, trading of OTC derivatives on securities listed or admitted to trading on a Swiss regulated exchange as underlyings fall into the scope of the transaction reporting requirements under the Swiss rules, to the extent that the weight of such securities exceeds 25%. Also, ETDs fall into the scope of the transaction reporting obligation, to the extent that the underlyings are securities listed or admitted to trading on a Swiss regulated exchange.

Disclosure of Shareholdings

Exposures to equities listed on a Swiss regulated exchange resulting from derivatives transactions (including cash-settled derivatives) are counted towards the long and short positions in such equities for the purposes of the disclosure thresholds for significant shareholdings (the lowest threshold being at present 3%).

3.1.6 Business Conduct

Any firm that trades in derivatives is subject to the rules of the Swiss derivatives regulation of the FinMIA and the FinMIO and must have a policy in place that specifies how it complies with its regulatory obligations resulting from these rules (see **1.1 Overview of Derivatives Markets**).

To the extent that it is a firm subject to prudential supervision, compliance with such rules is reviewed by the regulatory auditors as part of the annual regulatory audit process. In addition to such process, there are no specific business conduct rules to be taken into account with respect to trading derivatives other than the following.

A party engaged in derivatives trading with a Swiss counterparty is subject to business conduct requirements, to the extent that it not only trades with a counterparty in the same way as in the inter-dealer market, but that it establishes a client relationship with the counterparty in the context of trading the derivatives. Derivatives transactions are classified as "financial instruments" under the rules of the FinSA.

Any of the following activities would be deemed to give rise to such a client relationship for the purposes of Swiss regulatory requirements and this would also give rise to an activity of providing a "financial service" to the counterparty:

- providing brokerage services regarding financial instruments (buying and selling "financial instruments") and/or receipt and transmission of orders regarding transactions in "financial instruments";
- marketing "financial instruments";
- providing advisory services regarding transactions in "financial instruments" (this would also include corporate finance services provided to a buy-side client);
- providing discretionary investment management services regarding a portfolio including "financial instruments"; and
- acting as a lender financing transactions in "financial instruments".

As a result of providing such a "financial service", the FinSA point-of-sale obligations would need to be taken into account, which include the following:

- an obligation to classify the counterparty into the categories of:
  (a) professional client;
  (b) institutional client; or
  (c) retail client;
- an obligation to provide information on the financial instruments (including general risk disclosures for trading financial instruments generally and specific disclosures for the products traded), provided that this obligation may be waived by professional clients;
- a best execution obligation;
- an obligation to register front office staff members with a client adviser registry, unless the financial services provider is already FINMA supervised or, if it is subject to prudential supervision by a foreign regulatory, the Swiss counterparties are only "per se professional clients"; and
- a record-keeping and accountability obligation, provided that this obligation may be waived by professional clients.

With respect to the obligation to provide information on CFDs, see the proposed new requirements by FINMA as stated in **2.5 Asset Classes**.

3.1.7 Commercial End Users

Commercial end-users may benefit from certain exemptions from regulatory requirements, to the extent that they are classified as small non-financial counterparties. In such capacity, they benefit from the following:

- neither they nor the counterparty are subject to the margin requirements for the transactions traded with the small non-financial counterparty (neither variation margin, nor initial margin requirements);
- they are not subject to a reporting obligation (to the extent that the proposed new rules will be adopted on the context of the pending FinMIA reform, not even after 1 January 2028);
- the transactions they trade do not fall into the scope of an obligation to clear derivatives; and
- the transactions entered into with such counterparties do not fall into the scope of an obligation to perform portfolio reconciliations.

3.2 Local

Switzerland does not have regulatory authorities on a local level (cantons or municipalities) that would be competent in this field.

3.3 Self-Regulatory Organisations, Independent Authorities, and Exchanges

For the derivatives market, there are no self-regulatory organisations or independent authorities that would be competent in this field.

However, Switzerland has trade associations such as the Swiss Bankers Association that are setting standards in respect of the documentation used (eg, by publishing the Swiss Master Agreement for OTC Derivatives Transactions or Other Master Agreements) and by being the most relevant forum for the discussion of the industry position to new rules and laws and developing best practices.

Given that the country does not have a Swiss exchange for derivatives and no Swiss CCP for clearing derivatives, Switzerland does not have such Swiss market participants.

However, as the Swiss securities custodian, SIX SIS offers a solution for the custody of securities for the purposes of using this with respect to initial margin assets under either SMAs for OTC Derivatives or ISDA documentations.

4. Documentation Issues

4.1 Trading Documentation

4.1.1 Industry Standards and Master Agreements

Documentation of OTC Derivatives Transactions

Use of ISDA terms

The industry standard documentation used in OTC derivatives transactions traded on a cross-border basis are ISDA Master Agreements and the definitions published by ISDA for the different asset classes, jointly with the relevant supporting documents published by ISDA (including credit support documents, such as VM credit support annexes (CSAs) for transactions subject to variation margin requirements, and IM collateral transfer agreements (CTAs) with the relevant security agreements for transactions subject to initial margin requirements).

For transactions traded in the domestic Swiss market, such ISDA documentation is also frequently used, to the extent that the transactions are entered into between financial counterparties or the transactions are subject to terms that mirror transactions traded internationally.

Use of SMAs

For OTC derivatives traded with Swiss end-users or transactions traded between banks and their clients, an SMA for OTC derivatives transactions in the form published by the Swiss Bankers Association is often used. This agreement is subject to Swiss law as the governing law and is available not only in English, but also in German, French and Italian. The SMA was first published in 2003 and a revised version was published in 2013. The SMA of 2013 has a set of its own definitions that allow documentation with confirmations referring to such definitions. To the extent that the parties wish to use ISDA definitions under an SMA, the SMA of 2013 can be entered into in a version that includes the relevant bridge language, allowing the incorporation by reference of the most frequently used ISDA definitions into the relevant SMA.

The Swiss Bankers Association also published CSAs as the relevant supporting documents to be used for the purposes of exchanging collateral. This includes a CSA that may be used for the purposes of exchanging variation margins, to the extent that the parties are in scope for the exchange of variation margins.

Where an SMA is used to document derivatives transactions with private wealth management clients of a bank, such counterparties are not in scope of variation margin requirements and the banks usually do not enter into a bilateral margin documentation with such clients, but a one-sided general deed of pledge under which the client provides collateral to the bank for its exposure to the client.

Use of own documentation of the relevant banks

A Swiss bank may also have its own trade documentation for trading OTC derivatives, particularly to the extent that derivatives transactions are entered into with private wealth management clients. Such documentation is usually governed by Swiss law and the banks do not enter into a bilateral margin documentation with such clients, but a one-sided general deed of pledge under which the client provides collateral to the bank for its exposure to the client. Such master agreements may be limited to certain asset classes (eg, for the purposes of trading FX derivatives).

Documentation of ETDs

As regards ETDs, Swiss banks providing indirect clearing services to clients usually have their own trade documentation to use in ETDs with clients. However, the Swiss Bankers Association also published a standard Master Agreement for Exchange Traded Derivatives, which is sometimes used by certain banks.

In relations between a Swiss bank and international clearing services providers, the prevailing international documentation is used.

4.1.2 Margins

Under ISDA documentations, the exchange of variation margin is usually documented in the VM CSA published by ISDA or by amending a CSA to be in line with the variation margin requirements.

To the extent that an SMA is used, the exchange of variation margin is usually documented with the VM CSA published by the Swiss Bankers Association.

The Swiss rules for the exchange of initial margin are aligned with the rules of EMIR and apply to transactions with counterparties other than small non-financial counterparties, provided that both parties cross the threshold of CHF8 billion in aggregate average notional amounts (AANA) and the amount of initial margin to be exchanged reaches the threshold of CHF50 million.

Where parties are within the scope of the exchange of initial margin, they usually opt for the use of ISDA documentation as opposed to an SMA. However, Swiss parties may choose to appoint SIX SIS to act as the custodian of the initial margin. SIX SIS has the relevant documentation in place for a solution to document the exchange of initial margin both under ISDA terms and, as regards transactions with domestic counterparties, in the event that an SMA is used.

4.1.3 Other Agreements

In the repurchase agreement (Repo) market, where a Swiss counterparty is involved in a cross-border transaction, global master repurchase agreements (GMRAs) are widely used. In the domestic repo market, many firms participate in the repo trading platform operated by SIX SIS under the terms of the Swiss master repo agreement (SMRA), which is entered into by adhering to such SMRA on a multilateral basis. However, the trading occurs bilaterally between the relevant firms that both adhered to the SMRA.

In the securities lending market, where a Swiss counterparty is involved in a cross-border transaction, global master securities lending agreements (GMSLAs) are widely used. As regards domestic transactions, no standard master agreement prevails, but each firm has its own template documentation that is used.

4.2 Clearing Documentation

Clearing brokers and Swiss firms offering indirect clearing services usually use their own trade documentation to document the clearing terms. Such terms are usually the same for all asset classes.

The Swiss clearing brokers and indirect clearing services providers usually have a set of disclosure documentation that is prepared on the basis of the Futures

Industry Association (FIA) standards that are provided to the clients of the cleared derivatives.

4.3 Opinions and Other Documentation Issues

The Swiss regulatory capital requirements require netting and collateral enforceability opinions for the purposes of allowing Swiss banks to account for derivatives transactions on a net basis for regulatory capital purposes (see **2.4 Listed v Over-the-Counter**). Such opinions must cover the enforceability of the netting arrangement and the enforceability of the collateral in the insolvency of the counterparty and under the governing law of the agreement, as well as under the governing law of the transactions.

The Swiss margin rules require opinion coverage for the enforceability of the collateral provided by the counterparty (the "collateral provider opinion") and, as regards initial margin, for the availability of the collateral to the collateral provider in the insolvency of the collateral taker (the "collateral taker opinion").

With respect to ETDs, the Swiss regulatory capital requirements also require a legal opinion regarding the positions and margin assets held through the clearing chain with the CCP for the purposes of applying a risk weight of 2% for own account positions (see **2.4 Listed v Over-the-Counter**).

5. Enforcement Trends

5.1 Regulator Priorities and Enforcement Trends

FINMA has not published guidance on its priorities with respect to enforcement activities regarding derivatives. Given that the first level of enforcement activities lies with the auditors, any audit points tend to be addressed at that level.

For the future, increased scrutiny may be expected for any derivatives transactions entered into with retail clients, in particular, regarding compliance with any requirements to provide adequate disclosures under the point-of-sale information obligations of the FinSA (eg, for CFDs or similar retail products).

Trends and Developments

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Baker McKenzie Switzerland is one of the largest law firms in Switzerland. Its offices in Geneva and Zurich have been an integral part of the Swiss legal landscape for more than half a century, firmly establishing Baker McKenzie as a prominent force for its domestic and foreign clients. The firm's vast, experienced team of experts, comprised of more than 130 lawyers, provides Swiss and multinational industry players, financial institutions, private equity houses and insurance companies with top-tier legal advice. The lawyers have a fantastic track record in providing domestic and cross-border advice in all areas of business law. Their dedication to providing clients with practical and innovative solutions, along with the quality of their work, have been consistently recognised with top rankings from Chambers and Partners.

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FinMIA Refit – Adjustments to Swiss Derivatives Regulation

FinMIA and Swiss derivatives regulation

The Federal Act on Financial Market Infrastructures and Market Conduct in Securities and Derivatives Trading ("FinMIA") came into force on 1 January 2016, and has since played a crucial role in regulating the Swiss financial market. The FinMIA governs the organisation and operation of the financial market infrastructure, as well as the conduct obligations of financial market participants in securities and derivatives trading. It regulates the organisation and operation of financial market infrastructures, which include exchanges, other trading systems, central counterparties, payment systems, central securities depositories, and trade repositories.

Further details of the regulation are set out in the Ordinance on Financial Market Infrastructures and Market Conduct in Securities and Derivatives Trading ("FinMIO"), and in relation to the derivatives regulation, to a limited extent, also in the Ordinance of the Swiss Financial Market Supervisory Authority on Financial Market Infrastructures and Market Conduct in Securities and Derivatives Trading ("FinMIO-FINMA"), which both came into force together with the FinMIA.

The introduction of the FinMIA was a reaction to the global financial market crisis of 2008, which revealed considerable weaknesses in the regulation and supervision of financial markets worldwide. Against this background, the FinMIA pursued two main objectives: to strengthen the stability of the financial system and to promote the competitiveness of the Swiss financial centre. In addition to these primary objectives, the FinMIA also aimed to ensure the protection of financial market participants and the equal treatment of investors.

