PANORAMIC

EQUITY DERIVATIVES 2025

Contributing Editor

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LEXOLOGY

Equity Derivatives 2025

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Panoramic guide (formerly Getting the Deal Through) enabling side-by-side comparison of local insights into equity derivatives issues, including market structure; typical over-the-counter equity derivatives; borrowing, selling, and repurchasing shares; applicable laws and regulations for dealers and for eligible counterparties; securities registration issues; bankruptcy and insolvency risks and rules; reporting obligations; restricted periods and insider trading rules; tax issues; transaction liability regime; stock exchange filings; typical document types; legal opinions; hedging activities; regulatory authorities; clearing rules; collateral arrangements; territorial scope of regulations; registration and authorisation requirements for market participants; and recent trends.

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Equity Derivatives: Overview

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The past several years have emphasised the growing importance of strategic equity solutions as part of corporate finance advisory services for both listed issuers and their controlling shareholders. Strategic equity solutions are a range of equity derivatives products, including capital-raising, equity-linked products, structured share buy-back and share accumulation and disposal products, and hedging and monetisation products. Interestingly, the period of the covid-19 pandemic highlighted the continued demand for sophisticated methods of capital raising, balance sheet management and hedging solutions, all of which utilise strategic equity solutions. That trend continued until the 2022 downturn in global equity markets, which went through a slower cycle in the capital markets side of the business in 2023, but has been on a further upswing since 2024, even if we are experiencing quite a bit of macroeconomic volatility. This 10th edition of the *Equity Derivatives* volume in the Lexology Panoramic series aims to survey the equity derivatives landscape in key jurisdictions around the world and highlight the critical issues that practitioners and market participants should be aware of. This introduction gives a brief overview of the state of the global market and the primary product classes discussed in this volume.

When considering which jurisdictions are relevant to the legal analysis of a particular equity derivatives product, practitioners must look beyond the jurisdiction of the counterparty to the product's contract. In addition to considering the laws of the counterparty's jurisdiction, practitioners must consider the laws of the jurisdictions in which the underlying equities are listed and traded (likely to be the jurisdiction in which the equity derivatives product is going to be hedged), the laws of the jurisdiction in which the underlying issuer is organised and in which it conducts business, the laws of the jurisdiction in which the collateral is held, the laws of the jurisdiction in which the dealer is organised and regulated, and the laws governing the equity derivatives product itself. Not infrequently, an equity derivatives transaction will span a number of jurisdictions and will require collaboration among practitioners around the globe.

Efficient equity derivatives markets depend on liquid equity markets, making the United States, Japan, greater China, continental Europe and the United Kingdom natural centres for equity derivatives trading. According to data obtained from Statista, as of March 2025, the New York Stock Exchange (NYSE) remained the largest exchange operator worldwide, with market capitalisation of approximately US$32 trillion, followed by the Nasdaq Stock Market (US$30 trillion), the Shanghai Stock Exchange (US$7 trillion), Japan Exchange Group Inc (US$6.5 trillion), National Stock Exchange of India (US$5.7 trillion) and Euronext (US$5.4 trillion).

The equity derivatives most commonly used by listed issuers are capital-raising, equity-linked derivative securities (such as convertible notes); products for hedging those derivative securities; and synthetic share repurchase transactions. Issuances of equity-linked derivative securities exploded in 2020 and 2021, tailed off significantly since in public markets, but have recovered substantially in the latter part of 2023 and 2024. Equity-linked products have also been more and more active in private capital markets. In addition to raising capital through traditional offerings of equity-linked convertible and exchangeable notes, issuers have also marketed alternative structures to investors, including convertible preferred shares, mandatory convertible preferred shares and tangible equity units (a combination of a prepaid stock purchase contract and an amortising note). As these convertible securities approach maturity, structured exchange transactions with existing convertible noteholders have provided issuers with an efficient method of refinancing their convertible debt.

Derivative overlays that synthetically raise the conversion price of convertible securities – namely, call spreads and capped calls – have been very popular for US issuers, who enjoy favourable tax and accounting treatment. While that treatment may not be available to non-US issuers, many still use capped calls to hedge against potential dilution or cash expenditure on conversion of the underlying securities, and such issuers can take advantage of alternative structures with potentially more favourable features for which tax integration and accounting concerns are not constraining factors. Call spreads and capped calls have been adapted to hedge a range of other equity-linked securities in addition to convertible notes.

Additionally, US, European and Asian issuers continued robust equity repurchase activity at record levels, driven in large part by initially lower stock market valuations, availability of cash on their balance sheets and investors’ demand for capital returns. Many of these repurchase programmes have taken the form of structured repurchase strategies, such as accelerated share repurchase transactions and guaranteed price repurchases. In addition, overall concerns and the restrictions on repurchases by companies receiving financial assistance from the government, which might have had implications not just for stock buy-backs but also other issuer hedging products have largely subsided, and new rules in the US focusing on insider trading and repurchase reporting should have minimal impact on these transactions going forward. While buy-back activity picked up in Europe and Asia, US issuers still repurchase significantly more equity than Asian or European issuers. Chinese authorities have sought to encourage share buy-backs to provide support for share prices, including allowing companies to fund such buy-backs through the issuance of bonds and other securities. China has also provided greater flexibility for getting corporate approvals for share buy-backs.

Also, controlling shareholders most commonly use margin loans as a pure monetisation strategy for their ownership position. This product class provides preferred means for controlling shareholders to obtain liquidity from their holdings without losing upside (or, depending on the structure, hedging downside) risk in the stock price or their controlling position. The collateral underlying these margin loans may itself be equity derivative products, including convertible notes, convertible preferred shares or other derivative securities. Increasingly, margin loans are being used as a form of acquisition finance in public takeovers. Finally, the continued presence of ‘unicorns’, highly valuable pre-initial public offering companies without public markets for their securities, has created a lot of pressure to find 'private market' solutions that would provide liquidity to founders and employees.

Outside the margin loan market, funded collars, prepaid forwards, enhanced-yield sale strategies, mandatory exchangeable trust securities and other derivative structures allow controlling shareholders to monetise their positions while hedging against future price fluctuations of the equities they own. In addition, investors have used accelerated accumulation and disposal transactions to acquire or make outright dispositions of their stakes, especially in periods of sudden market downturns. In the United Kingdom and Europe, accelerated 'stake-building' transactions have been popular in recent years among investors looking to quickly and quietly establish a significant toehold in listed companies, either as an end in itself or as a first step in a public-to-private transaction or other public offer.

The market for strategic equity solutions is likely to continue to expand in 2025 and beyond, as hedging products grow in popularity amid the market turmoil, market volatility, rising interest rates and geopolitical factors and issuers in need of immediate liquidity tap the convertible notes market. But the growth of particular product classes will also be shaped by traditional macroeconomic influences, such as global growth; equity prices and liquidity; interest rate changes; and tax, regulatory and accounting policies. In addition, new market entrants and disruptive technologies are challenging the way that many equity derivative products have historically been structured and marketed. Corporate finance advisory services and their clients will need to be prepared to adapt to rapidly evolving market practices and an increasingly globalised landscape.

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Summary

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Recent developments

OVERVIEW

Typical types of transactions

1 Other than transactions between dealers, what are the most typical types of over-the-counter (OTC) equity derivatives transactions and what are the common uses of these transactions?

The market for OTC derivatives transactions in France is well established, and equity derivative products are routinely used in the implementation of stake-building transactions, equity price risk hedging strategies and share repurchase schemes.

Typical equity derivatives products used by issuers on the French market include (but are not limited to):

- call options, put options and total return swaps to hedge equity price risks on a bespoke basis;
- funded collar in the context of the leveraged acquisition of a stake in a publicly listed company involving an embedded hedge to the market price of the equity purchase (often on a tranched basis);
- unfunded collar in the context of the disposal of a stake in a publicly listed company involving an embedded hedge to the market price of the equity disposal (often on a tranched basis);
- combination of a zero strike call and a call spread with a view to fund and hedge a new stake in a publicly traded company;
- prepaid equity forward in the context of share buy-backs involving a forward transaction that is settled on the basis of the discounted volume-weighted average price of the shares over a certain period (often to hedge a share employee participation scheme);
- variable prepaid forward in the context of the monetisation of an equity stake combined with a deferral of the taxes owed on the capital gains (this structure is often combined with a call spread for hedging purposes);
- accelerated share buy-backs with guaranteed discount in the context of share buy-backs involving the immediate delivery of shares at a discount with a future adjustment based on the volume-weighted average price of the shares over a certain period;
- contingent prepaid forward allowing for the prepayment and purchase of shares being delivered only subject to certain contingencies occurring (ie, regulatory approvals);
- combination of an equity spot sale and refinancing through a total return swap; and
- all spread to hedge certain features of exchangeable bonds.

Margin loans are not widely used on the French market to finance or leverage large shareholdings. This is essentially due to the idiosyncrasies of the transposition of Directive (EU) 2002/47/EC of 6 June 2002 on financial collateral arrangements under French law, which has created, in respect of margin loan structures specifically, uncertainty in the enforcement of the security interest against an insolvent French borrower (as the enforcement process may be potentially affected, delayed and (or) limited, by the opening of insolvency proceedings in France).

Law stated - 15 May 2025

Borrowing and selling shares

2 May market participants borrow shares and sell them short in the local market? If so, what rules govern short selling?

Yes. The French rules on short selling are derived from Regulation (EU) 236/2012 of 14 March 2012 on short selling and certain aspects of credit default swaps (these rules are therefore applicable across all EU member states for all EU-listed shares unless they are primarily traded on a third-country venue). Naked short selling is prohibited in France, and market participants can only create short positions in shares on the French market if they own or have borrowed the relevant shares or have entered into an agreement with a third party, providing reasonable assurances that the shares will be delivered.

Any natural or legal person who holds a short position equal to or higher than 0.1 per cent of the share capital of a company whose shares are admitted to trading on a French trading venue must notify the French regulator (*l'Autorité des marchés financiers* (the Financial Markets Authority (AMF)) of this position within one trading day (and of each movement through a 0.1 per cent threshold above 0.1 per cent). The filing is made electronically on the system used for filing regulated information. When the net short position reaches or falls below 0.5 per cent of the share capital, the AMF will publicly disclose the information.

In exceptional circumstances (such as during the opening Lehman bankruptcy proceedings or the covid-19 crisis), the AMF has exercised its power to temporarily restrict or ban short selling in case of a significant fall in the price of financial instruments on a given day (a 10 per cent drop for liquid shares, a 20 per cent drop for illiquid shares when the share price is higher than €0.50 and a 40 per cent drop when the share price is below €0.50).

Transactions entered into in connection with market-making activities or as an authorised primary dealer do not fall within the scope of applicable rules, provided that these activities fall with the scope of an exemption and the AMF is notified beforehand. The AMF may prohibit the use of these exemptions if it considers that the relevant conditions for their use are not satisfied.

The AMF provides market participants with a file containing the history of net short positions published since 1 November 2012 (the file can be found on the AMF website).

Law stated - 15 May 2025

Applicable laws and regulations for dealers

3 Describe the primary laws and regulations surrounding OTC equity derivatives transactions between dealers. What regulatory authorities are primarily responsible for administering those rules?

There is no single body of rules regulating equity derivatives in France. Dealers, as financial counterparties subject to licensing requirements, are generally subject to all the rules and regulations affecting the treatment of derivatives (including equity derivatives). These rules affect various aspects of the life cycle of equity derivative transactions.

We note, in particular, the applicability of the following rules (this list is not exhaustive) pertaining to:

- financial netting: France has implemented Directive (EU) 2002/47/EC of 6 June 2002 on financial collateral arrangements in the Monetary and Financial Code, which introduced derogatory rules to French insolvency and security laws (known as the Financial Netting Regime) that are applicable to derivatives transactions entered into between dealers if certain conditions are met. In particular, the Financial Netting Regime allows counterparties to implement the close-out netting provisions of derivatives framework agreements concluded by a French counterparty, including where it is subject to insolvency proceedings;
- threshold crossing: market participants (when they are unable to benefit from the bank trading exemption) need to comply with the relevant provisions of the French Commercial Code and the General Regulations of the French Financial Market Authority relating to the filing of disclosure threshold notifications by the close of trading on the fourth trading day following the acquisition or disposal of a significant holding, including when long exposures are created through synthetic financial instruments (either cash or physically settled);
- market abuse: market participants are subject to Regulation (EU) No. 596/2014 (Market Abuse Regulation (MAR)) on market abuse containing provisions on insider dealing, unlawful disclosure of inside information and market manipulation, which all need to be considered in the context of equity derivative transactions (especially where persons discharging managerial responsibilities within issuers, and persons closely associated with them, are involved);
- market infrastructure: market participants are subject to Regulation (EU) No. 648/2012 on OTC derivatives, central counterparties and trade repositories (the European Market Infrastructure Regulation (EMIR), as amended), which imposes risk-reducing or transparency obligations on all EU undertakings (including, but not limited to, dealers and corporates) that enter into derivative transactions (clearing through central counterparties, reporting of transactions to trade repositories, risk mitigation techniques);
- short selling: market participants are subject to Regulation (EU) 236/2012 of 14 March 2012 on short selling and certain aspects of credit default swaps; and
- benchmark: market participants are subject to Regulation (EU) 2016/1011 on indices used as benchmarks in financial instruments and financial contracts, or to measure the performance of investment funds.

The AMF is the authority primarily responsible for policing these rules in France.

Law stated - 15 May 2025

Entities

4 In addition to dealers, what types of entities may enter into OTC equity derivatives transactions?

There are no general regulatory exclusions on the types of entities that may enter into OTC equity derivatives transactions in France. France has implemented the various provisions relating to customer classification under the Markets in Financial Instruments Directive II (MiFID II) or the Markets in Financial Instruments Regulation regulatory framework. As a result, OTC derivatives counterparties benefit from a different level of protection depending on their regulatory classification (professional versus non-professional clients). Entities that enter into OTC equity derivatives transactions in France are mainly banks, credit institutions, financial services institutions, funds and large corporates.

Law stated - 15 May 2025

Applicable laws and regulations for eligible counterparties

5 Describe the primary laws and regulations surrounding OTC equity derivatives transactions between a dealer and an eligible counterparty that is not the issuer of the underlying shares or an affiliate of the issuer? What regulatory authorities are primarily responsible for administering those rules?