Despite the success of the FinMIA during the first few years of its application, technological advances and changes in international standards became apparent in the following years, necessitating a revision of the law. Particularly in the area of derivatives trading, international standards have evolved significantly in recent years. For instance, the Financial Stability Board (FSB) recommended the introduction of global identifiers such as the legal entity identifier (LEI), the unique transaction identifier (UTI), and the unique product identifier (UPI) as early as 2014 to enhance the transparency and oversight of derivatives transactions.

The review of the FinMIA, conducted by the Federal Department of Finance (FDF) in 2022, revealed that the law in its current form no longer fully meets today's requirements. Adjustments were found to be necessary to align the FinMIA with technological developments and the evolution of international standards, as well as with relevant foreign legal systems, particularly EU regulations.

A key point of this revision is the simplification and appropriate structuring of the norms and proportionality of the regulations. The goal is to ease regulations, particularly for small market participants, without compromising the stability of the financial system. Additionally, legal uncertainties identified over the years are to be addressed by the revision to increase legal certainty for all market participants.

Legislative process and launch

After the legal consultation process was completed last autumn, a revised draft bill was submitted to the Federal Council. The Federal Council is preparing the dispatch on this draft bill, which contains the draft bill as well as a report and analysis. The dispatch is expected to be published later this year and submitted to parliament for discussion in 2026. Therefore, the amendments to the FinMIA are expected to come into force in 2027 at the earliest.

In line with the EMIR Refit (European Market Infrastructure Regulation Regulatory Fitness and Performance Programme), the authors have taken the liberty of referring to such amendments to the FinMIA as the "FinMIA Refit".

Current challenges

Since the introduction of the FinMIA, derivatives trading in Switzerland has been subject to various regulatory obligations based on international standards. These obligations include the clearing obligation via a central counterparty, the reporting obligation to a trade repository, the risk mitigation obligations and the obligation to execute certain derivatives transactions on an exchange or other trading system.

Despite such comprehensive regulations, various challenges have arisen in practice. One of the major weaknesses of the previous system was the reporting obligation, which was intended to increase market transparency and contribute to the stability of the financial system by enabling systematic monitoring of derivatives transactions. However, in practice, it was found that the quality of the reported data was often inadequate. This was mainly due to a lack of harmonisation of the data to be reported and the fragmentation of the data reported to various trade repositories.

In addition, the access of foreign supervisory authorities to Swiss trade repositories was severely restricted, which hindered international co-operation and impaired the efficiency of supervision. Further, the complex calculation of the thresholds for classifying counterparties as large or small led to a high administrative burden, especially for smaller non-financial counterparties. This caused unnecessary costs.

The revision of the FinMIA therefore aims to eliminate these weaknesses and improve derivatives trading for both domestic and international market participants.

Adaptation to international standards and EU law

The existing regulations in the area of derivatives trading are primarily based on EU law. Since the introduction of the FinMIA in 2016, EU law has evolved, particularly through the revision of the EMIR Regulation (EMIR Refit) in 2019. This revision aimed to simplify the regulation of derivatives trading and make it more proportionate, especially for small market participants.

Against this backdrop, it was necessary to adapt the FinMIA to the new EU regulations to maintain the competitiveness of the Swiss financial centre and ensure consistency with international standards.

Key changes

Reporting obligation

Current issues

The reporting obligation for derivatives transactions to a trade repository is a central element of the FinMIA. It aims to ensure that all relevant derivatives transactions can be recorded and monitored to identify systemic risks early and increase market transparency. However, this reporting obligation currently faces various challenges.

One of the biggest challenges is the inadequate quality of the reported data. This is mainly due to insufficient harmonisation of the data to be reported, making it inconsistent and incomparable. These inconsistencies make it difficult to analyse the data and identify potential risks. In addition, the fragmentation of the data reported to different trade repositories further diminishes the data quality. As a result, risks associated with derivatives transactions by Swiss counterparties have so far only been systematically monitored to a limited extent based on the data reported to trade repositories.

Another issue is that access for foreign supervisory authorities to Swiss trade repositories is severely restricted, hindering international co-operation and making it more challenging to monitor cross-border risks in the derivatives market.

Adjustments

As part of the revision of the FinMIA, the reporting obligation will be fundamentally revised to address these weaknesses. One of the key changes is the alignment of the reporting content with international standards. In future, the reported data should correspond to international identification systems, such as the LEI, the UTI and the UPI. These identifiers were developed to ensure uniform and standardised recording of derivatives transactions worldwide.

The introduction of these global standards is expected to significantly improve the quality of the reported data. The use of uniform identifiers will ensure that the data is consistent and comparable, facilitating the analysis and monitoring of derivatives markets. Aligning with international standards also helps Switzerland to better co-ordinate its regulatory practices with other major financial centres, thereby strengthening the competitiveness of the Swiss financial centre.

Another important innovation is the facilitation of access for foreign supervisory authorities to Swiss trade repositories. According to the new regulation (new Article 78, paragraph 1, letters a–c of the FinMIA), trade repositories must grant foreign financial market supervisory authorities free access to the data they require to perform their tasks, provided there is a co-operation agreement between the Swiss and foreign supervisory authorities, in which the foreign supervisory authority confirms that it is subject to a statutory confidentiality obligation. This amendment facilitates international co-operation and contributes to better monitoring of cross-border risks in the derivatives market.

Relief for small non-financial counterparties

Current issues

Under the existing FinMIA, small non-financial counterparties are also required to report their derivatives transactions to a trade repository. However, this reporting obligation leads to a considerable administrative burden and high costs for such counterparties. Many of these small non-financial counterparties only carry out a few derivatives transactions per year, and the benefit of their reports was considered minimal. Nevertheless, in principle, they are required to meet the same complex reporting requirements as large financial institutions.

Further, the existing calculation method for determining whether a non-financial counterparty is classified as small or large is not effective. It is based on calculating the average gross position over 30 working days, which poses a significant administrative burden for many small companies. This method requires constant monitoring and calculation of positions, which is particularly challenging for smaller companies that do not have the same resources as large financial institutions.

Adjustments

As part of the revision of the FinMIA, various measures have been taken to ease the regulatory requirements for small non-financial counterparties. One of the key changes is the complete exemption of these small counterparties from the reporting obligation (new Article 104, paragraph 3 of the FinMIA). This exemption applies to transactions between small non-financial counterparties, as well as transactions between a small non-financial counterparty and a financial counterparty that is not domiciled in Switzerland. Such change aims to reduce the administrative burden for small companies without jeopardising the stability of the financial system.

In addition, the method for calculating the thresholds used for classification as a small or large counterparty has been simplified. Instead of calculating the average gross position over 30 working days, the average of the aggregated gross month-end positions for the preceding 12 months in the relevant outstanding OTC derivatives transactions per derivatives category will be calculated in future (new Article 98 of the FinMIA). The new calculation method is less complex and only needs to be performed once a year, significantly reducing the administrative burden for small counterparties. The calculation method for defining whether a non-financial counterparty is classified as small is now based on the EU calculation method (EMIR Refit).

Furthermore, this new calculation method will also be applied to small financial counterparties, creating a uniform and coherent regulation for all small counterparties (new Article 99 of the FinMIA). This simplification helps to increase the consistency and transparency of regulation while minimising the burden on the companies concerned.

Cross-border derivatives transactions

Current issues

Cross-border derivatives trading is subject to complex regulatory requirements, making it difficult for market participants to fulfil their obligations. Under the existing FinMIA, market participants engaging in cross-border derivatives transactions first have to determine whether the foreign law is recognised as equivalent by theFINMA, and whether the obligations under the FinMIA also apply to the foreign counterparties. This review was associated with significant costs and uncertainties, as market participants often have difficulties in practice assessing the obligations of their foreign counterparties correctly.

Additionally, market participants must categorise their foreign counterparties (in accordance with Article 93 of the FinMIA), which further increases the administrative load. This complexity and the associated costs were a significant burden, especially for smaller companies.

Adjustments

The revision of the FinMIA aims to simplify cross-border derivatives trading and increase legal certainty for market participants. One of the most important changes is the introduction of a uniform regulation for cross-border transactions in the new Article 95a of the FinMIA. This regulation clearly defines which obligations apply to transactions with foreign counterparties if these counterparties would be subject to the obligations if domiciled in Switzerland. This new regulation replaces several previous provisions, including Articles 102 and 114 of the FinMIA, as well as parts of Article 106, paragraph 1 of the FinMIO (which all deal with cross-border transactions). The consolidation improves the clarity of the regulations and reduces the administrative burden for market participants.

Another important change is the simplification of the application of foreign law. In the future, market participants can assume that the foreign law recognised by FINMA, as the equivalent, can be used not only for fulfilling obligations but also for categorising counterparties (new Article 95, paragraph 2 of the FinMIA). This means that market participants no longer have to categorise their foreign counterparties separately under Swiss law, which significantly reduces the administrative burden and increases legal certainty.

These changes will help to facilitate cross-border derivatives trading and strengthen the competitiveness of the Swiss financial centre in the international environment. Particularly for smaller companies engaged in cross-border activities, these simplifications mean a significant reduction in costs and administrative burden.

Valuation obligations and risk mitigation

Current issues

The valuation obligation for outstanding derivatives transactions is a key instrument for risk mitigation in derivatives trading. It is intended to ensure that market participants are informed at all times about the current value of their outstanding positions and can react accordingly to market changes. This valuation is particularly important for large counterparties, as they typically have extensive derivative positions that can carry significant risks.

However, under the existing FinMIA, the valuation obligation is not clearly regulated, particularly as far as transactions between large and small counterparties are concerned. This leads to uncertainties in practice and makes it difficult to apply the valuation regulations.

Adjustments

As part of the revision of the FinMIA, the valuation obligation has been clarified and adapted to practice. New Article 109, paragraph 2 of the FinMIA now clearly provides that the valuation obligation also applies to large counterparties in transactions with small counterparties.

Such clarification ensures that an adequate valuation of outstanding positions is carried out even in transactions with smaller counterparties. Further, it ensures that the valuation obligation is consistently applied and that all relevant risks in derivatives trading can be adequately monitored, which also increases the stability of the financial system and improves market transparency.

FinMIA Refit's importance to the Swiss financial centre

The revision of the FinMIA and the associated changes to derivatives trading are an important step towards strengthening the stability and competitiveness of the Swiss financial centre. Harmonisation with international standards and the simplification of regulations will improve transparency and risk assessment in the derivatives market. Small non-financial counterparties will particularly benefit from the simplifications and significantly reduce their administrative burden.

The introduction of a uniform regulation for cross-border transactions and the harmonisation of reporting obligations will also strengthen the competitiveness of Swiss companies in the international environment. Overall, the FinMIA Refit will help strengthen confidence in the Swiss financial market and further consolidate its position as a stable and attractive financial centre. The clarification of valuation obligations and the facilitation of foreign supervisory authorities' access to Swiss trade repositories are additional measures that contribute to improving market stability and transparency. In summary, the FinMIA Refit is a necessary step towards making the Swiss financial market fit for the future and securing its role in the global financial system. As mentioned above, it is expected to enter into force in 2027 at the earliest.

UK

Law and Practice

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Katten Muchin Rosenman UK LLP (Katten) is a law firm with a derivatives practice in the UK that represents a wide range of clients (proprietary traders, brokers, investment managers, commodity trading companies, corporates, exchanges and clearing organisations) on an equally wide range of commercial transactions encompassing many different asset classes, including crypto. This breadth of practice gives the team a valuable perspective and a basis for creative problem-solving. The practice is founded on a deep understanding of derivatives regulation, market practices and documentation. The lawyers help clients understand and comply with the myriad of rules and regulations affecting their businesses, and negotiate agreements to assist clients in closing deals, rather than prolonging the negotiation process. The firm's UK team is fully co-ordinated with its US practice, enabling the lawyers to efficiently and effectively provide cross-border advice to serve the needs of clients doing business on both sides of the Atlantic. Clients rely on Katten to design three-cornered analyses for their activities in the UK, EU and US.

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1. General

1.1 Overview of Derivatives Markets

The UK's regulatory framework over the derivatives markets and products is currently comprised of a mixture of UK domestic and EU-derived rules and regulations. The key pieces of legislation and regulations that impact the UK derivatives markets include the following.

- Financial Services and Markets Act 2000 (FSMA) – This is the cornerstone of UK financial regulation. The "general prohibition" therein states that a person carrying out particular activities in relation to specified investments (including derivatives) must be authorised to do so or have an exemption. The FSMA also places restrictions on financial promotions (ie, invitations or inducements to engage in investment activity).
- Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (RAO) – This sets out the specified activities (eg, dealing as principal, arranging deals in investments) and specified investments that fall within the scope of the FSMA. Schedule 2 of the RAO lists 11 categories of financial instruments, with paragraphs 4–10 covering derivatives.
- European Market Infrastructure Regulation (EU EMIR) – Although initially an EU regulation, post-Brexit, the UK adopted EU EMIR into domestic law (UK EMIR). UK EMIR and EU EMIR focus on the regulation of derivatives and introduced several requirements relating to over-the-counter (OTC) derivatives. Among other things, UK EMIR and EU EMIR require the central clearing of standardised OTC derivatives, reporting of transactions in all derivatives to trade repositories, and implementation of risk mitigation techniques for non-cleared OTC derivatives. UK EMIR and EU EMIR have also been amended over the years, including by the UK and EU EMIR Refit.
- The European Markets in Financial Instruments Directive II and Markets in Financial Instruments Regulation (EU MiFIR) (together, EU MiFID II) - Similar to EU EMIR, EU MiFID II was also onshored in the UK (primarily through amendments to the FSMA and an assimilated version of EU MiFIR (UK MiFIR; together, UK MiFID II)). These cover investment services and activities conducted in relation to financial instruments, including derivatives. UK MiFID II contains a number of significant measures relevant to derivatives, including requiring standardised derivatives to be executed on a trading venue, pre- and post-trade transparency requirements, and position limits for certain commodity derivatives. UK MiFIR also mandates the reporting of certain derivatives transactions.
- Regulation on Wholesale Energy Market Integrity and Transparency (UK REMIT) – UK REMIT applies to wholesale energy markets, covering contracts for the supply and transportation of electricity and natural gas, including derivatives. It includes obligations relating to registration, market abuse and reporting.

Derivatives can also fall within, or be affected by, a number of other legislative frameworks in the UK, including the Short Selling Regulation, Market Abuse Regulation, Benchmarks Regulation, Packaged Retail and Insurance-based Investment Products Regulation, Undertakings for Collective Investment in Transferable Securities (UCITS) Directive, Alternative Investment Fund Managers Directive, and capital rules.

1.2 Historical Trends and Looking Forwards

Following the global financial crisis of 2007–08 and the 2009 G20 Pittsburgh Summit agreement to, among other things, clear all standardised OTC derivative contracts through a central counterparty (CCP), the EU adopted EU EMIR in 2012. EU EMIR was intended to increase transparency in the OTC derivatives markets, mitigate credit risk and reduce operational risk, and it had a significant impact on the EU derivatives landscape.

The UK's departure from the EU in January 2020 also hugely influenced the development of the derivatives markets in the UK. EU financial markets legislation, including EU EMIR, was largely onshored in the UK following Brexit under the European Union (Withdrawal) Act 2018. However, the UK government intended to repeal and replace the majority of EU law with the UK's own domestic rules over time.

The Financial Services and Markets Act 2023, published in July 2023, established the legislative framework for the revocation of all EU retained law (now referred to as "assimilated" law) relating to financial services and the transition to new requirements under the UK's FSMA regime. The UK's HM Treasury (HMT) has begun the process of revoking assimilated EU legislation in a piece-by-piece manner. Such revocation relies upon the relevant UK regulators having drafted and consulted on replacement rules in the required areas. It is expected that it will take several years to complete the process of revoking assimilated EU law.

Much of the next 12 months (and beyond) will likely be spent on the further repeal and replacement of assimilated EU law. Any such replacement legislation and rules are not initially expected to be significantly different to the EU law versions, but divergence is anticipated. Over time, as the EU amends its rules and regulations, further divergence between the UK and EU regimes can be expected. Ultimately, this could lead to increased compliance costs for those international firms that might have to comply with both regimes. We have already seen the implications of this for firms that are subject to both the UK and EU EMIR Refit.

As with other jurisdictions, ESG (ie, environmental, social and governance practices), operational resilience, and the use of new technologies such as artificial intelligence and distributed ledger technology are also expected to have an impact on the development of the derivatives markets in the UK.

2. Types of Derivatives

2.1 Futures and Options

The UK does not use the term "futures" contract solely to refer to a derivative that must be traded on a UK-regulated market or an equivalent third-country market (ie, exchange). A futures contract, which is a regulated financial instrument under the RAO, can be traded both OTC as well as on a regulated market (ie, one that is registered with the Financial Conduct Authority (FCA)). Futures are defined in the RAO as "rights under a contract for the sale of a commodity or property of any other description under which delivery is to be made at a future date". However, such a contract will not fall within the definition of a futures contract, and therefore not be a financial instrument when the contract is made for commercial rather than investment purposes. If such a contract is traded on a regulated market or third-country market, however, the contract will be deemed to be for investment purposes and will be a futures contract. The term "exchange-traded derivative" (ETD) is more frequently used in UK regulation to refer to derivatives traded on a UK-regulated market; however, the regulated markets themselves use the terms "futures" and "options on futures" to describe their products.

The UK currently only has five regulated markets, three of which are stock exchanges. The two non-stock exchanges, ICE Futures Europe (IFEU) and the London Metal Exchange (LME), both list various futures and options on futures across an array of asset classes. IFEU lists such products for energy, soft commodities, emissions, interest rates and securities. The LME lists such products for various metals, including non-ferrous, ferrous and EV metals, and platinum.

In March 2024, the FCA announced that it would not oppose requests from regulated markets to list exchange-traded notes backed by crypto assets. As a result, institutional investors can now participate in this type of trading. Additionally, a select group of multilateral trading facilities (MTFs) have been approved by the FCA to facilitate trading in crypto derivatives. In January 2021, the FCA implemented a ban on UK firms offering or selling crypto derivatives and exchange-traded notes that reference certain types of crypto-assets (cETNs) to UK retail consumers. In June 2025, the FCA issued proposals to lift such a ban in relation to cETNs, which it subsequently confirmed would be effective from 8 October 2025.

2.2 Swaps and Security-Based Swaps

In the UK, OTC derivatives (the financial instruments that are most similar to swaps and security-based swaps as defined under the US federal commodities and securities laws) that have underlying securities, as opposed to those on non-securities, do not have a distinct regulatory regime. Under UK EMIR, derivatives are linked to one of five applicable asset classes:

- interest rates;
- foreign exchange (FX);
- commodities;
- equity; and
- credit.

The regulation of derivatives under UK EMIR does not differ based on the derivative's underlying asset class.

Cleared OTC derivatives are not regulated separately from uncleared OTC derivatives under UK EMIR. Most of the UK regulation applicable to cleared OTC derivatives under UK EMIR applies to the CCP and the clearing member.

2.3 Forwards

Under UK regulation, a "forward" is considered to be a form of derivative (and therefore a regulated financial instrument) and is generally regulated in the same way as any other form of derivative. However, in the UK, FX forwards and physically settled commodity forwards are regulated differently from forwards on interest rate, cash-settled commodities, equities and credit.

OTC derivatives on a commodity that must be physically settled and cannot be cash-settled, and are not traded on a regulated market, an MTF or an organised trading facility (OTF) – together, a trading venue – generally fall outside of the definition of a financial instrument and are therefore not subject to UK regulation.

Physically settled FX forward contracts and physically settled FX swaps contracts, although still regarded as financial instruments, are not subject to the obligation to exchange variation margin (VM) if one of the counterparties to the OTC derivative is not a credit institution or would not be such an institution if it were to be established in the UK. The posting of initial margin (IM) is not required for physically settled FX forward contracts and FX swaps.

2.4 Listed v Over-the-Counter

The regulation of derivatives under UK EMIR differs not by asset class but according to whether the derivative is an ETD or an OTC derivative. Derivatives can trade either bilaterally or on one of three types of regulated trading venues. If a derivative is traded on a regulated market, it is classified as an ETD (ie, listed). If a derivative trades on either an MTF or OTF, it is classified as an OTC derivative, as is any derivative agreed bilaterally between the two counterparties.

Under UK EMIR, both ETDs and OTC derivatives must be reported to an FCA-registered or FCA-recognised trade repository. The other UK EMIR obligations are only applicable to OTC derivatives and include:

- risk mitigation (including the uncleared margin rules (UMRs)); and
- mandatory clearing.

The G20 obligation of requiring mandatory trading of any OTC derivative subject to a mandatory clearing obligation is provided for in UK MiFID II.

2.5 Asset Classes

In the UK OTC derivatives market, interest rates are the largest traded asset class by a significant margin, with FX following as a distant second. Derivatives in the credit, equity and commodity asset classes represent a very modest share of the overall UK OTC derivatives market.

An emission allowance is a financial instrument under paragraph 11 of Schedule 2 of the RAO, but not a derivative. However, derivatives on emission allowances are included in the definition of a derivative in paragraph 4 of the RAO.

The UK is generally agnostic regarding the asset classes that can underlie a derivative contract. Paragraph 10 of Schedule 2 of the RAO includes a broad catch-all for evolving asset classes to include "any other derivative contracts relating to assets, rights, obligations, indices and measures not otherwise mentioned in this Section, which have the characteristics of other derivative financial instruments". The FCA does, however, ban or restrict the sale of certain derivatives to retail consumers, including contracts for differences (CFDs) on equity securities and indices, commodities, FX and cryptocurrencies, spread bets and rolling spot FX transactions that qualify as financial instruments.

Derivative products related to crypto-assets and carbon credits (ie, UK allowances and voluntary carbon credits) are steadily increasing in size and liquidity.

2.6 Exemptions, Non-Derivative Products and Spot Transactions

As discussed in **2.3 Forwards**, OTC commodity derivatives that must be physically settled and cannot be cash-settled, are not traded on a trading venue or equivalent third-country trading venues, or are equivalent to such transactions traded on such markets generally fall outside the definition of a financial instrument and therefore are out of scope of UK regulation, especially if one of the parties to the transaction is a supplier or producer of the commodity.

The UK does have a broad exemption for certain FX transactions that are either considered spot transactions or forward FX transactions connected to a payment transaction. Although an FX transaction involving two major currencies must be settled within two trading days to be considered a spot transaction, an FX transaction that is used for the main purpose of the sale or purchase of a transferable security or a unit in a collective investment scheme will also be considered a spot transaction if it settles within the shorter of:

- the period generally accepted in the market for the settlement of that security or unit as the standard delivery period; and
- five trading days.

Additionally, an FX transaction involving the exchange of a non-major currency for either another non-major currency or a major currency will be considered a spot transaction if it settles within the longer of:

- two trading days; and
- the period generally accepted in the market as the standard delivery period for that currency pair.

A physically settled FX forward contract will not be considered a financial instrument if:

- it is used as a means of payment;
- it must be physically settled (other than for reasons of a default or other termination event);
- one of the parties is not a financial counterparty (FC);
- it is not traded on a trading venue; and
- it is entered into to facilitate payment for identifiable goods or services, or for direct investment.

Physical spot commodities transactions do not fall within the definition of a financial instrument and therefore are not subject to UK regulation. A leveraged spot commodity transaction, however, would fall under the CFD definition and is therefore banned by the FCA from being sold to UK retail market participants.

3. Regulation of Derivatives

3.1 National

3.1.1 National Regulators

The Prudential Regulation Authority (PRA), which is part of the Bank of England, and the FCA are the UK regulators with primary responsibility for the supervision and oversight of derivatives market participants in the UK. The PRA's primary role is the authorisation and prudential regulation of banks, building societies and credit unions. In contrast, the FCA's primary role is to establish the business conduct standards that apply to derivatives market participants as well as the trading venues that list derivatives products for trading. The FCA is also responsible for the prudential supervision of firms that are not PRA-regulated.

Other UK regulators also play an important role and have significant responsibilities. The Bank of England supervises certain key market infrastructures that are vital to the derivatives markets, including CCPs and payment and settlement systems. Additionally, the UK's energy regulator, the Office of Gas and Electricity Markets (Ofgem), is responsible for the registration of market participants in the wholesale energy market, which encompasses wholesale energy derivatives under UK REMIT.

3.1.2 Clearing

There are two independent derivatives-clearing obligations under UK law. Under the first obligation, all derivatives concluded on a UK-regulated market must be cleared at a CCP without exception.

Separately, the Bank of England is responsible for determining which standardised OTC derivatives must be cleared at a CCP; this list currently includes a number of interest rate and index credit default products. Whether the clearing obligation applies to an in-scope product depends on the nature of the counterparties to the transaction. Generally, transactions between some combination of financial counterparties (FCs) and/or non-financial counterparties (NFCs) that exceed the clearing threshold applicable to the relevant asset class (NFC+s) must be cleared unless an exemption applies. Relevant exemptions include qualifying intra-group transactions, which are subject to an application process with the FCA, as well as transactions by certain qualifying UK and EEA pension schemes, which the FCA has recently made permanent. In addition, certain "small" FCs are not required to clear OTC derivatives transactions that are otherwise subject to mandatory clearing, provided they do not exceed the relevant clearing threshold.