The primary laws and regulations surrounding OTC equity derivatives transactions between a dealer and an eligible counterparty that is not the issuer of the underlying shares or an affiliate of the issuer are as follows:

- financial netting: France has implemented Directive (EU) 2002/47/EC of 6 June 2002 on financial collateral arrangements in the Monetary and Financial Code, which introduced derogatory rules to French insolvency and security laws (known as the Financial Netting Regime) that are applicable to derivatives transactions entered into between a dealer and an eligible counterparty if certain conditions are met. In particular, the Financial Netting Regime allows a counterparty to trigger the termination of outstanding derivative transactions and implement the close-out netting provisions of derivatives framework agreements concluded by a French counterparty, including where it is subject to insolvency proceedings;
- threshold crossing: market participants (when they are unable to benefit from the bank trading exemption) need to comply with the relevant provisions of the French Commercial Code and the General Regulations of the French Financial Market Authority relating to the filing of disclosure threshold notifications by the close of trading on the fourth trading day following the acquisition or disposal of a significant holding, including when these exposures are created through financial instruments (either cash or physically settled) – we note that the bylaws of French issuers may contractually impose a different set of disclosure threshold requirements by shareholders to the company (so these need to be checked as well);
- markets in financial instruments: dealers that are trading OTC equity derivative transactions with eligible counterparties (that are not dealers) are subject to the

rules relating to the provision of regulated investment services under MiFID to counterparties located in France;

- market abuse: market participants are subject to MAR, containing provisions on insider dealing, unlawful disclosure of inside information and market manipulation, which all need to be considered in the context of equity derivative transactions (especially where persons discharging managerial responsibilities within issuers, and persons closely associated with them, are involved);
- market infrastructure: market participants are subject to EMIR, which imposes risk-reducing or transparency obligations on all EU undertakings (including, but not limited to, dealers and corporates) that enter into derivative transactions (clearing through central counterparties, reporting of transactions to trade repositories, risk mitigation techniques, etc);
- short selling: market participants are subject to Regulation (EU) 236/2012 of 14 March 2012 on short selling and certain aspects of credit default swaps;
- benchmark: market participants are subject to Regulation (EU) 2016/1011 on indices used as benchmarks in financial instruments and financial contracts, or to measure the performance of investment funds; and
- securities financing: market participants are subject to Regulation (EU) 2015/2365 (the Securities Financing Transactions Regulation (SFTR)) on securities financing transactions and collateral reuse, which provides for a legal framework of transparency requirements to facilitate monitoring and risk identification. SFTR sets out, inter alia, reporting rules in respect of details of securities financing transactions (such as securities lending and repo transactions or certain margin lending transactions) to trade repositories and minimum transparency rules and consent requirements for parties involved in collateral use.

However, for certain types of counterparties that are regulated in France, French law imposes additional restrictions that will impact the entry into, or the treatment of, derivative positions (including equity derivatives). For example, with respect to insurance or reinsurance companies licensed in France, the French Insurance Code allows for entry into derivative instruments only if these instruments contribute to reducing risks or improving the efficiency of the management of the portfolio of assets. Similarly, for certain collective investment schemes organised in France, derivative positions can only be entered into if their use is consistent with the strategy of the fund in question, and the derivative position can be terminated at any time (at market value or at a predetermined value) by the fund. The AMF is generally primarily responsible for administering these rules, together with, in certain cases, the French Prudential Supervision and Resolution Authority.

Law stated - 15 May 2025

Securities registration issues

6 | Do securities registration issues arise if the issuer of the underlying shares or an affiliate of the issuer sells the issuer’s shares via an OTC equity derivative?

No specific securities registration issues would arise under French law as a result of the issuer of the underlying shares or an affiliate of the issuer selling the issuer's shares via an OTC equity derivative. In all instances, these transactions would, however, be subject to compliance with the applicable disclosure provisions under MAR relating to persons discharging managerial responsibilities, as well as persons closely associated with them.

Law stated - 15 May 2025

Repurchasing shares

7 | May issuers repurchase their shares directly or via a derivative?

Yes. French public companies may repurchase their own shares directly or indirectly via a physically settled OTC derivative within prescribed regulatory limits (French public companies are legally prohibited from holding more than 10 per cent of their own shares). If shares are repurchased via a derivative, it will typically be via an equity forward transaction contemplating the delivery by the dealer counterparty of a certain number of shares to the issuer at maturity, and calculated based on the volume-weighted average price (often discounted) of the shares over a certain period.

The following issues are typical of share repurchases via a derivative:

- the shareholders' authorisation taken in the context of the repurchase programme of the issuer must set out explicitly that share repurchases can be conducted via derivative instruments;
- the delivery of the shares being repurchased must not result in the issuer holding more than 10 per cent of its own shares, and the shares must be repurchased for one of the objectives stated in the share repurchase programme (ie, cancellation, hedging stock options or other share allocations granted to some or all eligible employees or executive officers);
- share repurchases conducted via derivatives are not covered by the safe harbour provisions contemplated under MAR and, therefore, do not benefit from the presumption relating to the absence of insider trading or market manipulation (the burden of proof will be on the purchaser of the equity securities listed in France to show that it has not used privileged information or manipulated the market if it uses a derivative to purchase the shares);
- share repurchases conducted via derivatives will generally need to be calibrated to follow the parameters of transactions eligible to fall within the safe harbour under MAR (notwithstanding that these derivative transactions do not benefit from the safe harbour, counterparties will generally need to take precautions to ensure that they can demonstrate to the French regulator that relevant anti-abuse precautions have been taken); and
- issuers purchasing their own shares via a derivative instrument will need to immediately inform the market (often via a press release) once they have concluded the derivative. They must also disclose, in that context, various items of information, including the number of shares to be repurchased, the maximum price and the

period during which the investment service provider will intervene on the market to repurchase the shares.

In recent years, some French issuers have started experimenting with environmental, social and governance (ESG)-linked share buybacks whereby the issuer allocates part of the outperformance of the share buyback (ie, the discount to volume-weighted average price) to the funding of an ESG project (in line with its ESG values and commitments).

Law stated - 15 May 2025

Risk

8 What types of risks do dealers face in the event of a bankruptcy or insolvency of the counterparty? Do any special bankruptcy or insolvency rules apply if the counterparty is the issuer or an affiliate of the issuer?

Dealers with outstanding equity derivative positions with a bankrupt or insolvent French counterparty are, in much the same way as with other derivative positions, subject to the uncollateralised mark-to-market exposure resulting from the termination and close-out of these transactions. On the assumption that these outstanding equity derivative positions are documented under a market derivative framework agreement (a French Banking Federation (FBF) Master Agreement or an International Swaps and Derivatives Association (ISDA) Master Agreement governed by French or English law) (a version of the ISDA Master Agreement governed by French law was also published by ISDA in 2018 in the context of contingency planning for Brexit), dealers facing an insolvent French counterparty will be able to terminate their outstanding derivative positions and calculate a net close-out balance owed by one party to the other under that contract and taking into account any amount of collateral previously posted (a net close-out debit or a net close-out credit).

In this context, dealers will be able to rely on the derogatory rules to French insolvency and security laws (known as the Financial Netting Regime) introduced in the French Monetary and Financial Code following the implementation under French law of Directive (EU) 2002/47/EC of 6 June 2002 on financial collateral arrangements. The Financial Netting Regime allows counterparties to implement the close-out netting provisions of derivatives framework agreements concluded by a French counterparty, including where it is subject to insolvency proceedings. The provisions of the Financial Netting Regime operate by exception to the general French insolvency regime. There are no specific applicable insolvency rules that would apply if the counterparty is the issuer or an affiliate of the issuer.

In 2024, the French High Court of Justice (*Cour de Cassation*) confirmed the compatibility of the Financial Netting Regime with the French Constitution, thereby ruling out any challenge to the constitutionality of the French statutory provisions relating to the Financial Netting Regime in the event of insolvency.

Law stated - 15 May 2025

Reporting obligations

9 What types of reporting obligations does an issuer or a shareholder face when entering into an OTC equity derivatives transaction on the issuer's shares?

Issuers are generally subject to the transaction reporting rules to trade repositories under EMIR.

In addition, shareholders entering into equity derivatives transactions on a French issuer's shares listed on Euronext (the Paris regulated market) are required to file with the AMF a disclosure threshold notification by the fourth trading day after reaching, exceeding or falling below:

- 5, 10, 15, 20, 25 or 30 per cent, one-third, 50 per cent, two-thirds, 90 and 95 per cent of the share capital of an issuer whose shares are listed on Euronext Paris; and
- 50 and 95 per cent of the share capital of an issuer whose shares are listed on Euronext Growth (in either case, under French law, this requirement is triggered at such percentage levels of either voting rights or of non-voting capital).

Disclosure is needed where these thresholds are met from holding either shares with voting rights or financial instruments referencing shares with voting rights (entitlements to acquire and financial instruments with similar economic effect) or a combination of both. The notification by the shareholders shall include, inter alia, the total number of shares or voting rights they hold, the number of securities they hold that give deferred access to future shares and the voting rights attached thereto, and the shares already issued that they may acquire by virtue of the derivative instrument. When the underlying securities are effectively acquired through physical delivery, another notification will also need to be filed with the issuer and the AMF. When the derivative that gives exposure to the shares is cash settled, the calculation of the amount required to be disclosed is based on the notional value of the referenced shares and then delta-adjusted as appropriate.

At the 10, 15, 20 and 25 per cent levels, the shareholder's notification must include a statement of intent whereby the shareholder sets forth its intent with respect to the issuer during the coming six-month period. Any change in plans during such six-month period requires an amended filing (this disclosure must be made by the fifth trading day). Securities representing 5 per cent or less of an issuer's voting rights held within the trading book of a credit institution are exempt from these filing requirements, provided that the institution ensures that the voting rights in respect of those shares are not exercised or otherwise used to intervene in the management of the issuer (this is commonly referred to as the 'trading exemption').

Issuers can also set separate contractual disclosure thresholds in their articles of association, requiring shareholders to notify them when they cross individual thresholds upwards or downwards (which can be as low as 0.5 per cent).

Law stated - 15 May 2025

Restricted periods

10

Are counterparties restricted from entering into OTC equity derivatives transactions during certain periods? What other rules apply to OTC equity derivatives transactions that address insider trading?

The applicable rules relating to insider dealing and market abuse will apply to any counterparty to an OTC equity derivative transaction referencing shares admitted to trading on a regulated market. In fact, MAR includes a prohibition on the ability of a counterparty to enter into a transaction (including an OTC equity derivative transaction) on the basis of inside information (information of a precise nature that is not publicly available and that would be likely to significantly impact the price of the shares if it were to be made publicly available) or engage in the unlawful disclosure of inside information or market manipulation. If the counterparty to an OTC derivative transaction involving shares in an issuer is a 'person discharging managerial responsibility' in respect of that issuer, that person and any person closely associated with them must not deal in that issuer's securities during certain closed periods (30 calendar days before the announcement of an interim financial report or year-end report). In addition, equity derivative instruments (like other types of derivatives) do not qualify for the safe harbour exemption under article 5 of MAR, which means that transactions in own shares conducted by an issuer via a derivative do not benefit from the presumption that they do not constitute market abuse.

Law stated - 15 May 2025

Legal issues

11 What additional legal issues arise if a counterparty to an OTC equity derivatives transaction is the issuer of the underlying shares or an affiliate of the issuer?

If a counterparty to an OTC equity derivatives transaction is also the issuer of the underlying shares, it will be constrained by the requirement imposed under French law that an issuer cannot hold more than 10 per cent of its own shares. Issuers entering into an OTC equity derivatives transaction on their own shares will typically have to represent that the physical delivery of own shares under the OTC equity derivative transaction will not entail the crossing of this 10 per cent threshold and, if it did, the transaction would have to be terminated. This is in addition to legal issues relating to market abuse under MAR. In particular, if a counterparty to an OTC equity derivatives transaction is also an affiliate of the issuer, it is often the case that issues relating to 'persons discharging managerial responsibilities' within issuers, and persons closely associated with them, have to be examined in the context of the applicability of market abuse regulations.

Law stated - 15 May 2025

Tax issues

12 What types of taxation issues arise in issuer OTC equity derivatives transactions and third-party OTC equity derivatives transactions?

French tax law provides for a specific corporate income tax regime applicable to equity derivatives traded on organised markets (or markets assimilated to organised markets) that revolves around the recognition of latent capital gains or losses on such instruments (ie, mark-to-market taxation) and the possibility to benefit from a tax rollover regime on certain specific transactions. For all other aspects of French direct and indirect taxation, French tax law does not provide for specific rules but more general tax provisions may apply depending upon the means pursuant to which equity derivatives transactions are structured (eg, exercise of options, conversion or exchange of equity or debt instruments). Issues related to the characterisation of income and gains may also be triggered regarding the application of French withholding tax in the case of cross-border transactions. Consequently, a tax analysis generally needs to be conducted on a case-by-case basis.

In practice, counterparties to equity derivatives transactions will consider the timing of the physical delivery of the shares and the nature of the securities being transferred as collateral in the context of their potential tax implications (including the crystallisation of a gain or a loss at a particular point in time, the tax characterisation of this gain or loss and the possibility to benefit from a tax rollover regime under certain circumstances). In addition, counterparties will generally explicitly address in the documentation the allocation of the payment of French transfer taxes or the French financial transaction tax (when the shares are those of a French company that is listed on a stock market with a market capitalisation greater than €1 billion), irrespective of fall back indemnity provisions that may already be contained in the related derivative framework agreement.

Law stated - 15 May 2025

Liability regime

13 Describe the liability regime related to OTC equity derivatives transactions. What transaction participants are subject to liability?

There is no specific liability regime applicable to OTC equity derivatives transactions in France. Counterparties to OTC equity derivatives transactions are subject to the general principles and mandatory rules of civil law liability arising under contracts (consent, certainty and legality of the contract's purpose, absence of fraud) and to defined statutory offences governing, in particular, the provision of regulated investment services, market abuse and market manipulation, short selling, and compliance with applicable disclosure thresholds (both statutory and pursuant to the by-laws of the issuer). These offences may, in some instances, give rise to criminal liability (in particular, in relation to insider dealing, unlawful disclosure, market manipulation, attempted market manipulation or the provision of regulated investment services in France without a proper licence).