FCs and NFCs must therefore determine on an annual basis whether, for a given asset class, their cleared and uncleared derivatives not executed on a UK-regulated market or a third-country exchange deemed to be equivalent by the FCA, exceed the threshold applicable to a given asset class (currently EUR3 billion for interest rate, FX and commodities products, and EUR1 billion for credit and equity products). If a threshold is exceeded, the FC or NFC must begin clearing the relevant in-scope OTC derivatives within four months of crossing the relevant threshold(s). NFCs are permitted to exclude hedging transactions from the UK EMIR clearing threshold calculation. NFC+s are only required to clear OTC derivatives in the asset classes where they exceed the relevant threshold, whereas a "small" FC that exceeds the relevant threshold in any asset class must then clear OTC derivatives subject to a clearing obligation in all asset classes.

The Bank of England has the authority to suspend the clearing obligation in respect of one or more OTC derivatives, initially for a period not exceeding three months, where certain conditions are met. The suspension period may be renewed for successive three-month periods, up to a maximum of 12 months.

3.1.3 Mandatory Trading

ETDs must, by definition, be concluded on a UK-regulated market or an equivalent third-country market.

Additionally, the FCA may decide that an OTC derivative, which is subject to a UK clearing obligation, is also subject to a UK trading obligation. This applies if the OTC derivative is traded or admitted to trading on at least one UK trading venue, or on a third-country trading venue deemed equivalent for the trading obligation. Furthermore, there must be adequate third-party buying and selling interest to facilitate trading in the product. Where the UK trading obligation applies to an OTC derivative, in-scope FCs and NFC+s must conclude all transactions in such an OTC derivative on a UK or equivalent third-country trading venue. Currently, only venues in Singapore and the United States regulated by the Commodity Futures Trading Commission benefit from such equivalence, although the FCA has used its powers in relation to the UK trading obligation to permit firms to transact on EU trading venues in certain circumstances.

The UK's rules require that derivatives' clearing and trading obligations operate together. This means that if the clearing obligation is suspended, the related trading obligation is also suspended.

3.1.4 Position Limits

The FCA has recently published its final rules overhauling the UK's position limits regime for commodity derivatives. The FCA's reforms are intended to enhance the flexibility and effectiveness of the limits, while maintaining the competitiveness of the UK market. Key aspects of the new framework, which takes effect on 6 July 2026, are summarised below.

- The scope of the FCA's upcoming regime is limited to a prescribed set of 14 "critical contracts" listed for trading on the LME and ICE Futures Europe, which have been designated based on the risks associated with abusive or disorderly trading practices in such contracts, and the FCA's determination that position limits are most likely to mitigate such risks. Responsibility for setting the relevant position limits rests with the venues themselves rather than the FCA; however, venues are required to satisfy the criteria and standards set by the FCA when establishing their limits.
- The new framework also establishes a mechanism for identifying certain contracts that are "closely related" to the identified "critical contracts"; such "closely related" contracts will then be included within the applicable position limit calculations. The closely related contracts replace the economically equivalent OTC (EEOTC) contracts from the previous regime.
- The UK position limits apply regardless of the location of the person at the time of entering into a position, or the location of execution.

Where the FCA determines that a commodity derivative should be added to the list of critical contracts, market participants will have a 45-day notice period to submit comments, following which the determination will be amended or finalised. Trading venues must then establish and apply the relevant limits no later than the date on which the contract becomes a critical contract.

Eligible firms may apply to the FCA for an exemption from an applicable position limit. The revised UK framework maintains the so-called "hedging" exemption for non-financial firms in relation to positions that qualify as reducing risks relating to their commercial activities. The FCA has also added a new "pass-through" hedging exemption for financial firms that facilitate hedging activities, as well as a further exemption for liquidity providers in critical contracts.

UK trading venues must establish position accountability thresholds in the spot month, which are set below the applicable position limit to monitor activity in the contract. Trading venues are also afforded a measure of discretion when determining whether to establish position accountability thresholds in non-spot months for critical contracts.

When a market participant exceeds an accountability threshold, a trading venue in the UK must have rules that empower it to require the market participant to provide information. This includes details about the market participant's OTC activities and any client-related trading. The UK trading venue also has the authority to require the market participant to reduce its position to below the accountability threshold.

3.1.5 Reporting

Both UK EMIR and UK MiFIR impose reporting requirements on OTC derivatives transactions.

UK EMIR Derivatives Transaction Reporting

Article 9 of UK EMIR requires UK counterparties and CCPs to report all ETDs and OTC derivatives concluded, modified or terminated to a trade repository registered or recognised by the FCA by the following working day. As of 30 September 2024, due to UK EMIR Refit, all UK counterparties (including those that are unregulated) that are required to report under UK EMIR must notify the FCA (or in the case of CCPs, the Bank of England) of any material errors or omissions in their reporting as soon as they become aware of them. UK EMIR previously required 129 reporting fields for each transaction reported, but this was increased to 204 on 30 September 2024 due to the requirements under UK EMIR Refit.

UK EMIR requires double reporting. This means that both counterparties to a derivative are solely responsible and legally liable for reporting their side of the derivative with the exception that, due to the changes brought in by UK EMIR Refit, an FC is obliged to report both sides of the OTC derivatives it enters into with an end user that is an NFC below all UK EMIR clearing thresholds (NFC-), unless such NFC- determines to do its own reporting. Further, an NFC- is not required to report any OTC derivative transaction with a third-country entity that would be an FC were it to be established in the UK, where an equivalence decision for reporting has been made for that jurisdiction. In addition, UK EMIR, as amended by UK EMIR Refit, requires an alternative investment fund manager (AIFM) to report on behalf of its alternative investment fund (AIF), and the management company of a UCITS to report on behalf of UCITS. Due to the fact that UK EMIR Refit has modified the definition of an FC to include both an AIFM and an AIF, a UK AIFM is required to report the OTC derivatives entered into by any of the third-country AIFs it manages, as well as for its UK AIFs. Delegated reporting is permitted under UK EMIR, but the UK counterparty with the UK EMIR reporting obligation remains solely responsible and legally liable for the reporting.

Due to the UK's back-to-back clearing model, an ETD can be required to be reported by multiple counterparties. For example, if an investment firm enters into an ETD through its clearing firm, which a CCP then clears, all parties involved – namely the investment firm, the clearing firm, and the CCP – will be required to report the ETD. This will result in four reports, as each entity must document its respective part of the transaction.

UK EMIR provides an exemption from the reporting obligation for intra-group transactions, which requires at least one counterparty to be an NFC (or that it would be if it were established in the UK) and notification to the FCA. The exemption additionally requires that:

- both counterparties are included in the same consolidation on a full basis;
- both counterparties are subject to appropriate centralised risk evaluation, measurement and control procedures; and
- the parent undertaking is not an FC.

UK MiFIR Transaction Reporting

UK MiFIR requires all UK investment firms to report transactions they execute in certain financial instruments to the FCA. Such reports must be made as soon as possible, and no later than the close of the next working day. The requirement applies to trades in financial instruments, including derivatives, to which any of the following criteria apply:

- they are admitted to trading or are traded on a UK, Gibraltar or EU trading venue;
- the underlying is a financial instrument traded on a UK, Gibraltar or EU trading venue; or
- the underlying is an index or basket composed of financial instruments traded on a UK, Gibraltar or EU trading venue.

"Transaction" and "execution" each have specific definitions for the purposes of the transaction reporting regime:

- "Transaction":
  - (a) includes the purchase/sale of a financial instrument, entering into/closing out a derivative contract or an increase/decrease in the notional amount of a derivative contract; and
  - (b) specifically excludes certain post-trade and settlement-related actions, including contracts arising exclusively for clearing or settlement purposes, the post-trade assignment or novation of a derivative contract and portfolio compressions.
- "Execution" includes the reception and transmission of orders (unless made under certain specified requirements), the execution of orders on behalf of clients, dealing on own account and making an investment decision in accordance with a discretionary mandate given by a client.

In November 2024, the FCA published a discussion paper on improving the UK's transaction reporting regime, including removing unnecessary burdens for reporting firms. A follow-on consultation paper is expected in 2025.

3.1.6 Business Conduct

A number of business conduct requirements can apply to parties engaged in derivatives trading in the UK, depending on their status under UK EMIR (eg, FC or NFC) and their regulatory status.

The key conduct requirements under UK EMIR include those outlined below.

- Margin requirements: Subject to certain exemptions and exceptions, UK EMIR margin requirements (VM and IM) generally apply where an FC

or an NFC+ established in the UK enters into non-centrally cleared OTC derivative contracts with either another FC or NFC+, or a third-country counterparty that would be an FC or NFC+ if it were established in the UK.
- Risk mitigation techniques: FCs and NFCs must implement risk mitigation techniques for OTC derivative contracts not cleared by a CCP. These techniques include timely confirmation, portfolio reconciliation, portfolio compression, and dispute resolution processes.
- Mark-to-market and mark-to-model valuations: FCs and NFCs must perform daily mark-to-market valuations of their derivative positions. If market conditions prevent this, they must use reliable and prudent mark-to-model valuations.
- Reporting obligations: as discussed in **3.1.5 Reporting**.
- Clearing obligations: as discussed in **3.1.2 Clearing**.
- UK FCs, as authorised entities, can also be subject to the full range of requirements under, among other things, UK MiFID II and the FCA's Handbook. This includes the FCA's high-level principles, as well as specific requirements relating to, for instance:
  (a) financial promotions and client communications;
  (b) client classification and suitability;
  (c) conflicts of interest;
  (d) business continuity and outsourcing;
  (e) the FCA's Senior Managers and Certification Regime;
  (f) market conduct;
  (g) anti-money laundering, bribery and fraud; and
  (h) record-keeping.

3.1.7 Commercial End Users

It would be prohibitively expensive for many end-users to have the middle- and back-office infrastructure to support compliance with the UK EMIR reporting, clearing and risk management obligations and the UK MiFID II trading obligations. Therefore, UK EMIR, as amended by UK EMIR Refit, provides substantial relief for those end users who are NFC-s. UK FCs must now report, on behalf of the NFC-, any OTC derivative transaction they enter into with an NFC-, unless the NFC- determines to do its own reporting. Further, NFC-s are no longer required to report the OTC derivatives transactions they enter into with third-country entities that would be FCs were they established in the UK, provided a reporting equivalence decision has been made for that jurisdiction. NFC-s are exempt from both UK EMIR clearing and UMRs. NFC-s are, however, subject to the UK EMIR risk mitigation obligation, which requires portfolio reconciliation, dispute resolution and portfolio compression (if certain thresholds are met). However, such compliance obligations in general are more burdensome to the FC than to an NFC-; for instance, an NFC- can elect to be a receiving entity and not a sending entity for the purposes of the portfolio reconciliation obligation.

In contrast, NFC+s are equally subject to all UK EMIR obligations as an FC above one or more clearing thresholds (FC+). However, certain UK EMIR exemptions apply for NFC groups, regardless of whether the NFC is an NFC-. As discussed in **3.1.5 Reporting**, an exemption from UK EMIR reporting exists when, among other conditions, one party to the OTC derivative transaction is an NFC and the parent undertaking of the group is not an FC. An intra-group exemption from both the UK EMIR clearing obligation and margin obligation for uncleared OTC derivatives exists for NFCs (and FCs) provided an application is filed with and granted by the FCA.

3.2 Local

UK regulation of the derivatives markets and market participants occurs solely at the national level.

3.3 Self-Regulatory Organisations, Independent Authorities, and Exchanges

The UK derivatives regulatory regime does not have any "self-regulatory organisations" with quasi-statutory rulemaking authority akin to the US National Futures Association, nor do UK trading venues have the authority to establish or enforce any industry-wide standards or regulations.

4. Documentation Issues

4.1 Trading Documentation

4.1.1 Industry Standards and Master Agreements

Uncleared OTC Derivatives

Uncleared OTC derivatives are commonly governed by the standard agreements published by the International Swaps and Derivatives Association, Inc. (ISDA), regardless of product type or counterparty, and are generally governed by either English or New York law.

As part of ISDA's aim to streamline derivatives documentation, it has developed a standardised framework of documentation for derivatives transactions. Such documents include:

- the 1992 and 2002 master agreements – a pre-printed framework document comprised of boilerplate provisions;
- the schedule to the master agreement – amends the terms of the master agreement as agreed by the parties;
- the credit support document – an optional document that offers each party security against the other party's credit risk, either in the form of:
  (a) a credit support annex (CSA); or
  (b) a credit support deed (CSD); and
- the confirmation – sets out the economic terms of an individual trade.

The master agreement, schedule, CSA (if any), and all confirmations form one single contract. The CSD (if any) is a standalone document.

Cleared OTC Derivatives

Cleared OTC derivatives can also be documented under standard ISDA documentation. However, frequently, a Futures Industry Association (FIA)–ISDA Cleared Derivatives Execution Agreement is used instead of negotiating a full ISDA. Additionally, an FIA–ISDA Cleared Derivatives Addendum is generally used to document the relationship between a clearing member and its client. However, there can be practical differences between the documentation process for cleared and uncleared OTC derivatives. For example, the cleared OTC derivatives documentation process is generally heavily dependent on automated information technology processes. Additionally, the terms of cleared OTC derivatives documents must conform to the relevant clearing house's contract specifications.

ETDs

The parties involved in ETDs do not execute bilateral derivatives documentation, such as the standard ISDA documentation, but are subject to the rules of the underlying exchange.

ETDs are generally governed by standard documentation in line with the exchange's contract specifications, as applied through the exchange's rules. If a party to an ETD is not itself a member of the exchange, it will be required by its clearing firm and/or brokerage firm to negotiate a clearing/brokerage agreement, which is generally bespoke to each such firm.

4.1.2 Margins

ISDA has produced standard credit support documents that take the form of either a CSA or a CSD. Generally, the governing law of the credit support document matches the governing law of the ISDA master agreement (although this is not mandatory).

VM

In 2016, ISDA introduced a new CSA for VM that is used for documenting the posting of VM under English law (2016 VM CSA). The 2016 VM CSA forms part of a suite of credit support documents introduced to aid compliance with margin requirements for derivatives that are not subject to mandatory clearing under UK EMIR and comparable legislation in other major financial jurisdictions.

The 2016 VM CSA revises the 1995 ISDA CSA (Bilateral Form–Transfer) (1995 CSA) to allow parties to determine VM arrangements that meet the regulatory requirements for uncleared derivatives (ie, UMRs) that entered into force in March 2017. The structure of the 2016 VM CSA remains consistent with the 1995 CSA. The updates in the 2016 VM CSA relate solely to VM. ISDA has also published a 2016 VM CSA under New York law.

ISDA has also published the 2016 Variation Margin Protocol to help market participants comply with the VM requirements of the UMRs. This enables market participants to amend their CSAs with multiple counterparties to comply with the UMRs.

IM

Under UK EMIR, as further detailed in the UMRs, parties to a derivatives agreement are required to post IM if they have uncleared derivatives portfolios with an aggregate average notional amount exceeding certain thresholds.

At a minimum, parties will likely need the following suite of documentation regarding the posting of IM:

- a collateral agreement between the parties – the relevant CSA, CSD or collateral transfer agreement and security agreement (where posted collateral is held outside the UK or with Euroclear/Clearstream);
- an account control agreement – a tripartite agreement between the parties and the custodian, which sets out control and access provisions in accordance with the relevant segregation requirements under the applicable margin rules;
- an eligible collateral schedule between the parties;
- a custody agreement between a party and the custodian; and
- a Euroclear/Clearstream representative agreement – required where the counterparty posts IM via Euroclear/Clearstream.

4.1.3 Other Agreements

Global Master Repurchase Agreement (GMRA)

Repurchase (repo) transactions can be documented individually, but they are typically documented under a master agreement. The International Capital Market Association (ICMA) and the Securities Industry and Financial Markets Association (SIFMA) have published standard forms of the repo master agreement, namely the GMRA.

The 2011 version of the GMRA is generally used to document non-US repo transactions.

The GMRA is comprised of three parts:

- standard boilerplate legal and credit provisions: these include warranties, events of default, margining provisions and netting provisions;
- annexes: Annex I allows the parties to modify the boilerplate provisions of the GMRA, and certain other annexes can be added to cover particular types of security; and
- confirmation: this contains the commercial terms of each repo transaction.

Global Master Securities Lending Agreement (GMSLA)

Securities lending transactions are usually documented by the GMSLA, which is a market standard master agreement produced by the International Securities Lending Association (ISLA). The ISLA is a trade association representing the interests of participants in the securities lending market.

The GMSLA was originally drafted to comply with English law on securities lending. It has been developed as a market standard for securities lending and sets out the obligations of the borrower and the lender. It is now recognised as the most-used agreement in the UK and EU bilateral securities lending market. While various versions of the GMSLA exist, the 2010 version is the most widely used for new trading relationships.

The GMSLA is comprised of the following parts:

- master agreement – the preprinted form;
- schedule – where the parties can amend the preprinted form;
- confirmation – sets out the economic terms of individual securities lending transactions; and
- annexes and addendums – there are various annexes and addendums that the parties might agree to attach to the GMSLA (eg, the agency annex and an addendum for pooled principal agency loans).

Master Repurchase Agreement (MRA)

The MRA, published by SIFMA, is the primary form of standardised repo agreement used for US repo transactions. The latest version of the MRA was published in 1996 by SIFMA.

Master Securities Lending Agreement (MSLA)

The MSLA, published by SIFMA, is the primary form of standardised agreement used for US securities or stock lending transactions.

Master Securities Forward Transaction Agreement (MSFTA)
The MSFTA, published by SIFMA, is the primary form of standardised agreement used to document a US securities forward transaction that is subject to margin requirements under Financial Industry Regulatory Authority Rule 4210.

4.2 Clearing Documentation
In summary, the following documents may be relevant with respect to cleared derivatives.

- CCP rulebook and procedures: These set out details in relation to access to clearing and how clearing works.
- Clearing agreement between the clearing member and the client: The terms on which contracts are cleared are stipulated in the clearing house's standard clearing agreement. The FIA has published terms of business that are commonly used to document this relationship.
- Collateral agreement regarding the cleared transactions: Pursuant to this agreement, the client will provide IM and VM to the clearing member, who then posts IM and VM to the CCP.
- Other ancillary agreements between the clearing member and the client: These include engagement letters and service and licensing agreements.
- Indirect clearing documentation between the clearing member, client and indirect client, as appropriate: This documents the provision of indirect clearing services along an indirect clearing chain. The FIA has published a number of industry-standard documents to help firms comply with the indirect clearing requirements.

4.3 Opinions and Other Documentation Issues
While legal opinions are not generally required by regulation in this jurisdiction for entering into derivatives under trading agreements, various opinions and other documents in this section are widely used in the derivatives market and have been issued for this jurisdiction.

ISDA Opinions
ISDA has published several legal opinions covering various issues and jurisdictions. Such opinions include, among others:

- netting opinions;
- collateral opinions;
- Notices Hub Platform (Notices Hub) opinions;
- international financial institutions opinions; and
- client clearing opinions.

To the degree that a UK counterparty is not covered under the UK ISDA netting or collateral opinion, its counterparty would likely request an opinion relating to the UK counterparty's capacity and authority to enter into the transaction, as well as a netting and collateral opinion.

ISDA Netting and Collateral Opinions
ISDA has commissioned netting opinions in over 80 jurisdictions and collateral opinions in over 60 jurisdictions, including for England and Wales. These opinions are available to ISDA members and are generally updated on an annual basis.

The ISDA netting opinions address the enforceability of the termination, bilateral close-out netting and multibranch netting provisions of the 1992 and 2002 ISDA master agreements. The collateral opinions examine the enforceability of the ISDA credit support documents in different jurisdictions. The ISDA England and Wales netting and collateral opinions currently consider the following English entities (as defined in such opinions, as necessary): (i) corporations; (ii) friendly societies; (iii) co-operative or community benefit societies; (iv) statutory corporations; (v) chartered corporations; (vi) banks/credit institutions; (vii) investment firms; (viii) building societies; (ix) banking group companies and bank holding companies; (x) trustees of English trusts; (xi) insurance companies; (xii) charities; (xiii) pension funds; (xiv) investment funds; (xv) partnerships; (xvi) Standard Chartered Bank; (xvii) the Bank of England (only considered in the netting opinion); and (xviii) the UK acting through HMT (only considered in the netting opinion).

ISDA Notices Hub Opinion

ISDA has published a memorandum of law considering certain issues arising under English law in relation to the Notices Hub. The Notices Hub is an online central platform developed by ISDA and S&P Global Inc, initially to provide market participants with a secure electronic means to:

- deliver and receive certain notices under ISDA Master Agreements; and
- update their notice address information for delivering notices by other permitted means.
- Future releases may enable similar functionality on the Notices Hub for other Master Agreements.

ISDA Protocols

ISDA has published various contractual amendment mechanisms that enable parties to enter into standardised amendments through adhering to relevant protocol agreements with counterparties. Generally, ISDA publishes these protocols in response to regulatory, technological and market developments. The ISDA protocols relating to the UK include:

- the ISDA 2025 Notices Hub Protocol;
- the ISDA 2020 UK EMIR Portfolio Reconciliation, Dispute Resolution and Disclosure Protocol;
- the ISDA 2020 UK (PRA Rule) Jurisdictional Module to the ISDA Resolution Stay Jurisdictional Modular Protocol;
- the ISDA 2016 Bail-in Article 55 BRRD Protocol; and
- the ISDA 2013 EMIR NFC Representation Protocol.

5. Enforcement Trends

5.1 Regulator Priorities and Enforcement Trends

UK EMIR Derivatives Reporting Enforcement

To date, the FCA has only taken one enforcement action in October 2017 in respect of UK EMIR transaction reporting, specifically regarding ETDs. Such action was against a large financial institution for breach of the transaction reporting requirements under Article 9 of UK EMIR and Principle 3 of the FCA's Principles for Businesses in the FCA Handbook. The FCA noted that this was the first enforcement action against a firm for failing to report details of trading in ETDs under UK EMIR.

UK MiFID II Transaction Reporting in Respect of Derivatives

In contrast, the FCA has been more active in taking enforcement actions against UK firms for failure to report transactions under UK MiFID II, and the predecessor regime under the original Markets in Financial Instruments Directive (MiFID) that entered into force in 2007.

Under the predecessor regime, the FCA fined 14 firms for MiFID transaction-reporting breaches. In 2019, the FCA fined a large financial institution GBP 34.3 million for failing to provide accurate and timely reporting relating to 220.2 million transaction reports. In January 2025, the FCA fined an investment firm GBP 99,200 for failing to submit 46,053 transaction reports under UK MiFIR. This was the first enforcement action against a firm for a breach of transaction reporting requirements under UK MiFIR. Subsequently, in July 2025, the FCA fined another investment firm GBP 1.1 million for submitting transaction reports to the FCA that were either incomplete, inaccurate, or both, over a period of 5 years. The FCA found that these deficiencies affected 924,584 transactions, which represented nearly 100% of the reportable transactions undertaken by all of the firm's trading desks during this period.

As a result of UK EMIR Refit, there are several new reporting standards under UK EMIR (including an increase in the number of reporting fields from 129 to 204), which came into effect on 30 September 2024 in the UK. While it is expected that the FCA will take a lenient approach for a requisite time period for transaction-reporting errors relating to UK EMIR Refit, the FCA will continue to take a strict approach regarding any transaction-reporting breaches under UK MiFID II.

FCA's Key Priorities

The FCA has launched its five-year strategy for 2025-2030 (Strategy), focusing on its priorities to deepen trust, rebalance risk, support growth and help consumers.

The FCA publishes an annual work programme detailing the work that it intends to complete over the next

12 months. In line with the Strategy, the FCA's work programme for 2025–26 explains that the FCA will continue to deliver on its four strategic priorities:

- being a smarter regulator who is more efficient and effective;
- supporting growth;
- helping consumers navigate their financial lives; and
- fighting financial crime.

The FCA explains that it supports these priorities through its ongoing focus on technology, data and the development of its workforce to match future needs.

Separately, the FCA regularly publishes its Market Watch newsletter. This is the FCA's newsletter on market abuse risks, transaction reporting issues and other market conduct issues. The newsletter aims to assist market participants in understanding such areas and considering the related practices.

Trends and Developments

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Katten Muchin Rosenman UK LLP (Katten) is a law firm with a derivatives practice in the UK that represents a wide range of clients (proprietary traders, brokers, investment managers, commodity trading companies, corporates, exchanges and clearing organisations) on an equally wide range of commercial transactions encompassing many different asset classes, including crypto. This breadth of practice gives the team a valuable perspective and a basis for creative problem-solving. The practice is founded on a deep understanding of derivatives regulation, market practices and documentation. The lawyers help clients understand and comply with the myriad of rules and regulations affecting their businesses, and negotiate agreements to assist clients in closing deals, rather than prolonging the negotiation process. The firm's UK team is fully co-ordinated with its US practice, enabling the lawyers to efficiently and effectively provide cross-border advice to serve the needs of clients doing business on both sides of the Atlantic. Clients rely on Katten to design three-cornered analyses for their activities in the UK, EU and US.