Law stated - 15 May 2025

Stock exchange filings

14 What stock exchange filings must be made in connection with OTC equity derivatives transactions?

There are no specific stock exchange filings that must be made in connection with OTC derivatives transactions under French law. However, some stock exchange markets have set out specific rules governing reporting obligations when trading on their derivative markets.

In addition, various filing requirements with the AMF and, potentially, the issuer, will arise in the event of crossing an ownership or voting rights threshold (under the French Commercial Code or the by-laws of the issuer), the build-up of a short selling position (under the Short Selling Regulation) or the involvement of persons discharging managerial responsibilities and persons closely associated with them (under MAR). Also, in connection with a share buy-back, some issuers using equity derivative instruments have chosen, in addition to reporting share buy-back transactions to the AMF, to report to the competent authority of the trading venue on which the shares have been admitted to trading or are traded each transaction relating to the share buy-back programme (irrespective of the fact that these transactions do not fall within the safe harbour under MAR).

Law stated - 15 May 2025

Typical document types

15 | What types of documents are typical in an OTC equity derivatives transaction?

OTC equity derivatives transactions are typically documented under a transaction confirmation forming part of either the FBF Master Agreement governed by French law or the ISDA Master Agreement governed by English or French law (a version of the ISDA Master Agreement governed by French law was published by ISDA in 2018 in connection with contingency planning for Brexit). Counterparties using the FBF Master Agreement and the ISDA Master Agreement governed by French law do, in much the same way as counterparties using the ISDA Master Agreement governed by English law, have the benefit of market legal opinions relating to the enforceability of close-out netting. The type of master agreement and the governing law used to document equity derivatives transactions in France will mainly depend on the jurisdiction of incorporation of the relevant bank and the documentation policy of the company (some French companies insist on using the FBF Master Agreement).

When using the FBF Master Agreement, parties will often incorporate the Share Option Technical Schedule published by the FBF, as well as additional relevant technical schedules for the transaction. The Share Option Technical Schedule contains a set of definitions used by counterparties in their equity derivative transactions (it is very high-level and counterparties often amend these definitions in the transaction confirmation to bring them closer in line with the 2002 ISDA Equity Derivative Definitions). When using the ISDA Master Agreement, parties will incorporate the 2002 ISDA Equity Derivatives Definitions. Although the 2002 ISDA Equity Derivatives Definitions were updated in 2011, French market participants rarely use the 2011 version. Parties to OTC equity derivatives transactions may also be required to adhere to ISDA protocols or equivalent bilateral documentation for the purpose of complying with various regulatory requirements under EMIR.

When the equity derivatives transaction is a structured transaction, counterparties will most often (but not always) document the transaction on the basis of a long-form confirmation (a standalone confirmation incorporating the terms of the relevant derivatives framework FBF or ISDA agreement) so as to ensure that the close-out netting set related to that transaction with a particular dealer does not overlap with the close-out netting set under the derivatives framework agreement used for the day-to-day treasury activities of the counterparty with such dealer.

Law stated - 15 May 2025

Legal opinions

16 For what types of OTC equity derivatives transactions are legal opinions typically given?

If transactions are entered into under an ISDA Master Agreement or an FBF Master Agreement, the parties will usually rely on the industry market opinions. However, these industry opinions cover only the enforceability of close-out netting vis-a-vis a French counterparty in specific scenarios and, therefore, the parties may agree on the need to provide legal opinions if there are specific enforceability issues in a given transaction. Similarly, legal opinions of capacity may be required when there are concerns on the ability of a non-dealer counterparty to enter into derivative transactions. It is also not unusual for an enforceability opinion to be given in relation to collateral arrangements.

Law stated - 15 May 2025

Hedging activities

17 May an issuer lend its shares or enter into a repurchase transaction with respect to its shares to support hedging activities by third parties in the issuer's shares?

An issuer may lend its shares (via a traditional stock borrow facility to help the bank with establishing its delta position) or enter into a repurchase transaction with respect to its shares to support hedging activities by third parties in the issuer's shares subject to applicable share buy-back rules.

If the stock-lending or repurchase transaction involves a transfer of title to the counterparty, the issuer may repurchase its own shares at the maturity of the transaction. In that case, the issuer will need to ensure that it complies with the 10 per cent restriction on the holding of its own shares mandated under French law. A shareholder resolution will also be needed for the share buy-back at maturity unless the shareholder resolution authorising the issuer's buy-back programme is already in place and such transactions fall under the programme. The title transfer of shares under a stock-lending or repurchase transaction may potentially trigger disclosure threshold notifications for the dealer counterparty unless an exemption is available.

As in other jurisdictions, stock-lending and repurchase transactions can raise market manipulation and market abuse issues. The return of shares upon the maturity of such transactions should comply with MAR and the guidance from the AMF on share buy-backs (including, but not limited to, restrictions on transfers during closed periods). Repurchase transactions, securities lending and sell-buy back transactions qualify as securities financing transactions, and these transactions will likely be subject to reporting obligations under Regulation (EU) 2015/2365 of 25 November 2015 on transparency of security financing transactions and of reuse and amending Regulation (EU) No. 648/2012.

Law stated - 15 May 2025

Securities registration

18 What securities registration or other issues arise if a borrower pledges restricted or controlling shareholdings to secure a margin loan or a collar loan?

If the shares are listed on Euronext Paris and are freely transferable, there are no specific securities registration requirements in the event a borrower pledges restricted or controlling shareholdings, except for (if security is established via title transfer) the requirement to comply with applicable disclosure threshold obligations and, as the case may be, filing requirements set out under MAR in the case of the involvement of persons discharging managerial responsibilities and persons closely associated with them.

Law stated - 15 May 2025

Borrower bankruptcy

19 If a borrower in a margin loan files for bankruptcy protection, can the lender seize and sell the pledged shares without interference from the bankruptcy court or any other creditors of the borrower? If not, what techniques are used to reduce the lender's risk that the borrower will file for bankruptcy or to prevent the bankruptcy court from staying enforcement of the lender's remedies?

If a French corporate borrower to a margin loan files for bankruptcy protection, the lender will not be able to immediately seize and sell shares provided as collateral, custodied in France and subject to a French law pledge without potential interference from the French bankruptcy court or other creditors of the borrower.

This is because a loan does not qualify as an instrument eligible to the benefit of the Financial Netting Regime within the meaning of the French financial collateral arrangement rules resulting from the transposition into French law of Directive (EU) 2002/47/EC of 6 June 2002 on financial collateral arrangements (at least not if only one of the parties is an eligible financial counterparty). As a result, as from the opening of an insolvency proceeding against a French corporate borrower, the pledge would be potentially subject to a stay of enforcement and, therefore, the lender may not be able to appropriate the collateral and apply it against any debt owed to it under the margin loan without being potentially subject to a risk of stay.

As a consequence, a margin loan with a French borrower will typically be structured as a form of derivative under an ISDA or FBF framework agreement, such that it would qualify as a category of financial instrument benefiting from the provisions of the financial collateral arrangement regime (which does not completely rule out the risk that a court may re-characterise the derivative as a loan so that the financial collateral arrangement would not benefit from the financial collateral arrangement regime).

Alternatively, French corporate borrowers tend to use English-law documentation and custody the shares in the United Kingdom for the purpose of ensuring that the security structure under English law benefits from the financial collateral arrangement regime as implemented in the United Kingdom. However, this structure remains largely untested and, in the absence of case law, some commentators have argued that French shares credited to an account in the United Kingdom may still be deemed to be located in France for the purposes of French insolvency proceedings.

Law stated - 15 May 2025

Market structure

20 | What is the structure of the market for listed equity options?

The equity option market allows trading of both stock options and index futures and options (such as on the CAC 40 index).

The main markets for options on French shares are Marché des Options Négociables de Paris (MONEP) in Paris (part of the Euronext Group) and EUREX (Deutsche Börse Group). A much smaller portion of options on French shares is traded on Euronext Amsterdam, the Italian derivatives market or ICE (Intercontinental Exchange). According to a document published by the AMF in July 2021, more than half of the trades are placed outside the order book in the form of blocks of option trades.

There is a great variety of instruments for the same underlying share proposed for trading (mainly due to the combination of different maturities and exercise price) but a small number of these is actually traded.

Law stated - 15 May 2025

Governing rules

21 | Describe the rules governing the trading of listed equity options.

Trading of listed equity options on Euronext France is governed by the Euronext Rulebook (the Harmonised Rules in Book I and specific rules applicable to the French regulated markets in Book II). Part II contains the rules applicable to MONEP.

Trades carried out on the MONEP are cleared and guaranteed by Banque Centrale de Compensation (LCH.CLEARNET), according to the conditions and limits specified by the operating rules of the clearing house LCH.CLEARNET.

The clearing house fixes the required amount of collateral deposit and calculates margin calls (if the position is out-of-the-money) and the relevant settlement price per option.

Options expire several times a year. The standard expiry date is the third Friday of the expiry month unless the third Friday is a public holiday and the exchange is closed, in which case it is the third Thursday. For the CAC 40 Index derivatives, Euronext France offers weekly futures, mini-index derivatives and total return futures. The participants are clearing members, broker-dealers and dealers for own account authorised to carry out execution.

The main rules governing the trading of listed equity options on Eurex include the Exchange Act (BörsG) as the overall statutory framework, the Exchange Rules, and the Trading Conditions of Eurex as well as the Eurex Contract Specification Rules.

Law stated - 15 May 2025

TYPES OF TRANSACTION

Clearing transactions

22 What categories of equity derivatives transactions must be centrally cleared and what rules govern clearing?

The clearing obligation under Regulation (EU) No. 648/2012 on OTC derivatives, central counterparties and trade repositories (the European Market Infrastructure Regulation (EMIR)) requires (assuming a clearing threshold is reached) that all OTC derivative contracts within scope are subject to mandatory clearing and must be cleared with a central clearing counterparty (CCP) that is authorised under EMIR (or that is recognised under EMIR for non-EU CCPs). Currently, EMIR does not mandate the clearing of equity derivatives. The specific classes of products that are within the scope of the mandatory clearing obligation under EMIR are set out in the Annex to the EMIR Delegated Regulation and cover standardised and liquid products (including certain interest rate swaps and credit default swaps). While it is contemplated that single stock equity derivative products will become clearable in the future, the equity derivatives market is already predominantly exchange-based. As a result, equity derivatives that remain traded OTC are generally bespoke products and, therefore, are unlikely to easily meet the standardisation and liquidity requirements for clearable products under EMIR.

Law stated - 15 May 2025

Exchange-trading

23 What categories of equity derivatives must be exchange-traded and what rules govern trading?

There is no legal requirement for any category of equity derivatives to be exchange-traded, even if the types of OTC derivatives that are exchange-traded are typically equity options and futures. Regulation (EU) No. 600/2014 of 15 May 2014 on markets in financial instruments (MiFIR) introduced a mandatory trading obligation for certain types of derivatives (article 28 of MiFIR). It requires financial counterparties (FCs) and non-financial counterparties above the clearing threshold (NFC+) to conclude in-scope derivatives on a trading venue (a regulated market, a multilateral trading facility or an organised trading facility) or an equivalent third-country trading venue when they trade with other FCs or NFCs+. This trading obligation applies to any class (or sub-class) of derivatives that has been declared subject to the EMIR clearing obligation, is admitted to trading or traded on at least one trading venue (the venue test), is considered sufficiently liquid to be traded only on venue, taking into account the average frequency of trades, the average size of trades, the number and type of active market participants and the average size of spreads (the liquidity test), and has been declared by the European Securities and Markets Authority as subject to the trading obligation. However, currently, this trading obligation only applies to certain categories of interest rate swaps and credit default swaps and does not apply to equity derivatives.

Law stated - 15 May 2025

Collateral arrangements

24 | Describe common collateral arrangements for listed, cleared and uncleared equity derivatives transactions.

For uncleared equity derivatives transactions, counterparties will usually document their collateral arrangements contemplating for the exchange of periodic variation margin as title transfer under an International Swaps and Derivatives Association (ISDA) Collateral Support Annex (under English or French law) to the ISDA Master Agreement or the equivalent local collateral annex under the French Banking Federation (FBF) derivative framework documentation. In that context, EMIR imposes risk-reducing and transparency obligations on all EU undertakings (including, but not limited to, dealers and corporates) that enter into derivative transactions (including equity derivatives transactions). In particular, EMIR contemplates risk mitigation techniques for OTC derivatives transactions not cleared by a CCP that include timely exchange of collateral and periodic compression requirements.

For cleared equity derivatives transactions, counterparties will generally document their clearing relationship under a principal-to-principal clearing model with a clearing broker acting as riskless principal (as between the counterparty and the CCP) under the ISDA/Futures and Options Association Client Cleared OTC Derivatives Addendum (English law), which works as an addendum to the ISDA Master Agreement (with corresponding French law adjustments for the FBF Master Agreement). In addition, counterparties subject to clearing requirements under EMIR may also have to put in place specific initial margin arrangements to guard against the margin period of risk – that is, the risk that there is not enough posted collateral as variation margin.

For listed equity derivatives transactions, the relevant collateralisation requirements will be determined by the relevant clearinghouse.

Law stated - 15 May 2025

Exchanging collateral

25 | Must counterparties exchange collateral for some categories of equity derivatives transactions?

The rules for collateralisation of derivatives transactions under EMIR are not specific to equity derivatives transactions. EMIR requires the exchange of variation margin between financial counterparties (credit institutions, insurance undertakings, undertakings for the collective investment in transferable securities, alternative investment fund managers, etc) and between financial counterparties and non-financial counterparties, depending on whether they are above the clearing threshold. Please note, single stock equity options and index options remain out of scope for a transitional period; however, while this transitional period formally ended on 4 January 2024, the European Supervisory Authorities published joint draft regulatory technical standards proposing a two-year extension to 4 January 2026, which was accompanied by a 'no action' letter confirming that supervisory authorities should not prioritise supervisory or enforcement actions with respect to equity options in the meantime.

Law stated - 15 May 2025

LIABILITY AND ENFORCEMENT

Territorial scope of regulations

26 | What is the territorial scope of the laws and regulations governing listed, cleared and uncleared equity derivatives transactions?