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Cryptoasset Derivatives in the UK: A New Dawn?

The UK's approach to cryptoasset regulation has been generally characterised by a significant level of caution. Nowhere is this more apparent than in the approach by the UK regulators to the retail market in cryptoasset derivatives, where a ban has been in place since January 2021. Recently, however, the Financial Conduct Authority (FCA) has begun to reconsider certain aspects of its ban, which raises the possibility that the UK will join other leading jurisdictions in embracing the cryptoasset derivative markets and boosting London's role as a key financial centre in this sector.

History of the FCA Retail Ban on Cryptoasset Derivatives

In 2018, the UK's Cryptoassets Task Force (CATF) – consisting of HM Treasury (HMT), the Bank of England, and the FCA – published a report setting out the UK government's comprehensive approach to the regulation of cryptoassets. In the report, the CATF expressed concerns about the risks inherent in cryptoassets and, as part of the UK's strategy to mitigate such risks, recommended that the FCA consider a ban on certain types of cryptoasset derivatives and cryptoasset exchange-traded notes (cETNs) for UK retail traders. Following this recommendation, the FCA consulted on such a ban in July 2019, which was then followed by a policy statement (PS20/10) in October 2020 that gave effect to the ban.

In PS20/10, the FCA described cryptoassets as having no intrinsic value and, as a result, could not be reliably valued, especially by retail traders. The FCA also noted that cryptoassets involve heightened risks relating to financial crime, such as money laundering. Concluding that cryptoasset derivatives "do not meet a legitimate investment need", the FCA rejected arguments that existing regulation, or restrictions short of a complete ban, would be sufficient to address the identified risks. The ban on retail access to cryptoasset derivatives and cETNs took effect on 6 January 2021.

Subsequent Developments in the Cryptoasset Derivatives Markets

In the years since the FCA ban, the market for cryptoasset derivatives – in particular those traded on exchange – has boomed. For example, the size of the market for cryptoasset exchange-traded funds (cETFs) has increased significantly following approval by the U.S. Securities and Exchange Commission (SEC) for spot Bitcoin funds in January 2024. The sector was also boosted when the SEC exempted staking from the US federal securities laws later that year, which in effect permitted spot Ethereum exchange-traded funds in the United States.

To give a sense of the scale of this market, just one cETF – BlackRock's iShares Bitcoin Trust, also known as IBIT – attracted over USD16 billion in investments in the first half of 2025, taking its overall assets under management to USD83 billion in July 2025. In addition, the underlying spot markets are now characterised by extraordinary depth and liquidity. For example, by late July 2025, the market capitalisation of Ethereum was over USD450 billion, with daily trading volumes regularly in excess of USD40 billion. The corresponding narrow bid-ask spreads are compelling evidence of a well-functioning and orderly market.

Cryptoasset derivatives have also become significant markets. For example, the Chicago Mercantile Exchange (CME) has offered futures contracts on cryptoasset underlyings since 2019. In addition, both Hong Kong and Australia permit retail traders to access regulated cryptoasset derivatives, as does the European Union following full implementation of the Markets in Cryptoassets Regulation. Sophisticated institutional investors have also begun to treat the cryptoasset derivatives market as a legitimate (and profitable) asset class. In a recent leading cryptoasset trading venue survey of several hundred top executives (ie, C-suite officials who were speaking on behalf of the investments by the firms they lead), nearly 90% have said that they have exposures to digital assets and nearly the same amount have said that they have increased their allocation to this asset class year-on-year, and intend to continue to do so.

In light of the significant maturation of these markets – and the ability of retail participants in the United States and several European countries to access exchange-traded cryptoasset products – the FCA's ban seems increasingly out of step, making the UK a significant outlier.

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Subsequent Developments in the United Kingdom

In parallel with the significant expansion of the cryptoasset derivative markets, the last several years have seen a number of developments in the United Kingdom relating to cryptoasset regulation.

Principally, the UK has taken meaningful steps to bring cryptoasset services and activities within the regulatory perimeter. The Money Laundering Regulations (MLRs) have been amended to impose registration requirements on cryptoasset exchange and custodian wallet providers, along with requirements to ensure appropriate know-your-customer and anti-money laundering arrangements are in place for such firms. In 2023, the FCA incorporated certain cryptoassets into the UK's financial promotion regime to ensure that any marketing activities in respect of such cryptoassets are "fair, clear and not misleading", amongst other requirements.

In addition, in October 2023, HMT set out proposals for establishing a regulatory regime for cryptoassets and stablecoins. A draft statutory instrument giving effect to this new regime was published in April 2025, and was swiftly followed by three FCA discussion papers on a variety of cryptoasset topics. One such discussion paper addressed the regulation of, among other things, cryptoasset trading platforms and intermediaries, as well as lending and borrowing of cryptoassets and staking activities. The other two addressed the regulation of stablecoin issuance and cryptoasset custody, respectively. Therefore, notwithstanding the UK's initial caution around cryptoassets exemplified by the CATF report, the UK is now moving swiftly to establish a comprehensive regime to regulate and supervise activities in the cryptoasset markets.

Separately, the new Labour Government has embarked on an ambitious "growth mission". HMT has designated the financial services sector as a key part of this growth agenda and has committed to securing the UK's ongoing competitiveness in financial services. For its part, the FCA's new 5-year plan focuses on supporting growth in the financial services sector, including supporting those with new ideas for the market. The Chairman of the House of Lords Financial Services Regulation Committee recently emphasised the importance of innovation and growth in the UK's financial services sector, stating that the FCA must "do more to remove, or mitigate at the very least, anything that makes the UK a less attractive place to do business".

The combination of the embrace of cryptoasset regulation and the need to drive economic growth in the UK may have opened the door to a relaxation of the FCA's ban on retail access to cryptoasset derivatives.

New Proposals to Permit cETNs for UK Retail Investors

In its most recent Quarterly Consultation published in June 2025, the FCA proposed to lift the retail ban on trading in cETNs, subject to certain conditions. The FCA subsequently confirmed that the ban would be lifted with effect from 8 October 2025. The fact that cETNs are the first to benefit from the FCA's newfound openness to cryptoasset derivatives is not entirely surprising, as the FCA acknowledged in PS20/10 that cETNs generally present fewer risks to retail investors than other cryptoasset derivatives. Moreover, in March 2024, the FCA permitted UK exchanges – known as recognised investment exchanges (RIEs) – to make cETNs available to professional investors only. Nevertheless, the retail ban remained in place.

In the Quarterly Consultation, the FCA referred to the regulatory and legislative developments that have occurred since the ban was proposed and implemented in the late 2010s, in particular the use of the MLRs and the financial promotions regime to limit the scope for financial crime and to protect consumers. The FCA also acknowledged that, notwithstanding the retail ban on cryptoasset derivatives, UK retail investors can gain exposure to spot cryptoassets and other types of crypto products.

The FCA then went on to note that, for purposes of consistency in regulatory treatment across different cryptoasset product types, and to reflect the changes in the market for these products, the FCA is considering whether to permit retail trading in RIE-listed cETNs. The FCA stressed, however, that such cETNs would be classified as "restricted mass market investments" and therefore subject to stringent obligations in terms of marketing activities. The FCA's consultation closed in mid-July 2025, and final rules to implement the relaxation of the ban on cETNs were published in August 2025.

Prospects for the Future

What does the FCA's newfound openness to cryptoasset derivatives – or at least to certain cryptoasset derivatives – portend for the future? While it may be too much to expect a complete reversal of the retail trading ban in the short term, there are solid reasons for extending the basis for permitting RIE-listed cETNs to other RIE-listed products. In fact, all financial instruments listed for trading on a UK RIE – including cryptoasset derivatives – would need to meet similarly stringent regulatory requirements as a precondition to being listed.

For example, a UK RIE must have rules to ensure that all products it lists for trading are capable of being traded in a fair, orderly and efficient manner and, specifically in relation to derivatives, that such products are designed to allow for orderly pricing and efficient settlement. A UK RIE must also have appropriate systems and controls to monitor transactions, including to detect instances of market abuse. In addition, a UK RIE must provide notice to the FCA before listing a new contract for trading, including providing the terms and conditions of the product. A UK RIE would only be able to list a cryptoasset derivative for trading when all such standards have been met.

These standards also ensure that, where a UK RIE does list a new financial instrument for trading, the instrument is suitable for trading by all investors, including retail, even if, in practice, the UK retail presence in the financial markets is comparatively limited. This is the case even where the underlying reference asset is prone to a certain level of price volatility; in this regard, we note that, as already mentioned above, the price volatility for the most liquid cryptoassets is no greater than that of other commonly accepted reference assets underlying exchange-traded derivatives listed on UK RIEs.

We would further note that cryptoasset derivatives concluded on UK RIEs would, as with any other UK RIE-listed derivatives, need to be cleared at a central counterparty authorised under the European Market Infrastructure Regulation, and would therefore be subject to margin and other risk management requirements that are designed to ensure the financial integrity of such transactions and, by the act of clearing, limit risks to the wider market and investors generally. Furthermore, regulatory obligations applicable to brokers dealing with UK retail clients that transact in derivatives also provide significant and robust retail protections. Such protections include obligations relating to product information and disclosure, suitability and appropriateness assessments, and, pursuant to the FCA's Consumer Duty, the overarching requirement for such brokers to act in the best interests of their clients.

Final Thoughts

The cryptoasset markets and the UK have come a long way since the FCA's ban on retail trading in cryptoasset derivatives in 2021. The depth and liquidity of the cryptoasset markets, and their related derivatives markets, have grown at a phenomenal pace, and many leading jurisdictions have enthusiastically embraced the opportunities presented by this new and dynamic asset class. While the UK had initially moved gingerly in relation to cryptoassets and cryptoasset derivatives, in recent years it has been very active in extending the financial services regulatory perimeter to bring more and more activities within the scope of supervision and oversight.

The latest initiative – to lift the retail trading ban on RIE-listed ETNs – represents the most significant deregulatory step yet taken by the UK authorities in this area. While a welcome development, it should represent only the first stage of opening up the UK's retail sector to cryptoasset derivatives. The FCA should next consider lifting the ban on all cryptoasset derivatives listed for trading on a UK RIE. These products would need to meet standards equivalent to those applicable to cETNs that will be available to retail investors. In fact, permitting such trading by UK retail investors would bring the UK in line with other leading jurisdictions and constitute the next logical step in expanding access by UK retail investors to this burgeoning new market.

USA

Trends and Developments

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ASKramer Law is a boutique law firm established in 2023. It provides legal counsel to clients managing multiple, complex risks in high-stakes transactions and trading environments on regulatory, governance, commercial and tax matters, and delivers incisive advice on US financial products law. The firm's integrated, common-sense approach to complex business challenges ensures that is a strategic partner of choice for its sophisticated clients. The firm marshals extensive experience in securities, commodities, derivatives, digital assets and emerging asset classes of all types, working primarily for finance and energy companies that are headquartered or do business in the United States. It also works for clients in Canada, the United Kingdom, Central and South America, several offshore locations and globally.

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The US derivatives markets are poised for more changes than they have ever experienced in their relatively short history. Although there are many reasons for these changes, the primary one is the explosion of the crypto markets.

By the end of 2024, the global derivatives markets had expanded above USD700 trillion notional, of which the United States' share was about 27%. Crypto derivatives are not centrally regulated and reported, so current estimates range widely from USD20 trillion to USD28 trillion at 2024 year-end (possibly higher), with crypto derivatives dwarfing the crypto spot market in volume. Only time will tell whether the integration of crypto derivatives into the traditional derivatives market is what the US markets need to support innovation, expansion and broad change.

A common idiom in the United States describes this situation: the tail wags the dog, instead of the dog wagging its tail. In 2025, the crypto "tail" wags the traditional derivatives "dog". That is, the smaller crypto market is driving change in the larger, traditional market.

US President Donald Trump, who was inaugurated on 20 January 2025, has made a commitment to crypto in his second term. He had appointed his Crypto Czar even before he was sworn into office, and invited crypto executives to his inauguration. Two days later, he issued Executive Order 14178, promising "to make America the Bitcoin superpower of the world and the crypto capital of the planet". Additional pro-crypto Executive Orders followed, including one establishing a strategic Bitcoin reserve and a US digital asset stockpile, and another opening the door for digital assets to be included in employer-sponsored retirement plans. He also:

- formed the President's Working Group on Digital Assets (PWG), which presented its findings and recommendations to the President in July;
- appointed senior officials who support crypto;
- hosted a White House crypto summit;
- signed pro-crypto legislation; and
- gave derivatives regulators authority to meet his promises and roll back innovation-impeding regulations.

In April, he signed a law to rescind an Internal Revenue Service (IRS) rule on broker reporting that would have disadvantaged decentralised finance (DeFi) platforms and liquidity providers. In July, he signed the GENIUS Act to support US dollar-backed stablecoins. Two more legislative initiatives – the CLARITY Act and the Anti-Central Bank Digital Currency Surveillance State (CBDC) Act – are moving through Congress, promising to significantly influence future derivatives market regulations.

The Executive Branch, Department of Justice (DOJ), Securities and Exchange Commission (SEC), Commodity Futures Trading Commission (CFTC) and Treasury Department have all developed ambitious 2025 derivatives agendas. They are collaborating to better anticipate and respond to market developments, seek public comments on "regulations that stifle American businesses and American ingenuity", and provide regulatory clarity for new and emerging products.

Unlike his predecessors, President Trump seems unencumbered by the existing regulatory structures of the derivative markets. He consistently leans towards deregulation. A businessman first and foremost, he did not come from a trading or regulatory background, and he seems to view market regulation flexibly. If the first half of 2025 is any indication, we will see regulatory regimes increasingly unconstrained and adjusting quickly to accommodate innovation, support DeFi, and transition towards emerging business models, products and technologies.

Regulatory Structure and Process

Calls to modernise the US derivatives markets are not new. However, because of the complex and fragmented ways in which derivatives regulations have evolved, barriers to reform remain stubbornly entrenched. Perhaps America is ready to look at "regulatory sandboxes", where regulatory and market innovations are encouraged and have proven effective abroad in accelerating "fit-for-purpose" regulatory developments. For decades, there have been calls for better and more expeditious oversight of the US derivatives markets. Maybe, in 2025, we will see innovation driving regulatory changes that reshape not just crypto derivatives but the derivatives markets as a whole, and even beyond.

But there is always a "but". Federal derivatives regulators face critical leadership challenges, structural and process changes, and shifts in regulatory strategies and direction. They need to tackle aggressive agendas against a backdrop of efficiency mandates, shrinking workforces and dwindling resources. The federal government's 2.4 million workforce is expected to be reduced by about 308,000 by year-end, which is a 12.8% reduction. Already understaffed regulators are being stretched past their limits.

While staff attrition at the SEC and CFTC is likely paling in comparison to the deep cuts at the IRS, all three regulators are experiencing such attrition and deficits in the leadership ranks, as well as changes in functional responsibilities and geographic reorganisations. The CFTC is at a fork in the road: will it rebuild, will it continue to shrink, or might it disappear altogether? These questions are likely to be resolved when Congress reconvenes in the autumn.

In response to the administration's pro-crypto push, derivatives regulators shifted their enforcement strategies, moved away from regulation by enforcement to regulation by rule-making, and backed away from the modus operandi of prior years where regulatory violators faced enforcement actions.

PWG Report Findings

The PWG issued its report to the President on July 30, providing five objectives to integrate crypto into the US financial markets:

- positioning the United States as the crypto world leader;
- allowing banks to serve crypto businesses, and allow bank customers access to crypto;
- strengthening the US dollar through adoption of dollar-backed stablecoins;
- modernising anti-money laundering rules to combat fraud; and
- ensuring fair and predictable crypto taxation that eliminates tax compliance hurdles.

The PWG Report and four of its five objectives are addressed in more detail in the following sections (banking regulations are beyond this article's purview).

Positioning the United States as the Crypto World Leader

The PWG recommends that Congress establish a clear crypto framework, draw clear regulatory jurisdictional lines and encourage intragovernmental collaboration. This section looks at pending legislation and relevant SEC and CFTC actions, addresses new products, and considers 24/7 trading and settlement.

The CLARITY Act

The Digital Asset Market Clarity Act of 2025 (the "CLARITY Act") was passed by the House in July and sent to the Senate. The House version "clarifies" crypto regulation, by calling crypto "digital commodities" subject to CFTC jurisdiction. In August, however, the Senate Banking Committee released its own version, giving the SEC primary authority over "ancillary assets". At the time of writing, it is not known how the CLARITY Act will ultimately be enacted.

The Anti-CBDC Act

Executive Order 14178 prohibits federal agencies from issuing central banking digital currency (CBDC). The Anti-CBDC Act passed the House and was sent to the Senate in mid-July. It provides that US digital currency policy "remains in the hands of the American people so that any future development of digital cash… [is] anchored around privacy, individual sovereignty, and free market competitiveness", according to the House Majority Whip, Tom Emmer.

SEC

On January 21st, the SEC established its Crypto Task Force to "set the SEC on a sensible regulatory path that respects the bounds of the law". As the agency noted, enforcement creates "an environment hostile to innovation and conducive to fraud", and there has been "confusion about what is legal". The SEC went on to announce roundtables on regulation, custody, tokenisation, moving assets on chain, and exploring the question of what is a "security" subject to SEC jurisdiction.

Moving away from rule-making by enforcement, the SEC:

- dropped litigation against Coinbase, Coinsensys, Open Seas and Binance;
- paused the Gemini Earn suit;
- dismissed its appeal of the court order vacating its definition of a securities dealer; and
- dropped its appeal in Ripple/XRP.

It also dropped investigations into Uniswap, Robinhood Crypto and Crypto.com, and dismissed its enforcement action against Dragonchain.

The SEC issued guidance that meme coins, certain digital assets and certain reserve stablecoins are not securities. The agency also issued guidance that mining, mining pools and certain protocol liquid staking activities do not involve security offerings.

Furthermore, the SEC:

- withdrew 14 rules proposed by the prior administration;
- withdrew an interpretation that broker-dealers cannot be crypto custodians;
- issued FAQs relating to crypto activities and distributed ledger technology (DLT); and
- issued new FAQs on broker-dealer responsibilities when carrying and custodying crypto assets, including assets such as bitcoin.

Broad guidance included application of rules with respect to:

- possession and control of securities carried in customer accounts, facilitating in-kind creation and redemption of shares of ETFs;
- SIPC applicability; and
- transfer agent obligations with crypto or DLT use.

In August, the SEC launched "Project Crypto", setting out five initiatives on US capital formation, facilitating custody and trading, and creating a "regulatory sandbox" with an innovation exemption to fast-track new technologies and businesses while avoiding incompatible or burdensome regulations. One of the first close collaborations between the SEC and the CFTC involved the CFTC's launch of crypto spot contracts to be traded on CFTC-regulated commodity exchanges, known as designated contract markets (DCMs).

CFTC

To engage stakeholders, refocus and foster crypto innovation, and provide regulatory clarity, Acting CFTC Chair Caroline Pham announced a series of public roundtables on "evolving trends and innovation in market structure, including issues such as affiliated entities and conflicts of interest, prediction markets and digital assets", renewing earlier calls for open public engagement on derivatives policy.

In February, the CFTC announced a Crypto CEO Forum to help launch a digital assets markets pilot programme for tokenised non-cash collateral such as stablecoins. In late 2024, the Digital Asset Market Subcommittee had laid the groundwork, recommending expanding the use of such collateral through blockchain technology to improve efficiency. The CFTC rescinded several advisory letters that had imposed special conditions on crypto derivatives, including Staff Advisories No 18-14 and No 23-07. In May, Acting Chair Pham announced plans to issue an advisory on exchange volatility controls to mitigate systemic risk and promote market resiliency. Also in May, CFTC Letter No 25-14 was released, addressing certain cross-border definitions of "US persons" under the CFTC Regulations.

In August, the CFTC launched "Crypto Sprint" to implement the PWG recommendations, which referenced one of the first collaborations with the SEC to facilitate trading of crypto spot contracts listed on a DCM so that "CFTC-regulated platforms [can] offer [certain investment contract] products with margin capabilities" to unlock "even greater liquidity for these assets".

New products

A key element in positioning the United States as a crypto world leader involves support for new products. The following focuses on two new products that are taking the US derivatives markets by storm: perpetual futures and prediction contracts.

Perpetual futures

At present, the global crypto derivatives markets are dominated by perpetual futures (perps). By many accounts, perps have taken over the lion's share of crypto's global spot and derivatives markets. At the beginning of 2025, US participants had been closed out of the perp market, despite very strong interest; however, by April 2025, perp-style trading had begun on US DCMs.

As the name suggests, perpetuals do not have maturity dates. They trade 24/7, are extremely leveraged, and buyers (longs) and sellers (shorts) can get into and out of their positions at any time with only margin being posted.

In April 2025, the CFTC requested comments as to whether it should approve perps for trading on DCMs, noting that perps are "unlike traditional futures contracts, in which the price benchmarking between the derivative and the underlying cash commodity market is done at or around the expir[y] of the contract. Open exposures on perps may settle many times during the day or continuously with the payment based on funding rates", depending on the terms of a particular contract. Perps "use funding rates to maintain price parity with spot markets".

Responses to the CFTC from perp advocates focused on the importance of supporting American global competitiveness; improvements in liquidity and financial stability; encouragement of innovation; reduction of weekend "gap risk"; "better" price discovery; and lowering rollover costs.

Criticisms and concerns focused on the regulatory classification of perps as swaps, futures or another asset class entirely; sufficiency of operational readiness for 24/7 trading and clearing; support for margining requirements; excessive contract leverage; and inability to manage defaults.

In some respects, the CFTC's outreach has been tacitly addressed by recent market developments. While the CFTC's comment period was still open, perp-style contracts started trading on US DCMs. Two CFTC-regulated DCMs – Bitnomial Exchange and Coinbase Derivatives – filed self-certifications with the CFTC for trading perp-style contracts, and the CFTC did not "stay" certification of these contracts within the ten business days as required by law. As a consequence, we should expect to see a flood of these contracts in 2025.

Prediction contracts

Prediction contracts are binary (yes/no; win/lose) options that pay out based on the outcome of an event, such as a political event, sporting event or entertainment event. Prediction contracts are subject to CFTC jurisdiction. Before 2025, DCMs seeking to self-certify such contracts were consistently stopped by the CFTC. The CFTC relied on the Commodity Exchange Act (CEA) and CFTC rules that allow it to "stay" any contract listing "that involves, relates to, or references terrorism, assassination, war, gaming, or any activity that is unlawful under any state or federal law", or that the CFTC determines is not in the public interest.

However, in late 2024 when the CFTC denied a self-certified prediction contract for the US presidential election, the DCM – Kalshi – sued the CFTC to allow the listing. The CFTC argued that the contract was an illegal gaming contract, but the United States District Court for the District of Columbia rejected the CFTC's arguments. The court found that the contract was not illegal gaming because it did not incentivise criminal behaviour or manipulate election outcomes. The CFTC appealed. While on appeal, Kalshi started trading election contracts, and election contracts have been actively traded since early 2025. In May, the CFTC dropped its *Kalshi* appeal.

While the CFTC appeal was still pending, the CFTC announced it would host a prediction contract roundtable. With that announcement, the CFTC suddenly found itself in the middle of a passionate turf fight over Constitutional law, Indian Tribal sovereignty, federal pre-emption, public interest objections, and state gambling and gaming authority.

At present, election contracts, such as those addressed in the *Kalshi* case, are not gaming or sports betting. However, where do things stand with sports prediction contracts? Sports betting, where it is legal, is under the jurisdiction of state gambling commissions or Indian Tribal jurisdictions. The legal question turns on whether sports contracts are "betting".

In January, the CFTC struck down self-certified sports contracts by Crypto.com. The CFTC requested that it suspend listing and trading such contracts, but Crypto.com did not do so. Rather, it asserted that the CFTC's position conflicted with the incoming Trump administration's pro-crypto, pro-innovation stance. Sports contracts are currently trading on CFTC-regulated DCMs, and are trading without CFTC challenge at present.

Even though sports contracts trade on DCMs, it is still not known whether they are legal. Under state gaming laws, several states are now suing DCMs that trade sports contracts. An increasing number of suits brought by Indian Tribes is also being seen. These state and Tribal actions raise more than an interesting legal wrinkle.

Whether a federal pre-emption applies to sports contracts is currently being fought in various courts around the country, with seminal cases in New Jersey, Maryland and California. Again, Kalshi is in the fray, fighting in several venues claiming that a federal pre-emption precludes state actions, and arguing that its DCM-traded sports contracts are legally protected from challenge because the CFTC has exclusive jurisdiction. In June, five friend-of-the-court (amici) briefs were filed in support of the New Jersey case against Kalshi, which Kalshi won. These amici briefs came from very powerful interests, including a coalition of Tribal organisations (nine groups and 60 individual Tribes); a coalition of attorneys general (from 34 US states, Washington, DC and the Northern Mariana Islands); and the American Gaming Association.