French law applies to counterparties transacting in France, or in respect of French shares or shares that are admitted to trading on a French exchange. The scope of directly applicable European legislation is, in general, also limited to the European Union and transactions with an EU nexus (although there is a tendency in new proposed regulations to extend beyond EU borders to maintain a level playing field between EU and non-EU market participants). Third-country counterparties may be indirectly impacted by French or EU laws in connection with cross-border business. For example, a counterparty located outside of the European Union may have to comply with requirements under Regulation (EU) No. 648/2012 on OTC derivatives, central counterparties and trade repositories (the European Market Infrastructure Regulation (EMIR)) to allow its French counterparty to comply with its own obligations under EU rules. Notably, EMIR would capture transactions with a 'direct, substantial and foreseeable effect' within the European Union or aimed at evading the obligations under EMIR. As a result, to that extent only, some regulations (such as EMIR) may have extra-territorial effect.

Law stated - 15 May 2025

Registration and authorisation requirements

27 | What registration or authorisation requirements apply to market participants that deal or invest in equity derivatives, and what are the implications of registration?

At least one of the market participants to an equity derivatives transaction will need to qualify as an eligible institution (a credit institution, an investment services provider, a financing company, etc) for the provisions of the Financial Netting Regime to apply to financial instruments (including equity derivatives transactions) under French law. Importantly, if one of the market participants needs to qualify as an eligible institution, it does not need to be registered in France as long as it is a foreign entity with comparable legal status (ie, a licensed foreign institution carrying banking and financial services).

The Financial Netting Regime is the cornerstone of derivatives trading (including equity derivatives) in France as it allows counterparties trading financial instruments to implement the close-out netting provisions of derivatives framework agreements entered into by a French counterparty, including where it is subject to insolvency proceedings. This is because the provisions of the Financial Netting Regime operate by exception to the general French insolvency regime.

If both counterparties qualify as eligible counterparties for that purpose, the Financial Netting Regime is expanded to cover not only financial instruments but also any financial transaction granting the right to cash settlement or the delivery of financial instruments.

Law stated - 15 May 2025

Reporting requirements

28 What reporting requirements apply to market participants that deal or invest in equity derivatives?

French market participants that deal in equity derivatives are generally subject to the transaction reporting rules to trade repositories under EMIR.

In addition, shareholders entering into equity derivatives transactions on a French issuer's shares are required to file with the the Financial Markets Authority (AMF) a disclosure threshold notification by the fourth trading day after reaching, exceeding or falling below 5, 10, 15 , 20, 25 or 30 per cent, one-third, 50 per cent, two-thirds, 90 and 95 per cent of the share capital of an issuer for which France is the home member state (under French law, this requirement is triggered at such percentage levels of both voting rights and of non-voting capital). Disclosure is needed where these thresholds are met from holding either shares with voting rights or financial instruments referencing shares with voting rights (entitlements to acquire and financial instruments with similar economic effect) or a combination of both. The notification by the shareholders shall include, inter alia, the total number of shares or voting rights they hold, the number of securities they hold that give deferred access to future shares and the voting rights attached thereto, and the shares already issued that they may acquire by virtue of the derivative instrument. When the underlying securities are effectively acquired, another notification will also need to be filed with the issuer and the AMF.

At the 10, 15, 20 and 25 per cent levels, the shareholder's notification must include a statement of intent whereby the shareholder sets forth its intent with respect to the issuer during the coming six-month period. Any change in plans during such six-month period requires an amended filing (this disclosure must be made by the fifth trading day). Securities representing 5 per cent or less of an issuer's voting rights held within the trading book of a credit institution are exempt from these filing requirements, provided that the institution ensures that the voting rights in respect of those shares are not exercised or otherwise used to intervene in the management of the issuer (this is commonly referred to as the 'trading exemption').

Issuers can also set separate contractual disclosure thresholds in their articles of association, requiring shareholders to notify them when they cross individual thresholds (these thresholds can be as low as 0.5 per cent).

Law stated - 15 May 2025

Legal issues

29 What legal issues arise in the design and issuance of structured products linked to an unaffiliated third party's shares or to a basket or index of third-party shares? What additional disclosure and other legal issues arise if the structured product is linked to a proprietary index?

No specific legal issue would arise in the design and issuance of structured products linked to an unaffiliated third party's shares or to a basket or index of third-party shares.

However, where the structured product is to be listed, Regulation (EU) 2017/1129 of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market (the Prospectus Regulation) will apply with specific disclosure requirements in relation to the issuer and the underlying (third- party shares, basket or index of shares) as well as the applicable tax regime (as detailed in Delegated Regulation (EU) 2019/980 of 14 March 2019 supplementing the Prospectus Regulation).

The following applies:

- where the product is linked to a basket of underlyings, the prospectus must include disclosure of various information in respect of each underlying and its relevant weighting in the basket; and
- where the product is linked to an index, the prospectus must include the name of the index and, where the index is not composed by the issuer, an indication of where information about the index can be obtained and also whether the index constitutes a benchmark under Regulation (EU) 2016/1011 of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No. 596/2014 (the Benchmark Regulation). The administrator of an index that qualifies as a benchmark for the purposes of the Benchmark Regulation is required to apply for authorisation and is subject to supervision by the competent authority of the country in which it is located. Also, as the Benchmark Regulation applies to all indices used in the European Union regardless of origin, third- country administrators located outside the European Union are required to seek approval to continue to serve their EU customers.

In that context, if the product references an index that constitutes a benchmark provided by external and independent providers, the issuer will be considered a 'user' under the Benchmark Regulation and, as such, the issuer must put in place written plans to designate an alternative if the benchmark used materially changes or ceases to be published (ie, fallbacks) and must ensure the prospectus or investment memorandum includes clear and prominent information stating whether the benchmark is provided by an authorised administrator. Conversely, if the product references a proprietary index that constitutes a benchmark (ie, an index built in-house to reduce costs that would otherwise have to be paid to external index providers), the issuer would be considered both a 'user' and an 'administrator' under the Benchmark Regulation (and, therefore, both the requirements for 'user' and the onerous requirements for 'administrator' would apply, in particular in relation to governance arrangements and the management of conflicts of interests).

As far as French tax is concerned, structured products might entail, among others, capital gains taxation, loss of the benefit of favourable tax regime on certain securities income, and withholding tax. In addition, French transfer taxes or French financial transaction tax (when the shares are those of a French company that is listed on a stock market with a market capitalisation greater than €1 billion). The tax analysis will need to be conducted on a case-by-case basis.

Law stated - 15 May 2025

Liability regime

30 | Describe the liability regime related to the issuance of structured products.

The liability regime related to the issuance of structured products essentially revolves around various overarching general principles, including:

- the sufficiency of the information provided to investors via the disclosure document allowing investors to make an informed investment decision (ie, appropriate content of the prospectus without misstatement or omission);
- the accuracy of the information provided by financial intermediaries to their clients; and
- the suitability of the proposed product to the target market.

Law stated - 15 May 2025

Other issues

31 | What registration, disclosure, tax and other legal issues arise when an issuer sells a security that is convertible for shares of the same issuer?

The offer and sale of a security convertible for shares of the same issuer are generally not subject to the requirements for the drafting, approval and distribution of a prospectus under Regulation (EU) 2017/1129 (the Prospectus Regulation) if the purchasers are qualified investors or the placement is made to fewer than 150 persons per member state of the European Economic Area (EEA). Under those circumstances, the convertible instrument would be exempt from registration with the French Financial Markets Authority unless the convertible instrument is admitted to trading on a regulated market – convertible instruments are generally admitted to trading on Euronext Access, a multilateral trading facility (MTF) operated by Euronext Paris.

The main legal issues that arise in the offer and sale of a convertible instrument are as follows.

Corporate law

Assuming that the shares underlying the convertible instrument represent a new issuance, shareholders' approval with a two-thirds majority of the shareholders present or represented with a quorum of one-quarter of the existing voting rights on first convocation and one-fifth of the existing voting rights on second convocation is required. New shares underlying the convertible instrument are generally issued via a capital increase, without the preferential subscription rights that normally apply for existing shareholders. There are three ways to accomplish this:

- the private placement exemption under article L225-136 of the French Commercial Code, permitting up to 20 per cent of the share capital (or equivalent through exercise of conversion rights) per year to be sold to institutional investors and other related categories;
- the crowd-sourcing exemption under article L441-2 of the Monetary and Financial Code, permitting an offer of up to €8 million; and
- the reserved capital increase under article L225-138 of the French Commercial Code, permitting the sale of shares to certain designated persons or determined categories of person fixed by the shareholders, with no limit in terms of share capital amount or price (as long as the price or appropriate pricing parameters are approved by the shareholders). Listed issuers often obtain delegations from their shareholders, permitting the board of directors to implement the capital increase that can be sub-delegated to management within prescribed time limits following the shareholders' meeting (26 months for the private placement exemption and 18 months for the reserved capital increase).

Disclosure

Articles 7 and 17 of Regulation (EU) No. 596/2014 on market abuse regarding the need to provide prompt disclosure of inside information regarding the underlying listed shares (assuming Regulation (EU) No. 596/2014 on market abuse containing provisions on insider dealing, unlawful disclosure of inside information and market manipulation (Market Abuse Regulation (MAR)) applies due to admission to trading on a regulated market or an MTF in the EEA) would apply if the issuance of convertible instruments is listed on a regulated market or an MTF in the EEA. Depending on the circumstances, the issuance of a convertible instrument may be price-sensitive for the listed shares, mandating disclosure of its terms, which, according to the recommendations of the AMF, should include, among other things, disclosure of the instrument type, nature of the offering or placement, nominal amount, interest rate, maturity, conversion rights, conversion ratio, number of shares that would be issued or granted to satisfy conversion rights, the dilutive effect, issue price, use of proceeds, undertakings assumed by the issuer, share capital of the listed company following the issuance and governance rights of the holders (if any).

Transparency

Articles 223-10-1 of the General Regulations of the AMF require that issuers provide all investors with the same level of information even in offers and sales that are not subject to the prospectus drafting, approval and distribution requirements of the same. Additionally, the General Regulations of the AMF provide, among other things, the approved and recommended modalities of effective dissemination of regulated information.

Tax

The issuance of convertible securities generally does not trigger any direct or indirect tax issues from a French tax standpoint at the level of the issuer. However, deductibility of interest accrued under such securities may be restricted under several provisions of French tax legislation, in particular in the event that the holders are shareholders or related parties to the French issuer. In addition and subject to certain exceptions, specific rules restrict the deductibility for tax purposes of payments made by a French debtor to persons domiciled in a 'non-cooperative State of territory' or paid on an account opened in a financial institution located in such a state or territory. Conversion of convertible securities into equity may entail immediate capital gains taxation at the level of the holders (directly or through a withholding taxes mechanism), subject to specific tax rollover regimes that may apply subject to certain conditions. Finally, conversion or transfer of such securities may be subject to French transfer taxes (or to the French financial transaction tax, as the case may be), depending upon the characteristics of the securities and the means pursuant to which the conversion or transfer is realised. A tax analysis generally needs to be conducted on a case-by-case basis.

Law stated - 15 May 2025

32 What registration, disclosure, tax and other legal issues arise when an issuer sells a security that is exchangeable for shares of a third party? Does it matter whether the third party is an affiliate of the issuer?

The offer and sale of a security exchangeable for shares of a third party is generally subject to the same legal issues that are discussed for convertible instruments in 'Other issues', with the exception of the corporate matters as the approval for the issuance of an exchangeable instrument would be subject to local applicable law and the by-laws of the issuer.

Although the MAR generally does not impose a disclosure obligation on a third party issuer with respect to the underlying shares, third-party issuers are still nonetheless subject to article 223-6 of the General Regulations of the AMF, which imposes an obligation of disclosure on 'any person [preparing] a financial transaction liable to have a significant impact in the market price of a financial instrument, or on the financial position and rights of holders of that financial instrument'. Third-party issuers should take care to comply with the foregoing disclosure obligations, which can be discharged in the manner indicated above. An affiliate issuer may have MAR obligations with respect to the underlying shares if such issuer is an insider with respect to the listed company, and in any case, should likewise comply with article 223-6 of the AMF General Regulations.

As far as French tax aspects are concerned, the sale by the issuer of a security that is exchangeable for shares of a third party (or an affiliate) should not per se trigger any direct or indirect tax consequences, other than, as the case may be, transfer taxes. Tax consequences that need to be reviewed on a case-by-case basis may arise at the time of the exchange or in the event of a fluctuation in the value of the underlying shares.

Law stated - 15 May 2025

UPDATE AND TRENDS

Recent developments

33 | Are there any current developments or emerging trends that should be noted?

Following Brexit, French counterparties have shown an increasing preference to document their structured equity derivatives transactions under framework documentation (French Banking Federation or International Swaps and Derivatives Association) governed by French law (as opposed to English law). This was a concerted effort by French counterparties to hedge the unintended effect of having equity derivatives transactions documented under English law (now a third-party non-EU law) to address substantive concerns including (but not limited to) the recognition of the choice of law for contractual and non-contractual obligations, the recognition of jurisdiction clauses or the enforcement of foreign judgments. This is in addition to French counterparties now generally requiring that the equity derivatives transactions be booked by the dealer counterparty out of a regulated entity located in the European Union (often in France, Germany or Ireland, depending on the dealer counterparty) to alleviate any concern relating to the provision of a regulated Markets in Financial Instruments Directive investment service by the dealer counterparty in France out of an entity regulated outside of the European Union. Additionally, France is one of the few EU jurisdictions where corporates routinely use equity derivatives for the repurchase of their own shares (including on an environmental, social and governance-linked or key performance indicator-linked basis) irrespective of the fact that derivatives do not benefit from the safe- harbour provisions of Regulation (EU) No. 596/2014 on market abuse. Finally, the ability of French issuers to issue securities on the blockchain is starting to raise novel legal issues in the context of equity financings.

Law stated - 15 May 2025

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Summary

UPDATE AND TRENDS

Recent developments

OVERVIEW

Typical types of transactions

1 Other than transactions between dealers, what are the most typical types of over-the-counter (OTC) equity derivatives transactions and what are the common uses of these transactions?

Typical issuer equity derivatives products include the following:

- equity swaps to hedge an issuer's obligations in respect of the relevant issuer's employee benefit plan, which entails shares or share price-related benefits;
- call options entered into by an issuer to hedge its payment obligations in respect of cash-settled convertibles, known as 'equity neutral' or 'non-dilutive convertible bond transactions';
- share loans and share repurchase transactions in the context of convertibles to facilitate hedging by investors in convertible bonds; and
- derivative-based share buy-back transactions.

Typical equity derivatives products that allow a shareholder to acquire a substantial position in a publicly traded equity or to monetise or hedge an existing equity position include the following:

- call options, put options, collars, forwards and total return swaps to hedge any equity price risk; and
- margin loans and margin bonds where shares are used as collateral for a leveraged loan bond, usually in the context of an acquisition.

Furthermore, equity derivatives transactions are entered into for general investment purposes or for hedging exposure from investment products issued by banks or funds, such as:

- share basket and index-linked transactions entered into by insurance companies, pension funds, etc;
- equity funds and exchange-traded funds (ETFs) entering into equity derivatives to get a synthetic exposure to a basket of shares or equity index; and
- retail certificates through which investors acquire an equity derivative exposure (eg, share-linked certificates, bonus certificates, express certificates, knock-in and knock-out certificates, index and performance certificates and discount certificates) – the retail equity derivatives market in Germany is one of the biggest retail markets for structured products in the world.

Law stated - 2 May 2025

Borrowing and selling shares

2

May market participants borrow shares and sell them short in the local market? If so, what rules govern short selling?

The rules on short selling are set out in Regulation (EU) No. 236/2012 of the European Parliament and of the Council of 14 March 2012 on short selling and certain aspects of credit default swaps, and is supplemented by various delegated and implementing regulations. The short-selling rules apply, among others, to shares admitted to trading on a trading venue in the European Union irrespective of whether the instruments are traded on such trading venue (except where the principal trading venue of that instrument is in a third country). The Regulation requires that short sales of shares must be covered either by having borrowed the relevant stock or by arranging for such borrowing, or having a locate arrangement with a third party. Uncovered (naked) short selling of shares is prohibited. In addition, significant net short positions in shares must be notified to the relevant competent authorities if they are equal to at least 0.2 per cent of the issued share capital of the relevant company (and every 0.1 per cent above that) and publicly disclosed if they are equal to at least 0.5 per cent of the issued share capital of the relevant company (and each 0.1 per cent above that). The competent authority is the authority of a relevant member state where the market that is most relevant in terms of liquidity for such shares is located. In Germany, the relevant competent authority is the Federal Financial Supervisory Authority (BaFin).

Market-making activities and authorised primary dealers are exempted from these restrictions. While these EU provisions are directly applied in all EU member states based on a generally harmonised approach, the regulatory practice of the national competent authorities may differ in detail. To mitigate such discrepancies and to provide more transparency, the European Securities and Markets Authority (ESMA) has published guidelines on the exemption for market-making activities and primary-market operations. In this regard, the Federal Financial Supervisory Authority (BaFin) announced compliance with ESMA's guidelines, with two exceptions. In BaFin's view, the short -selling regulation does not limit the application of the exemption for market-making activities to financial instruments traded on the trading venue where the market maker is a member and in respect of which the market-making activity is conducted, and, with regard to the product scope, to only shares and sovereign debts. Market participants should also assess whether any further restrictions (including short-selling bans with respect to shares of a particular issuer) imposed by supervisory authorities apply (which is possible in particular for measures protecting the markets).

Law stated - 2 May 2025

Applicable laws and regulations for dealers

3 Describe the primary laws and regulations surrounding OTC equity derivatives transactions between dealers. What regulatory authorities are primarily responsible for administering those rules?

The regulation of OTC derivatives, including equity derivatives transactions, in Germany primarily includes the following.

- Regulatory requirements at the level of the institution that undertakes licensable trading activities; namely, for establishing and maintaining the relevant business such as licensing requirements and related ongoing prudential requirements (including, eg, capital adequacy requirements and risk management requirements). These requirements are primarily set out in the Banking Act (KWG) and relevant EU legislation such as the Capital Requirements Regulation (CRR). Certain types of investment firms are subject to a regulatory framework comprising primarily the Investment Firms Regulation (Regulation (EU) No. 2019/2033) and the Investment Firms Act (WpIG) implementing the Investment Firms Directive (Directive No. 2019/2034) into German law.
- Supervision of the services and trading activities of an institution such as the rules on conduct and product governance, as well as the general market and market infrastructure supervision and transparency requirements to be complied with by all relevant market participants, such as disclosure of shareholdings and voting rights, insider trading and market abuse, which are primarily set out in the Securities Trading Act (WpHG) and, with respect to certain matters, in directly applicable EU legislation such as the European Market Infrastructure Regulation (Regulation (EU) No. 648/2012) (EMIR) on OTC derivatives, central counterparties and trade repositories; the Securities Financing Transactions Regulation (Regulation (EU) No. 2015/2365) (SFTR); the Market Abuse Regulation (Regulation (EU) No. 596/2014) (MAR); and the Short Selling Regulation, as well as the Markets in Financial Instruments Regulation (Regulation (EU) No. 600/2014) (MiFIR) and other delegated regulations that, in addition to the relevant provisions of the Securities Trading Act, further implement the Markets in Financial Instruments Directive (Directive No. 2014/65/EU) (MiFID).

Licensable activities under the Banking Act and the Investment Firms Act include financial services such as investment brokerage, investment advisory services, placement business, acquisition brokerage, portfolio management, dealing on own account and certain proprietary trading activities (in all cases if provided on a commercial scale). As regards own-account trading, the Banking Act and the Investment Firms Act distinguish between dealing on own account and conducting proprietary business. In particular, market-making activities, dealing on own account as service for third parties and high-frequency trading as a direct or indirect participant of a trading venue qualify as licensable dealing on own account and therefore as financial and investment services requiring a licence. Within the scope of the Banking Act, however, proprietary business is only deemed to be a financial service requiring a licence if it is conducted on a commercial scale and the respective company belongs to the same group or financial conglomerate to which a CRR institution also belongs. Further, CRR institutions and companies belonging to the same group as a CRR rendering proprietary trading and proprietary business activities are only allowed to do so up to a certain limit of business volume. Otherwise, such activities can only be conducted by a financially and legally independent favoured financial trading institution. Furthermore, proprietary trading in shares or equity derivatives undertaken at a commercial scale requires a licence (subject to certain exemptions) if undertaken by a participant of a regulated market or a multilateral trading facility or via direct electronic access to a trading venue. Finally, credit or financial institutions and investment firms require an additional licence for proprietary trading if they intend to conduct proprietary business alongside their main (licensable) business.

The main legal framework for trading in securities and other financial instruments such as derivatives in Germany is set by MiFID and MiFIR as transposed into German law by the Securities Trading Act and as supplemented by various German and EU regulations (eg, with regard to, among other things, definitions, transparency requirements and exemptions). The Securities Trading Act governs disclosure requirements, product governance rules, including organisational and transparency requirements, and the reporting regime, as well as the respective supervision of BaFin as competent authority and sanctions for breaches of law. Since its entry into force in 2016, the MAR provides a pan-European legal framework for prevention and detection of insider dealing, unlawful disclosure of inside information and market manipulation. In this regard, the Securities Trading Act only complements the rules set out in the MAR, including the application of the MAR rules to commodities and foreign currencies traded on a German stock exchange or on an equivalent European Economic Area market.

In the European Union, the G20 commitment on the regulation of OTC derivatives was introduced as part of EMIR, which states obligations on all EU undertakings (including banks, corporates and special purpose vehicles) that enter into derivative contracts, such as interest rate, foreign currency as well as inflation swaps and equity derivatives. These obligations include mandatory clearing of certain OTC derivatives through central counterparties, the implementation of risk mitigation techniques for non-cleared OTC derivatives, such as the exchange of collateral between parties (margin obligations), and the reporting of derivatives to trade repositories. The overall objective of EMIR is to improve transparency and reduce some of the risks associated with the derivatives market, in particular, the risk that the insolvency of one derivatives counterparty may spread through the derivatives market, triggering further insolvencies. EMIR has been amended by EMIR REFIT (Regulation (EU) No. 2019/834 of 20 May 2019), which, inter alia, simplifies some EMIR requirements, especially for small financial and non-financial counterparties, and aims to make supervision more efficient.

As regards the use of securities financing transactions and collateral reuse, the SFTR – supplemented by several implementing and delegated acts – provides for a legal framework of transparency requirements to facilitate monitoring and risk identification. The SFTR sets out, inter alia, reporting rules in respect of details of securities financing transactions (such as securities lending and repo transactions or certain margin lending transactions) to trade repositories and minimum transparency rules and consent requirements for parties involved in collateral use.

The Benchmarks Regulation (Regulation No. 2016/1011) stipulates a regime for benchmark administrators that ensures the accuracy and integrity of benchmarks and also applies to equity indices across Europe. In addition, a code of conduct for contributors of input data requires the use of robust methodologies and sufficient and reliable data. Users of benchmarks need to establish robust fallbacks and regulated entities may only use registered benchmarks for certain financial products.

The German regulatory authority that supervises compliance with the rules and regulations set out above (and that is the competent authority for purposes of the EU regulations) is primarily BaFin. With respect to the prudential supervision of credit institutions, competent supervisory authorities are BaFin, the German Central Bank and the European Central Bank. Furthermore, ESMA and the European Banking Authority have a guidance and coordination function at EU level.

In respect of share buy-backs and transactions with share issuers, certain restrictions on such share buy-backs (including a buy-back via derivative transactions) apply under the Stock Corporation Act (AktG).

The Civil Code (BGB) and the Commercial Code (HGB) set out certain general principles of contract law, which also affect documentation and interpretation of equity derivatives transactions to the extent that the governing law of the transaction is German law.

In light of standard market documentation for OTC equity derivatives (the German Master Agreement and the International Swaps and Derivatives Association (ISDA) Master Agreement) and the reliance on netting provisions, requirements under the Insolvency Act (InsO) and the Act on the Stabilisation and Restructuring Framework for Businesses (StaRUG) must be considered when transactions are entered into with German counterparties.

Law stated - 2 May 2025

Entities

4 In addition to dealers, what types of entities may enter into OTC equity derivatives transactions?

OTC equity derivatives are mainly entered into by banks and financial services institutions. In addition, regulated and unregulated funds, including ETFs and alternative investment funds, securitisation and repackaging vehicles, insurance companies, pension funds, professional pension schemes and corporates frequently enter into OTC equity derivatives. In addition, retail investors are heavily investing in equity-linked structured products (typically in the form of structured securities), and more experienced retail investors are also trading equity-linked contracts for differences.

Law stated - 2 May 2025

Applicable laws and regulations for eligible counterparties

5 Describe the primary laws and regulations surrounding OTC equity derivatives transactions between a dealer and an eligible counterparty that is not the issuer of the underlying shares or an affiliate of the issuer? What regulatory authorities are primarily responsible for administering those rules?

In addition to the primary rules and regulations, specific rules apply to counterparties that are themselves regulated in respect of their investments and transactions activities, such as insurance companies and regulated funds.

The Insurance Supervisory Act (VAG) is the equivalent of the Banking Act for insurance companies and was fundamentally revised in 2016 to implement the Solvency II Directive (Directive No. 2009/138/EC). When entering into OTC equity derivatives transactions, insurance companies must ensure compliance with the VAG rules in respect of their investments (including investments in equity derivatives), such as the newly introduced capital requirement rules. There are particular rules for investments made in respect of the guarantee assets of an insurance company, which serve as cover for the claims of insured persons under the relevant insurance contracts. For smaller insurance companies, such restrictions are included in the Investment Regulation.

The Investment Code (KAGB) implements several EU directives into German law. Whereas the rules for funds investing in transferable securities derive from Directive No. 2014/91/EU for undertakings for the collective investment in transferable securities, alternative investment funds are governed by the Directive on Alternative Investment Fund Managers (Directive No. 2011/61/EU) (AIFMD). The AIFMD provides for a regulatory framework for alternative funds and investments by such funds, including investments in assets in which other funds are not allowed to invest. The KAGB implements this EU legal framework into German law, the scope of which also includes entering into OTC equity derivatives transactions by funds. The relevant requirements differ depending on the type of fund and the investors to which the fund shall be distributed.

The competent German supervisory authority is BaFin and, as regards the guidance and coordination undertaken at EU level, the relevant authorities are the European Insurance and Occupational Pensions Authority (with respect to insurance companies) and ESMA (with respect to funds).

Law stated - 2 May 2025

Securities registration issues

6 | Do securities registration issues arise if the issuer of the underlying shares or an affiliate of the issuer sells the issuer's shares via an OTC equity derivative?

The issuer may sell either newly created shares or treasury shares. In the case of registered shares (in contrast to bearer shares) being sold, the share register will be updated following notice by the relevant custodian bank of the issuer and the purchaser. As German shares are predominantly cleared through Clearstream Banking AG, share registers are often updated electronically. In light of equity derivatives transactions, the obligation (or the right) to request a change to the share register only arises with the transfer of the legal ownership of the shares (see section 67 AktG); in other words, the derivative as such is not registered. The registration is decisive for determining voting and dividend rights.

Law stated - 2 May 2025

Repurchasing shares

7 | May issuers repurchase their shares directly or via a derivative?

The AktG (section 71) allows share buy-backs in the following limited cases:

- if the acquisition is necessary to avoid severe and imminent damage to the company;
-

if the shares are to be offered for purchase to the employees or former employees of the company or an affiliated enterprise;

- if the acquisition is made to compensate shareholders in the context of structural measures;
- if the acquisition is made without consideration or made by a credit institution in execution of a purchase order;
- by universal succession;
- on the basis of a resolution of the shareholders' meeting to redeem shares by reducing the share capital;
- if it is a credit institution or financial institution on the basis of a resolution of the shareholders' meeting for the purposes of trading in securities; or
- on the basis of an authorisation of the shareholders' meeting granted for a maximum of five years and defining the price range. Such authorisation may not exceed 10 per cent of the share capital.

The last possibility is most relevant from a practical perspective. To enable a share buy-back via derivatives (eg, options or forwards), the shareholders' resolution should be drafted carefully and include corresponding authorisations. The price range defined in the shareholders' resolution may also be determined as a percentage of the then-current stock price. A deviation of the purchase price from the fair market value may also have tax consequences. The company can use funds that would also be available for a dividend to finance a share buy-back, even though there are some differences in detail.

A company may hold up to 10 per cent of its nominal share capital shares as treasury shares. Treasury shares do not carry any rights, such as dividend or voting rights.