Later, in August, a Maryland federal judge refused to grant Kalshi a preliminary injunction in a different case, concluding that the federal pre-emption *does not* support Kalshi's position that the CEA pre-empts state gambling and gaming laws. In its decision, the court noted that when the federal pre-emption was enacted, betting was illegal under federal law; therefore, Congress could not have intended to pre-empt state gaming laws. The California case involves three Indian Tribes that have raised the stakes by suing Kalshi and its market maker Robinhood with sweeping claims, including RICO violations.

Given the Trump administration's pro-innovation position, the odds are better than even that sports contracts will continue to trade – that is, unless and until the state gaming regulators and the Indian Tribes have their way, and this new federally regulated sports prediction market is shut down.

Derivatives trading on a 24/7 basis

US regulated exchanges do not operate on a 24/7 basis. Rather, they are open for trading during traditional designated business hours and days, keeping Federal Reserve System (Fed)/banking settlement and payment hours. This is a long-term functional constraint that prevents 24/7 trading and clearing in the United States.

As previously mentioned, crypto derivatives (like perps) trade 24/7 because they do not rely on Fedwire operating hours or current banking system conventions. Crypto derivatives settle in crypto rather than fiat currencies, so they can operate on a 24/7 basis. These settlement logistics deliver a major competitive advantage to crypto over traditional derivatives.

It is worth looking briefly at the implications of 24/7 trading in the United States. In 2023, the Fed proposed to transition the wholesale funds settlement system to 24/7 operations sometime in 2027. The Fed payments infrastructure is expected to ultimately operate 22 hours of every day of the year. This would be a predicate to extending the hours of exchange operation.

In April 2025, the CFTC solicited comments on the "potential benefits and risks" of 24/7 derivatives trading and settlement. Key stakeholders, market participants and interested trade associations submitted comments to the CFTC, many having previously submitted feedback on 24/7 to the Fed. Most comments related to systems infrastructure, technology changes and staffing changes that would be required with bank settlements over the Fedwire.

Specifically, the CFTC noted the need to "maintain robust market surveillance for abusive trading practices, including front-running, wash trading, pre-arranged trading, and any other manipulative or disruptive trading practices […]". Along with such concerns, migration to 24/7 will inevitably raise new legal issues. For example, netting agreements and counterparty contracts would need to be modified to add crypto assets, especially in cross-product netting or cross-collateral arrangements. Substantial issues would need to be addressed with respect to netting of over-the-counter and exchange-traded products. In addition, individual agreements would need to be renegotiated.

Artificial intelligence (AI) and blockchain technologies will have a major impact on the 24/7 transition, and each clearing firm will need to modify its own systems, infrastructure and related contractual agreements.

These significant modifications and changes will require a substantial amount of lead time for the necessary planning and implementation.

Strengthening the US Dollar Through Adoption of Dollar-Backed Stablecoins

The administration's support for dollar-backed stablecoins was first communicated in Executive Order 14178 with the stated purposes of "promoting and protecting the sovereignty of the United States dollar, including through actions to promote the development and growth of lawful and legitimate dollar-backed stablecoins worldwide". The PWG Report noted that "US dollar-backed stablecoins represent the next wave of innovation in payments, and policymakers should encourage their adoption".

In July, the GENIUS Act was signed into law, setting out a regulatory framework for stablecoins to be more widely used in financial transactions. The law states that "payment stablecoins" are neither securities (subject to SEC jurisdiction) nor commodities (subject to CFTC jurisdiction). Broadly, the Act:

- provides an oversight system to allow certain state and federally regulated entities to issue stablecoins;
- protects consumers by requiring stablecoin issuers to maintain a 1:1 reserve ratio backed with US dollars, Treasury securities or certain other liquid assets;
- requires issuers to disclose their reserve composition on a monthly basis;
- provides stablecoin holders with a priority claim in an issuer's bankruptcy or insolvency; and
- classifies stablecoin issuers as financial institutions subject to banking rules, including the Bank Secrecy Act and anti-money laundering (AML) laws, and requires compliance with "Know Your Customer" (KYC) identification requirements and transaction monitoring.

Modernising AML Rules to Combat Fraud

To successfully encourage crypto innovation and expansion, the PWG Report notes the need to protect the US crypto market "by mitigating and combating illicit use". Crypto, "like traditional assets, [is] subject to abuse by bad actors – terrorists, drug traffickers, state-sponsored hackers, human traffickers, fraudsters, sanctions evaders, and others". To combat abuse, "law enforcement needs the tools to hold those who use digital assets for illegal activities accountable", including AML/CIF (Combat Illicit Finance) and sanctions that are tailored to crypto risks and industry structure.

Because of its decentralised nature, crypto has gained the reputation of harbouring fraudsters and hiding illegal transactions. In many circumstances, personally identifiable information and a bank account are not required to process crypto transactions. The PWG acknowledges that to combat crypto-specific fraud law enforcement needs appropriate tools, including AML/CIF and sanctions. The global discussion is broadening now, with the Bank of International Settlement raising recent concerns around "traditional AML policies – the very thing lacking in [DeFi]".

The DOJ, SEC, CFTC and FinCEN are all focused on prosecuting bad actors, with increased regulatory inter-agency collaboration taking place in 2025. Law enforcement agencies work closely with blockchain analytic firms, using AI and machine learning to track down illegally obtained crypto and process large amounts of data. The immutable nature of blockchain makes crypto fully traceable.

A snapshot of the regulatory developments through mid-2025 follows.

DOJ

In April, following Executive Order 14178, the DOJ issued a memorandum stating that it will "no longer target virtual currency exchanges, mixing and tumbling services, and offline wallets for the acts of their end users or unwitting violations of regulations". Instead, it will focus on:

- rug pulls;
- hacking of exchanges;
- thefts involving decentralised autonomous organizations (DAOs); and
- "unlawful conduct by cartels, Transnational Criminal Organizations, Foreign Terrorist Organizations, and Specially Designated Global Terrorists".

In addition, the DOJ rescinded inconsistent prior policies and directives, instructing closure of all inconsistent ongoing investigations and enforcement actions.

Refocusing on fraud, the DOJ:

- disbanded its National Cryptocurrency Enforcement Team; and
- filed civil forfeiture complaints, including a USD214 million "pump and dump" scheme and a USD225 million crypto "pig butchering" scam.

The DOJ also worked with the FBI and blockchain analytics companies to successfully link seized crypto to fraud victims.

The DOJ updated its corporate self-disclosure policy to set out more certainty about the consequences of misconduct, including deferred prosecution agreements. It also provided larger incentives to entities that self-disclose corporate misconduct.

SEC

The SEC formed its Crypto Task Force to work towards regulatory certainty, increase compliance and combat fraud. It established the Cyber and Emerging Technologies Unit (CETU) to apply AI and machine learning in countering cyber, blockchain and crypto fraud. As mentioned previously, the SEC walked away from several crypto enforcement actions and litigation over regulatory violations.

The SEC has not backed down from combating fraud. It has:

- filed fraud charges against a crypto firm that misappropriated USD57 million in a Ponzi-type scheme;
- charged a company and its executives over false claims that crypto tokens were backed by real estate;
- brought actions against an investment adviser that misappropriated funds from crypto and foreign exchange trading; and
- brought actions against an international bond Ponzi scheme.

CFTC

The CFTC reorganised its Division of Enforcement Task Forces into two units: the Complex Fraud Task Force, and the Retail Fraud and General Enforcement Task Force. The Complex Fraud Task Force investigates and litigates fraud and manipulation across all asset classes. The Retail Fraud and General Enforcement Task Force investigates and litigates all other CEA violations.

The CFTC has issued several public education alerts on fraud and cyber scams, focusing on "relationship investment fraud", "pig butchering" and binary options trading. It also issued other advisories as to how to avoid fraud, including use of generative AI.

The CFTC has modified its policy on self-reporting, co-operation and remediation. As revised, the policy provides companies with guidance on penalties and possible abatement, how penalties are calculated, how the CFTC will determine the company's level of co-operation it receives, and possible remediations.

Recent CFTC enforcement actions have included fines for crypto and foreign currency fraud. In May, the CFTC updated its Registration Deficient List ("RED List") by adding 43 entities, which identifies unregistered foreign entities. The RED List is a publicly available list of foreign entities operating in the derivatives markets without CFTC-required registration. It identifies and warns the public about firms that could be involved in fraudulent or illegal activities.

FinCEN

FinCEN is the US Treasury bureau tasked with safeguarding the US financial system from illicit activity, including crypto theft and ransom payments. FinCEN:

- participated in sanctioning an offshore crypto fraud facilitator for pig butchering theft in excess of USD4 billion;
- withdrew proposed rules that would have affected un-hosted crypto wallets and travel and record-keeping rules;
- pushed back final effective dates for investment advisers to comply with AML rules from 2026 to 2028;
- announced a new rule-making process to consider possible rule changes for investment advisers' AML compliance; and
- delivered public service advisories on investment scams and warnings about cryptocurrency kiosks.

Ensuring Fair and Predictable Crypto Taxation That Eliminates Tax Compliance Hurdles

Crypto tax reporting and compliance is difficult, given the types of digital assets and the wide variety of transactions. To add to compliance difficulties, there are few parallels with tax treatment for traditional assets, and the Treasury and IRS have provided limited guidance. As types of crypto products and transactions proliferate in the markets, guidance lags behind. Staff cuts across the IRS further complicate the situation.

Perhaps in recognition of these hurdles, the PWG recommended that Congress enact comprehensive legislation to ensure fair and predictable crypto taxation. In the absence of legislation, the Treasury and the IRS would need to provide whatever guidance they can within the limits of their statutory authority.

The PWG directs the Treasury and the IRS to provide sensible and enforceable rules to ensure that crypto transactions are accurately reported. It also instructed the IRS to update its crypto FAQs, which continue to serve as a key source of information about crypto tax compliance.

In line with the administration's pro-crypto goals, Congress passed a Joint Resolution in January to overturn a broker reporting requirement that would have become effective 1 January 2025. It invalidated the expanded definition of a "broker", requiring DeFi platforms to report to the IRS as commodity exchanges. DeFi platforms are now exempt from broker reporting, but centralised crypto exchanges must comply.

The IRS is attacking tax fraud in 2025 by:

- increasing its enforcement efforts;
- expanding audits;
- focusing on crypto reporting and compliance;
- targeting tax scams and fraud;
- increasing scrutiny of offshore accounts; and
- focusing on foreign income reporting.

"Operation Hidden Treasure", originally launched in 2021, remains active and ongoing in targeting taxpayers not reporting their crypto income. IRS agents are receiving special training in crypto logistics and blockchain analytics tools to help identify and find taxpayers that fail to report their crypto income.

The IRS, SEC and CFTC are also collaborating on various crypto regulations, focusing on perpetual swaps, synthetic digital tokens and wrapped digital assets.

Conclusion

The push-pull dynamic between derivatives regulation by enforcement and regulation by rule-making will continue to be driven by crypto derivatives as we move into 2026.

We are at a remarkable point in market evolution. It is a rare moment where there is likely to be a regulatory overhaul of the traditional derivatives markets while crypto derivatives are being folded into that new framework. The less-regulated and less-reported crypto derivatives markets are experiencing much faster growth. If the US share of the crypto derivatives markets were to increase even slightly, substantial US economic gains could be made. The President comes from a business background. He sees opportunities and seems undeterred by traditional regulatory frameworks and traditional ways of doing things.

While the opportunities "to do better" and to update disjointed regulatory frameworks are all around us, this article ends with a serious note of caution. The current regulatory and institutional checks and balances that govern the US financial markets were initially an outgrowth of the Great Depression in the 1930s and subsequent market events like those of 1987 and 2008. We learned from each one, and corrected for under-regulated and over-leveraged derivative portfolios. Huge, tangible worldwide damage in those crashes was also seen. Major companies folded, nations declared bankruptcy, millions of everyday investors got burned, and co-ordinated, massive-scale central bank interventions were required to calm the markets. Even with such enormous interventions, the repercussions in the US markets (housing, in particular) continued for years. At present, strong systems of oversight govern securities and commodities transactions that seek to double-check and back-stop one another through the various regulatory frameworks. History casts a long shadow, so US regulators have moved forwards cautiously.

The efforts of the current administration may be applauded. "Fit for purpose" regulations have never been more critical for the US derivatives markets than they are today. When the derivatives markets were out of step with their regulatory frameworks, legislative and regulatory changes resulted. As the crypto markets go mainstream, we are in uncharted territory. Derivatives policies and markets should be closely monitored. We must ensure that the next phase of US derivatives regulation *can and does* appropriately keep pace with business innovation, and that we get the regulatory framework right for crypto derivatives. The competitiveness of the US financial markets depends on it. After all, we are at a place in time where it looks like the crypto "tail" is wagging the derivatives markets "dog".

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