A third party acting in its own name but on behalf of the company may acquire or hold shares in the company only if and to the extent that the company would permitted to purchase or hold the shares as treasury shares. Share buy-backs are disclosed in the financial statements and reported to the following shareholders' meeting.

The decision to buy back shares will often constitute inside information that triggers restrictions on insider dealing and the publication duties of the company. There are no specific rules on share buy-backs via equity derivatives transactions. However, all parties need to comply with the insider dealing and market abuse provisions set out in the Securities Trading Act and the MAR. The MAR and further EU rules will also require an issuer to disclose individual transactions under a share buy-back if it wants to make use of the safe harbour rules.

Law stated - 2 May 2025

Risk

8 What types of risks do dealers face in the event of a bankruptcy or insolvency of the counterparty? Do any special bankruptcy or insolvency rules apply if the counterparty is the issuer or an affiliate of the issuer?

The risk that dealers face in the event of the bankruptcy or insolvency of the counterparty is the credit risk of the counterparty, namely, that the counterparty will not fulfil its payment or delivery obligations under the relevant equity derivative transaction. The time period between an event of default and the termination of the transaction and the related calculation of the close-out amount may also entail market risk. An equity derivative transaction (together with any other OTC derivative transactions of the counterparty under any master agreement that it would typically have entered into with a dealer) usually terminates or may be terminated following the occurrence of an insolvency of the counterparty. Under German insolvency law, the general rule is that the insolvency administrator may elect whether to continue the contract or to terminate it. However, equity derivative transactions would typically be subject to a statutory close-out regime that applies upon the opening of German insolvency proceedings to the extent that the equity derivative transaction has not already been terminated and closed out before in accordance with its contractual terms. Equity derivatives transactions are typically documented under a master agreement (eg, an ISDA Master Agreement or the German Master Agreement for Financial Derivative Transactions (DRV). In these circumstances, all transactions under the DRV will be automatically terminated upon the occurrence of an insolvency event as defined in the DRV and the contractual close-out netting will apply. The same will apply to transactions under the ISDA Master Agreement if automatic early termination was selected in respect of the insolvency of a German counterparty. Whether automatic early termination should be selected with respect to a German counterparty in the case of an English or New York law-governed ISDA Master Agreement depends on the type of counterparty and the commercial considerations of the dealer. In general terms, it is recommended by the relevant German industry close-out netting opinion that automatic early termination should be selected if the counterparty is a German corporate. As regards the enforceability of the close-out netting provisions of the DRV and the ISDA Master Agreement in the insolvency of a German counterparty, industry close-out netting opinions have been issued in which any enforceability risks are discussed and any recommendations made.

Where the German counterparty is a regulated entity that is in financial difficulties, supervisory measures, such as a prohibition on making payments, may be taken by BaFin pre-insolvency, and German credit institutions, certain financial services institutions and parent companies of groups that comprise such regulated entities may be subject to restructuring measures, such as bail-in measures outside insolvency proceedings based on the German and EU law implementing the Bank Recovery and Resolution Directive (Directive No. 2014/59/EU) of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms. Furthermore, the Act on the Stabilisation and Restructuring Framework for Businesses (StaRUG), most of the provisions of which entered into force on 1 January 2021, has introduced a new framework for the restructuring of companies, which, among others, allows a reorganisation of companies outside of insolvency proceedings based on majority decisions of creditors.

There are no special insolvency regimes where the counterparty is the issuer of the underlying shares. However, depending on the economics and the overall nature and purpose of the transactions, additional considerations may need to be made in respect of a potential insolvency of the counterparty (which is also the issuer of the underlying shares). Finally, it should be noted that special regimes as regards reorganisation, moratorium, restructuring and resolution apply in respect of an insolvency of credit institutions.

To deal with the credit risk, parties may agree that collateral must be provided. As for the ISDA Master Agreement, the DRV provides for standard forms of collateral annexes, including collateral annexes for margin to be provided for EMIR purposes. Under EMIR, counterparties may be obliged to provide variation margin and initial margin to cover the credit risk as well as any operational or settlement risk, and to reflect the risk involved in the fluctuation of the value of an equity derivative transaction and thus to mitigate the risk of any collateral shortfall.

Law stated - 2 May 2025

Reporting obligations

9 What types of reporting obligations does an issuer or a shareholder face when entering into an OTC equity derivatives transaction on the issuer's shares?

The issuer is subject to the reporting obligations applying to share buy-backs if derivatives are used for a share buy-back. In addition, the parties to the derivatives transaction may be subject to reporting obligations concerning voting rights notifications and related instruments. This depends very much on the precise structure of the transaction. Any party that holds 3, 5, 10, 15, 20, 25, 30, 50 or 75 per cent of voting rights of an issuer whose shares are traded on a regulated market must notify this fact. The same thresholds, with the exception of 3 per cent, apply to any party that holds financial instruments in relation to such shares. Even financial instruments without physical settlement will often be covered by this regime. Further, reporting requirements may be triggered under the rules of an exchange where the shares are listed as well as under MiFIR if the underlying shares are traded on a trading venue, and the issuer or shareholder is a MiFIR investment firm. Moreover, the MAR rules on the disclosure of inside information or safe harbour requirements may require adequate publication or reporting by the issuer. Finally, the usual trade reporting obligations of the counterparties under EMIR and MiFID and MiFIR apply.

Law stated - 2 May 2025

Restricted periods

10 Are counterparties restricted from entering into OTC equity derivatives transactions during certain periods? What other rules apply to OTC equity derivatives transactions that address insider trading?

There are no specific periods during which counterparties are restricted from entering into equity derivative transactions in general. Only the usual closed periods defined by the MAR apply to managers as parties to such transactions. However, the usual insider trading provisions also apply to equity derivatives transactions.

Law stated - 2 May 2025

Legal issues

11 What additional legal issues arise if a counterparty to an OTC equity derivatives transaction is the issuer of the underlying shares or an affiliate of the issuer?

The rules governing share buy-backs apply to such transactions. A violation of these rules may result in the equity derivative transaction being void. Consequently, it is crucial for any party dealing with the issuer itself in any derivatives transaction that the issuer is in compliance with the applicable corporate requirements. Such compliance should not only be ensured via appropriate representations and warranties but also by due diligence.

Law stated - 2 May 2025

Tax issues

12 What types of taxation issues arise in issuer OTC equity derivatives transactions and third-party OTC equity derivatives transactions?

There is no specific taxation regime applicable with respect to equity derivatives transactions as such, and the general rules should apply. For example, in the case of a share buy-back in issuer OTC equity derivatives transactions, such share buy-back is generally treated as a (tax neutral) capital reduction and a subsequent sale of such shares as a capital increase at the level of the Issuer. At the level of the shareholder, the buy-back should generally be treated as a sale of the shares. The overall tax consequences, however, depend on the precise structure of the transaction.

Law stated - 2 May 2025

Liability regime

13 Describe the liability regime related to OTC equity derivatives transactions. What transaction participants are subject to liability?

The general civil liability regime applies, which, in particular, includes liability for a breach of contract including ancillary contractual duties and pre-contractual duties. The civil law liability regime may already be applicable at an early stage of a proposed transaction. Even where the relevant engagement terms do not expressly contemplate that any advice be given by a party, a party may in fact provide financial advice, for example, where the circumstances suggest some financial advice (eg, structuring, assisting in modelling the transaction, tailored marketing). In such a case, the relevant party must provide appropriate advice and must not omit any facts or information that are material for the parties to which such duties are owed. Extensive case law exists in that area and the relevant party is obliged to explore the needs, the knowledge and the experience of the counterparty and suggest the appropriate derivative. Furthermore, the relevant party needs to disclose the risk and rewards associated with the relevant derivative.

In a series of judgments by the Federal Court of Justice and various regional courts in relation to interest rate swaps entered into between a credit institution and a corporate, the courts have further highlighted the conflict of interest for a party to a swap. If a credit institution is a party to a derivative transaction and at the same time a financial adviser (which is almost always the case in non-standard transactions that are outside the ‘execution only’ business), the credit institution is inevitably in a conflict. Any gain under the derivative is the counterparties’ loss, and if the credit institution is structuring the derivative it may structure it in its favour. Consequently, in these scenarios, credit institutions (which are also financial advisers) need to disclose to the counterparty any initial negative market value of a derivative transaction for the counterparty to fully evaluate the implicit costs of the transaction. This requirement does not need to be fulfilled if the derivative is a hedging transaction for a connected transaction (eg, a convertible or loan). Although these judgments have mainly been applied in respect of interest rate swaps, it is very likely that the same will apply to any other asset classes, including equity derivatives transactions.

If a party provides information about the underlying share issuer, it may be liable under the prospectus liability regime. Even if the information is drawn from publicly available sources, the party that makes available such disclosure about the issuer of the shares needs to ensure that the information is comprehensive and no material information is missing that would render the information provided as misleading or false.

Once the parties have entered into the transaction, the contractual arrangements apply, and the liability is usually limited to breach of contract or violation of applicable rules and obligations.

This liability regime applies to all transaction participants. As a rule of thumb, the less experienced a counterparty is (particularly if it is a retail investor), the higher the requirement for disclosure and information.

Law stated - 2 May 2025

Stock exchange filings

14 | What stock exchange filings must be made in connection with OTC equity derivatives transactions?

There are no stock exchange filings in respect of OTC equity derivatives transactions, unless as a result of such transaction a counterparty becomes the shareholder. Subject to the general EU and German regulatory requirements under the MAR and other EU or German regulatory law, and depending on the rules of the exchange in relation to shares, notification may be required if the transaction affects the price, the liquidity or the company as such. In addition, the rules governing the notification of voting rights and financial instruments apply even though, under such rules, the filing is not to the stock exchange.

Law stated - 2 May 2025

Typical document types

15 | What types of documents are typical in an OTC equity derivatives transaction?

The German OTC market predominantly uses the ISDA Master Agreement or the DRV. The equity derivatives transactions will then be documented by confirmations that set out the economic terms of the transactions. In addition, the confirmation refers to a standard set of definitions used with equity derivatives. Under the ISDA Master Agreement these are the 2002 ISDA Equity Derivatives Definitions or, although rarely used, the 2011 ISDA Equity Derivatives Definitions. It is not uncommon that the ISDA Equity Derivatives Definitions are also used for transactions entered into under the DRV rather than the corresponding DRV-specific set of securities derivative terms, which is the (equity) securities derivatives addendum. These definitions deal with the mechanics of exercising an option, valuations, market disruptions, extraordinary events, and share and index adjustment events (eg, merger events and tender offers). Furthermore, the EMIR-compliant collateral arrangements are documented under the collateral addendum for variation margin. There will also be a collateral addendum for initial margin that has, however, not yet been published. In addition, an EMIR addendum is available in which EMIR requirements (other than the margin requirements) are addressed.

In the case of cleared OTC derivatives, the terms and conditions of the relevant derivatives (once accepted for clearing) are set out in the standardised terms and conditions (as applicable to the relevant type of derivative) published by the relevant central counterparty (ie, Eurex Clearing AG, which is the German central clearing counterparty for derivatives). The retail equity derivatives market, which enables retail investors to invest in structured securities, utilises a retail prospectus, which is approved by BaFin for public offers and listing purposes. The EU Prospectus Regulation (Regulation (EU) No. 2017/1129) entered into force on 20 July 2017 and has been fully applied from 21 July 2019.

Furthermore, product manufacturers of equity derivative products to be sold to retail investors need to produce a short disclosure document, the favour ‘key information document’, based on Regulation (EU) No. 1286/2014 of the European Parliament and of the council on key information documents for packaged retail and insurance-based investment products.

Law stated - 2 May 2025

Legal opinions

16 For what types of OTC equity derivatives transactions are legal opinions typically given?

If transactions are entered into under an ISDA Master Agreement or a DRV, parties usually rely on the relevant industry opinion. However, these opinions mostly cover netting of transactions only and do not deal with any specific enforceability or capacity issues of a specific transaction. In the case of an equity derivatives transaction (which, for instance, relates to a share buy-back), the counterparty (not being the issuer) may require a capacity and compliance opinion to ensure the validity of the transaction. Capacity opinions are also given with respect to regulated or other private or public companies or entities that have a restricted, special or public company objective.

Law stated - 2 May 2025

Hedging activities

17 May an issuer lend its shares or enter into a repurchase transaction with respect to its shares to support hedging activities by third parties in the issuer's shares?

This is generally possible within the limits of the share buy-back rules. However, careful structuring is required in light of the relevant transaction. If an issuer enters into a repurchase transaction with a counterparty, the company will acquire them again after maturity of the repo and may have a security arrangement in place. Consequently, the company needs to comply with the 10 per cent restriction on holding of treasury shares (including the shares subject to the repo).

The analysis, however, depends on the details of the documentation of the specific transaction: if the shares are subject to a loan granted by the issuer and there is no security arrangement, the borrower is likely to be seen as a shareholder and the issuer acquiring them again upon maturity may also require a shareholder's authorisation.

Law stated - 2 May 2025

Securities registration

18 What securities registration or other issues arise if a borrower pledges restricted or controlling shareholdings to secure a margin loan or a collar loan?

If the shares are freely transferable, there are no specific securities registration requirements. However, depending on the details of the documentation, a disclosure of voting rights or financial instruments may apply under the Securities Trading Act, MiFID and MiFIR, the MAR and EMIR. Furthermore, it needs to be considered carefully, also in light of the jurisdiction where the shares are held in collective safe custody and where the custody account is located in which the shares to be pledged are held, under which governing law such pledge would have to be granted in accordance with applicable international private law, including section 17a of the Securities Custody Act (*Depotgesetz*), which is intended to implement the PRIMA (Place of Relevant Intermediary Approach) but which is subject to debate among German legal scholars and practitioners.

Law stated - 2 May 2025

Borrower bankruptcy

19 If a borrower in a margin loan files for bankruptcy protection, can the lender seize and sell the pledged shares without interference from the bankruptcy court or any other creditors of the borrower? If not, what techniques are used to reduce the lender's risk that the borrower will file for bankruptcy or to prevent the bankruptcy court from staying enforcement of the lender's remedies?

The position of the lender in the bankruptcy of a German borrower depends on the type of security interest created over the shares. Usually, the relevant shares and the custody account are pledged in favour of the margin lender. Such German law pledge agreement (assuming the account is located in Germany) is usually structured as a financial collateral arrangement within the meaning of the EU Financial Collateral Directive. Under German law, an appropriation right applies to securities having a market or exchange price and falling under the financial collateral regime pursuant to section 1259 of the Civil Code, and an enforcement privilege for financial collateral is provided for in section 166(3) of the Insolvency Code. Consequently, the margin lender will be able to appropriate the shares without the involvement of the insolvency administrator (provided that the requirements of section 1259 of the German Civil Code and section 166(3) of the Insolvency Code are fulfilled). In addition, a German pledge may be enforced by way of a private sale or a public auction.

Law stated - 2 May 2025

Market structure

20 | What is the structure of the market for listed equity options?

The market for listed equity options is dominated by Eurex Exchange, the derivatives exchange operated by Eurex Frankfurt AG, a subsidiary of Deutsche Börse AG. The equity option market of Eurex includes more than 900 options on the most popular European underlyings from 13 countries.

Law stated - 2 May 2025

Governing rules

21 | Describe the rules governing the trading of listed equity options.

The main rules governing the trading of listed equity options on Eurex include the Exchange Act (BörsG) as the overall statutory framework, the Exchange Rules, and the Trading Conditions of Eurex as well as the Eurex Contract Specification Rules. The Exchange Rules provide for, among others:

- the general rules on the electronic trading system and general trading rules (eg, in respect of position limits and market integrity);
- the role of the central counterparty;
- the admission of trading participants and their ongoing obligations;
- the suspension or exclusion of participants from trading and the termination of the admission to trading;
- access to the trading system;
- time of trading and price determination; and
- pre- and post-trade transparency.

The Trading Conditions govern the types of contracts and strategies that can be traded, the conclusion and cancellation of trades, the various types of orders, etc. The details of the contracts traded are specified in the Eurex Contract Specifications for Futures Contracts and Options Contracts. The clearing of listed equity options traded on Eurex is governed by the Eurex Clearing Conditions. Contracts relating to equity options traded on Eurex have a maturity of up to 12, 24 and 60 months.

Law stated - 2 May 2025

TYPES OF TRANSACTION

Clearing transactions

22 What categories of equity derivatives transactions must be centrally cleared and what rules govern clearing?

The clearing obligation under the European Market Infrastructure Regulation (Regulation (EU) No. 648/2012) (EMIR) on OTC derivatives, central counterparties and trade repositories requires that all OTC derivative contracts within scope are subject to mandatory clearing and must be cleared with a central counterparty (CCP) that is authorised under EMIR (or that is recognised under EMIR for non-EU CCPs). Currently, EMIR does not mandate the clearing of equity derivatives. The specific classes of products that are within the scope of the mandatory clearing obligation under EMIR are set out in the Annex to the EMIR Delegated Regulation and cover standardised and liquid products (including certain interest rate swaps and credit default swaps). While it is contemplated that equity derivative products will become clearable in the future, the equity derivatives market is already predominantly exchange-based. As a result, equity derivatives that remain traded OTC are generally bespoke products and, therefore, are unlikely to easily meet the standardisation and liquidity requirements for clearable products under EMIR.

Law stated - 2 May 2025

Exchange-trading

23 What categories of equity derivatives must be exchange-traded and what rules govern trading?

In Germany, equity derivatives are currently not required to be traded on an exchange. Following the clearing obligation under EMIR, the Markets in Financial Instruments Directive (Directive No. 2014/65/EU) (MiFID II) and the Markets in Financial Instruments Regulation (Regulation (EU) No. 600/2014) introduced a mandatory trading obligation for certain derivative transactions. Broadly, the trading obligation applies to a class of derivatives that is traded on at least one admissible trading venue and there is sufficient liquidity in the trading of such class of derivatives. The trading obligation does not currently apply to equity derivatives.

If, however, equity derivatives are traded on an exchange, the exchange rules governing the trading of these derivatives depend on the relevant market segment. On the regulated market, the admission to trading and the trading on the exchange are governed by the Exchange Act and the legal framework of the relevant derivatives exchange, which, in the case of Eurex, include the Exchange Rules, the Trading Conditions and the Eurex Contract Specifications as well as the Clearing Conditions. In respect of non-regulated markets, the exchanges have set up terms and conditions governing the trading on these markets.

Law stated - 2 May 2025

Collateral arrangements

24 Describe common collateral arrangements for listed, cleared and uncleared equity derivatives transactions.

Uncleared equity derivatives are subject to the bilateral collateral arrangements of the parties. Usually, parties collateralise their transactions under an International Swaps and Derivatives Association collateral support annex or the equivalent German Master Agreement for Financial Derivative Transactions (DRV) collateral addendum or the DRV collateral addenda for variation and initial margin for compliance with the margin requirements under EMIR. Any transaction will be valued and a shortfall or excess will be determined on a net basis. The parties are required to transfer relevant collateral to cover any shortfall or reduce any excess. Under the DRV collateral addendum and the DRV collateral addendum for variation margin, the collateral is transferred by way of an outright collateral transfer, allowing the collateral taker to reuse the collateral. Under the DRV collateral addendum for initial margin, the collateral is to be credited to and held in a pledged custody account and may not be re-hypothecated or re-used unless this is expressly agreed.

The collateral arrangements for cleared OTC derivatives and listed derivatives are set out in the legal framework of the relevant clearinghouse. The Clearing Conditions of the German central counterparty, Eurex Clearing AG, provide for two different margin methodologies that may be applied to a relevant liquidation group as well as different margin types depending on the relevant class of transactions. In general terms, both initial and variation margin must be posted.

Law stated - 2 May 2025

Exchanging collateral

25 Must counterparties exchange collateral for some categories of equity derivatives transactions?

As regards OTC equity derivatives that are not cleared by a central counterparty, the general margin requirements under EMIR apply. Under EMIR, variation margin and, subject to a phase-in, also initial margin must be exchanged between financial counterparties (broadly, credit institutions, insurance undertakings, undertakings for the collective investment in transferable securities, alternative investment fund managers, etc) and between financial counterparties and counterparties that are above the clearing threshold (NFC+). This means that most of the non-financial counterparties (ie, corporates) are not subject to the margin requirements of EMIR. The initial margin requirement currently applies to financial counterparties and NFC+ that each have outstanding OTC derivatives trades in an aggregate volume of €750 billion, but this threshold was reduced to €50 billion from 1 September 2021 and was further reduced to €8 billion in September 2022 in accordance with the applicable phase-in timetable. Most derivatives transactions are in scope for the variation and initial margin obligations, although single stock equity options and index options remain out of scope for a transitional period ending on 4 January 2024. On 20 December 2023, the European Supervisory Authorities (ESAs) published joint draft regulatory technical standards (RTS) which provide for the transitional period for single stock equity options and index options to be extended until 4 January 2026. The European Commission has not decided yet about these RTS but, for the period until such decision is made, the ESAs have issued a no-action Opinion proposing that the competent authorities should not prioritise any supervisory or enforcement action in relation to these margin requirements.

For cleared OTC derivative transactions and listed derivatives, margin requirements apply under the applicable clearing conditions. The Clearing Conditions of the German central counterparty, Eurex Clearing AG, provide for different margin types applying a margin methodology referred to by Eurex as the portfolio-based risk management approach (Eurex Clearing PRIMA). In general terms, both initial and variation margin components (or, in the case of option products, premium margin components) are covered by the Eurex Clearing PRIMA.

Law stated - 2 May 2025

LIABILITY AND ENFORCEMENT

Territorial scope of regulations

26 What is the territorial scope of the laws and regulations governing listed, cleared and uncleared equity derivatives transactions?

The laws and regulations governing listed, cleared and uncleared equity derivatives transactions do not have a uniform territorial scope. Whether the relevant German or EU legislation applies to cross-border transactions in which non-German or non-EU parties participate hinges on criteria differing depending on the legislative objective of the relevant law. For example, financial licence requirements under the Banking Act apply if the provider of the financial services is providing the services through a physical presence in Germany or – even in the absence of a place of business in Germany – targets the German market to offer its services repeatedly and on a commercial basis to companies or persons having their registered office or ordinary residence in Germany. Licence requirements for proprietary trading activities generally also apply if the trading activities are conducted as a participant of a regulated market or a multilateral trading facility or via direct electronic access to a trading venue. In contrast, the Short Selling Regulation applies irrespective of where and by whom the relevant financial instrument is traded, to all financial instruments admitted to trading on a trading venue in the European Union. Some legislation (eg, the European Market Infrastructure Regulation (Regulation (EU) No. 648/2012) (EMIR) on OTC derivatives, central counterparties and trade repositories) addresses the direct, substantial and foreseeable effect in the European Union or whether the purpose of the transaction is aimed at evading the obligations under EMIR.

Law stated - 2 May 2025

Registration and authorisation requirements

27 What registration or authorisation requirements apply to market participants that deal or invest in equity derivatives, and what are the implications of registration?

Market participants may require a banking or financial services or investment services licence or a 'European passport' based on a licence held in another EU/European Economic Area (EEA) member state, depending on their activities in the equities derivatives market. If a licence has been obtained in Germany, the relevant entity would be subject to ongoing supervision by the Federal Financial Supervisory Authority (BaFin). Where the European passport is used, for mere cross-border services the relevant entity would be mainly supervised by the competent authority of its home member state, but certain German regulatory requirements may still apply.

Law stated - 2 May 2025

Reporting requirements

28 What reporting requirements apply to market participants that deal or invest in equity derivatives?

The issuer is subject to the reporting obligations applying to share buy-backs if derivatives are used for a share buy-back. In addition, parties to the derivatives transaction may be subject to reporting obligations concerning voting rights notifications and related instruments. This depends very much on the precise structure of the transaction. Any party that holds 3, 5, 10, 15, 20, 25, 30, 50 or 70 per cent of voting rights of an issuer whose shares are traded on a regulated market must notify this fact. The same thresholds, with the exception of 3 per cent, apply to any party that holds financial instruments in relation to such shares. Even financial instruments without physical settlement will often be covered by this regime.

Counterparties to equity derivatives transactions are subject to the EMIR trade reporting requirements and counterparties to securities financing transactions are obligated under the Securities Financing Transactions Regulation to report details to every conclusion, modification and termination of recognised securities financing transactions within the working day following the respective event.

Furthermore, investment firms are subject to the transaction reporting requirements under the Markets in Financial Instruments Regulation (Regulation (EU) No. 600/2014) (MiFIR) and both financial counterparties and non-financial counterparties must comply with the reporting requirements relating to OTC derivative transactions under article 9(1) of EMIR.

Since the Sustainable Finance Disclosure Regulation (Regulation (EU) No. 2019/2088) (SFDR) entered into force in March 2021, financial market participants and financial advisers are subject to certain disclosure and reporting requirements relating to sustainability factors and considerations. The SFDR aims to provide a harmonised framework regarding transparency in relation to sustainability risks, the consideration of adverse sustainability impacts in investment processes and the provision of sustainability-related information with respect to financial products.

Law stated - 2 May 2025

Legal issues

29 What legal issues arise in the design and issuance of structured products linked to an unaffiliated third party's shares or to a basket or index of third-party shares? What additional disclosure and other legal issues arise if the structured product is linked to a proprietary index?

There are no specific legal requirements that apply to this type of product except for the requirements for packaged retail and insurance-based investment products, which, in particular, include the obligation to prepare a key information document.

However, the general regulatory requirements are to be considered. The sale of structured products in Germany, even if sold by the issuer itself, may constitute a licensable activity under the Banking Act or the Investment Firms Act. Furthermore, any public offer of such products or any listing on a regulated market would require that a prospectus be drawn up and approved by BaFin (or notified by another EU/EEA competent authority to BaFin under the European passport) and such prospectus must, among other things, include disclosure of various information in respect of the underlying and its weighting in the basket, or in respect of any underlying index (including as to whether the index constitutes a benchmark under Regulation (EU) No. 2016/1011 of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives No. 2008/48/EC and No. 2014/17/EU and Regulation (EU) No. 596/2014 (the Benchmark Regulation)).

In the case of index-linked products, the issuer may be regarded as an administrator or user of an index depending on whether the index is a proprietary index or provided by a third party. In both cases, additional regulatory requirements under the Benchmark Regulation are triggered, which, in the case of the administrator (including third-country administrators whose indices are used in the European Union), involves a rather onerous application requirement for authorisation.

Furthermore, the product governance rules of the Markets in Financial Instruments Directive (Directive No. 2014/65/EU) (MiFID II), as implemented through the German Securities Trading Act, are to be complied with by a manufacturer and distributor of the structured product (such as the definition of a target market).

Moreover, in the case of equity derivative products to be sold to retail investors, product manufacturers need to produce a short disclosure document, the favour 'key information document', based on Regulation (EU) No. 1286/2014 of the European Parliament and of the Council on key information documents for packaged retail and insurance-based investment products.

Law stated - 2 May 2025

Liability regime

30 | Describe the liability regime related to the issuance of structured products.

The applicable liability regime depends on the type of structured product and in particular, whether it is issued in the form of a structured security or not.

The general liability regime may apply in respect of the structured product (ie, an error of the product or the covenants or representations provided by the issuer of the relevant product). This regime is based on the principles related to breach of contract.

A further liability regime exists in respect of wrong or insufficient disclosure as regards the underlying risk or the mechanism of the relevant structured product. This favoured 'prospectus liability' may be established on the basis of section 8 et seq of the Securities Prospectus Act, if a prospectus under the EU Prospectus Regulation has been drawn up. A similar regime (although typically less relevant for market standard structured products) applies to instruments that are not securities in terms of the EU Prospectus Regulation but for which a prospectus needs to be drawn up under the Investment Code. If a relevant disclosure, information or marketing document has not been drawn up under any of these two regimes, an issuer may still be liable for any information provided to investors under the prospectus liability regime established by case law.

Finally, detailed and extensive case law exists in relation to the mis-selling of structured products in Germany. Sellers of structured products need to comply with the principles established by courts in respect of providing appropriate financial advice to investors.

Law stated - 2 May 2025

Other issues

31 | What registration, disclosure, tax and other legal issues arise when an issuer sells a security that is convertible for shares of the same issuer?

A company requires shareholder approval or authorisation for issuing convertible instruments. Convertibles are treated as a form of securitised equity derivative and are financial instruments for the purposes of MiFID II, the Securities Trading Act, the Banking Act and the Investment Firms Act (from June 2021). As convertible bonds typically are tradable securities, any public offer or listing on a regulated market is subject to the EU Prospectus Regulation.

Depending on the details of the documentation, a convertible may be regarded as a financial instrument that needs to be disclosed under the prescribed rules. This depends very much on the precise structure of the transaction. Any party that holds 3, 5, 10, 15, 20, 25, 30, 50 or 75 per cent of voting rights of an issuer whose shares are traded on a regulated market has to notify this fact. The same thresholds, with the exception of 3 per cent, apply to any party that holds financial instruments in relation to such shares. Even financial instruments without physical settlement will often be covered by this regime. Furthermore, reporting requirements may be triggered under the rules of an exchange where the shares are listed, as well as under MiFIR if the underlying shares are traded on a trading venue, and the issuer or shareholder is a MiFIR investment firm. Moreover, the Market Abuse Regulation (Regulation (EU) No. 596/2014) (MAR) rules on the disclosure of inside information or safe harbour requirements may require adequate publication or reporting by the issuer. Finally, the trade reporting obligations under MiFID and MiFIR may apply.

Law stated - 2 May 2025

32 What registration, disclosure, tax and other legal issues arise when an issuer sells a security that is exchangeable for shares of a third party? Does it matter whether the third party is an affiliate of the issuer?

Exchangeable bonds are regarded as equity derivatives or securities, depending on the scope of the relevant regulations, and no specific rules apply in that respect. They are financial instruments for purposes of MiFID II, the Securities Trading Act, the Banking Act and the Investment Firms Act (as of June 2021). Depending on the details of the documentation, an exchangeable bond may be regarded as a financial instrument that needs to be disclosed, or a relevant trade in such financial instrument may need to be reported, in accordance with the Securities Trading Act, MiFID, MiFIR and the MAR. As exchangeable bonds typically are tradable securities, any public offer or listing on a regulated market is subject to the EU Prospectus Regulation.

If the third party is an affiliate of the issuer, the issuer may require shareholder approval or authorisation.

Law stated - 2 May 2025

UPDATE AND TRENDS

Recent developments

33 Are there any current developments or emerging trends that should be noted?

Single-stock equity options and index options remained out of scope of the European Market Infrastructure Regulation (Regulation (EU) No. 648/2012) on over-the-counter derivatives, central counterparties and trade repositories margin requirements for a transitional period ending on 4 January 2024. On 20 December 2023, the European Supervisory Authorities (ESAs) published joint draft regulatory technical standards (RTS) that provide for the transitional period for single stock equity options and index options to be extended until 4 January 2026. The European Commission has not decided yet about these RTS but, for the period until such decision is made, the ESAs have issued a no-action

Opinion proposing that the competent authorities should not prioritise any supervisory or enforcement action in relation to these margin requirements.

Law stated - 2 May 2025

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Summary

UPDATE AND TRENDS

Recent developments

OVERVIEW

Typical types of transactions

1 Other than transactions between dealers, what are the most typical types of over-the-counter (OTC) equity derivatives transactions and what are the common uses of these transactions?

Typical types of OTC equity derivatives transactions in Hong Kong include the following (together with common uses):

- options and swaps: commonly used for hedging purposes, stake-building or to monetise an equity stake and for synthetic or physical share repurchases; in the convertible debt context, call spread transactions are entered into to effectively increase the conversion price of convertible debt;
- margin loans: commonly used to monetise or leverage large equity stakes held by shareholders (usually involving the granting of security over the underlying shares);
- collars, prepaid forward contract and collar loans: used to monetise a position, and as a hedge to limit the range of possible positive or negative returns; and
- stock borrowing transactions and economic equivalents: often entered into between a shareholder of the issuer and the underwriter of the issuer's convertible debt (and, separately, between such an underwriter and the holders of such convertible debt) in order to enable the holders of such convertible debt to hedge their equity exposure by short selling in the market.

Law stated - 15 May 2025

Borrowing and selling shares

2 May market participants borrow shares and sell them short in the local market? If so, what rules govern short selling?

Yes, market participants may borrow shares and short sell them in the local market provided that:

- the securities are on the list of designated securities eligible for short selling published by The Stock Exchange of Hong Kong Limited (SEHK); and
- they comply with the relevant trading rules of the SEHK.

Under the Securities and Futures Ordinance (Cap 571 of the laws of Hong Kong) (SFO), naked short selling of shares in Hong Kong is prohibited. Under section 170 of the SFO, a person shall not sell securities at or through a recognised stock market unless, at the time that person sells them:

- that person has or, where that person is selling as an agent, that person's principal has; or
-

that person believes and has reasonable grounds to believe that he or she has or, where selling as an agent, that his or her principal has, a presently exercisable and unconditional right to vest the securities in the purchaser of them.

Separately:

- under the Securities and Futures (Short Position Reporting) Rules, any person who has a reportable short position is required to notify the Securities and Futures Commission (SFC) by making a submission through the Short Position Reporting Service; and
- any short selling is subject to the general provisions on market misconduct in the SFO.

Law stated - 15 May 2025

Applicable laws and regulations for dealers

3 Describe the primary laws and regulations surrounding OTC equity derivatives transactions between dealers. What regulatory authorities are primarily responsible for administering those rules?

While there is no single unified regulatory framework on OTC equity derivatives transactions between dealers in Hong Kong, the SFO is the legislation of primary relevance. Among other things, it sets out:

- the licensing requirements for dealers in Hong Kong and the framework for mandatory clearing, reporting, record-keeping and trading requirements in Hong Kong;
- the authorisation requirements for advertisement, invitation or document in respect of the offering of structured products or equity derivatives products to the public in Hong Kong; and
- civil and criminal liabilities in respect of insider dealing, false trading, price rigging, stock market manipulation, disclosure of information about prohibited transactions and disclosure of false and misleading information inducing transactions.

The SFC (and, in certain respects, the Hong Kong Monetary Authority (HKMA)) are responsible for administering the SFO. Moreover, the HKMA plays a role in the OTC equity derivatives transactions by regulating authorised institutions and approved money brokers in respect of capital, liquidity and other relevant requirements under the Banking Ordinance (Cap 155 of the laws of Hong Kong), together with subsidiary legislation, regulations and guidelines.

In addition to the above, OTC equity derivatives transactions that reference shares of a listed company are subject to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (SEHK Listing Rules).

Law stated - 15 May 2025

Entities

4 In addition to dealers, what types of entities may enter into OTC equity derivatives transactions?

There are no specific prohibitions on the types of entities that may enter into OTC equity derivatives transactions. Subject to the memorandum and articles of association, charters or other constitutional documents of the relevant entities (as applicable), corporates, funds, private companies as well as individuals may enter into OTC equity derivatives transactions.

Law stated - 15 May 2025

Applicable laws and regulations for eligible counterparties

5 Describe the primary laws and regulations surrounding OTC equity derivatives transactions between a dealer and an eligible counterparty that is not the issuer of the underlying shares or an affiliate of the issuer? What regulatory authorities are primarily responsible for administering those rules?

The SFO is the primary regime governing OTC equity derivatives transactions in Hong Kong between a dealer and an eligible counterparty that is not the issuer of the underlying shares or an affiliate of the issuer. The SFO sets out the licensing requirements of dealers in Hong Kong and the laws relating to advertisement, invitation and offering documents made in respect of the offering of structured products or equity derivatives products to the public in Hong Kong. The SFC is the regulatory authority primarily responsible for the administering of the SFO.

Law stated - 15 May 2025

Securities registration issues

6 Do securities registration issues arise if the issuer of the underlying shares or an affiliate of the issuer sells the issuer's shares via an OTC equity derivative?

No. Hong Kong law securities registration issues arise if the issuer of the underlying shares or an affiliate of the issuer sells the issuer's shares via an OTC equity derivative. However, the seller should comply with the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap 32 of the laws of Hong Kong) (C(WUMP)O), the SFO and the SEHK Listing Rules when conducting such sale. Generally speaking, it is uncommon for the issuer of the underlying shares or an affiliate of the issuer to sell the issuer's shares via an OTC equity derivative.

Law stated - 15 May 2025

Repurchasing shares

7 | May issuers repurchase their shares directly or via a derivative?

An issuer may repurchase their shares either directly or via a derivative. An issuer may engage in four different types of share buy-back:

- on-market share buy-back;
- off-market share buy-back;
- exempt share buy-back; and
- share buy-back by general offer.

The Code on Share Buy-Backs published by the SFC sets out the rules and procedures relating to share buy-backs. In particular, for an off-market share buy-back, approval must be granted by at least three-fourths of the votes cast on a poll by disinterested shareholders in attendance or by proxy at a general meeting of the shareholders of the issuer and such buy-back must be approved by the Executive Director of the Corporate Finance Division of the SFC or his or her delegate. For on-market buy-backs, the SEHK Listing Rules also set out additional rules and regulations that an issuer must comply with, including timing and price restrictions.

In the case where the issuer enters into a cash-settled equity derivatives transaction referencing its own shares, the buy-back rules set out above do not apply.

The general provisions of the Companies Ordinance (Cap 622 of the laws of Hong Kong) and the SFO with respect to financial assistance and market misconduct, etc, will also need to be considered.

Law stated - 15 May 2025

Risk

8 | What types of risks do dealers face in the event of a bankruptcy or insolvency of the counterparty? Do any special bankruptcy or insolvency rules apply if the counterparty is the issuer or an affiliate of the issuer?

There are no special bankruptcy or insolvency rules that would apply to a counterparty if it is the issuer or an affiliate of the issuer.

However, more generally, in the case of a bankruptcy or insolvency of a counterparty, the key risk that a dealer would face is credit risk (its ability to recover any amounts and collateral owed to it by the counterparty). Generally speaking, a secured creditor may take enforcement action in respect of a validly granted and perfected security interest irrespective of whether the counterparty is factually or legally insolvent.

For a counterparty that is a Hong Kong company, the principal insolvency legislation is the C(WUMP)O (in the case of an authorised institution, the Banking Ordinance (Cap 155 of the laws of Hong Kong) is also relevant and for an individual, the principal bankruptcy legislation is the Bankruptcy Ordinance (Cap 6 of the laws of Hong Kong)). The C(WUMP)O sets out the primary statutory grounds upon which a liquidator of a counterparty being wound up may seek to challenge a transaction, including unfair preference, transaction at an undervalue, extortionate credit transactions, dispositions of property after commencement of winding up and floating charge created within the relevant hardening period.

The moratorium under section 186 of the C(WUMP)O that generally applies upon a winding-up order being made, or a provisional liquidator being appointed, in respect of a counterparty will not prevent a termination right against the counterparty being exercised (or an out-of-court of enforcement of security over the counterparty's assets).

If the counterparty is a 'within scope financial institution' for the purposes of the Financial Institutions (Resolution) Ordinance (Cap 628 of the laws of Hong Kong), certain obligations of the counterparty may be temporarily suspended and termination rights against the counterparty may be temporarily stayed, but set-off, netting, title transfer and security arrangements are generally protected in relation to partial property transfers and bail-in.

As regards OTC equity derivatives transactions documented using an International Swaps and Derivatives Association (ISDA) Master Agreement, ISDA has commissioned Hong Kong legal opinions regarding the enforceability of, among other things, close-out netting under an ISDA Master Agreement and collateral arrangements constituted under standard ISDA documentation.

Law stated - 15 May 2025

Reporting obligations

9 What types of reporting obligations does an issuer or a shareholder face when entering into an OTC equity derivatives transaction on the issuer's shares?

For a listed issuer, the key reporting obligations arise under Part XIVA of the SFO and the SEHK Listing Rules. Under Part XIVA of the SFO, a listed issuer is required to disclose specific material price sensitive information (about the issuer, a shareholder or officer of the issuer, or listed securities of the issuer or their derivatives) to the public as soon as reasonably practicable. A similar requirement is also set out in Rule 13.09(2) of the SEHK Listing Rules, which requires a listed issuer to simultaneously announce the information when the listed issuer is required to do so under Part XIVA of the SFO. Moreover, listed issuers are required to disclose certain 'notifiable transactions' and 'connected transactions' under the SEHK Listing Rules.

Under Part XV of the SFO, directors, chief executives and substantial shareholders of a listed issuer are required to disclose their interests in voting rights in the listed company. Generally speaking, a director or a chief executive of the listed company must disclose all interests and short positions in any shares of the listed company as well as all dealings in respect of such interests and positions. In contrast, the disclosable obligations of a shareholder are triggered when such person holds a long interest of 5 per cent or above and applies to any changes in such interest that cross a whole percentage point above the 5 per cent threshold. More generally, the disclosure obligations:

- take into account parties acting in concert;
- are applicable to OTC equity derivatives transactions on a gross basis (no netting of long and short positions); and
- apply regardless of whether a transaction is cash or physically settled.

Obligations under the SFC Code of Takeovers and Mergers to disclose certain dealings during an offer period should also be taken into account.

Law stated - 15 May 2025

Restricted periods

10 Are counterparties restricted from entering into OTC equity derivatives transactions during certain periods? What other rules apply to OTC equity derivatives transactions that address insider trading?

The Model Code for Securities Transactions by Directors of Listed Issuers (ie, the standard that the SEHK requires all listed issuers and their directors to meet, any breach of which is regarded as a breach of the SEHK Listing Rules) provides that, in essence, a director of a listed company is prohibited from dealing in the securities of such company:

- at any time when he or she possesses inside information in relation to those securities;
- on any day on which its financial results are published;
- during the period of 60 days immediately preceding the publication date of the annual results; and
- during the period of 30 days immediately preceding the publication date of the quarterly results (if any) and half-year results.

This restriction on dealings also extends to dealings by, among others, a director's spouse and minor children.

In addition, the SFO has civil and criminal regimes (Parts XIII and XIV of the SFO) in respect of market misconduct. In particular, the SFO defines various categories of 'insider dealing' in relation to a listed company including:

- a person connected with the issuer who has information that he or she knows is inside information in relation to the issuer:
  - deals in the issuer's listed securities or their derivatives (or those of a related corporation); or
  - counsels or procures another person to deal in such securities or derivatives, knowing or having reasonable cause to believe that the other person will deal in them; and
- a person connected with the issuer and knowing that any information is inside information in relation to the issuer, discloses the information, directly or indirectly, to another person, knowing or having reasonable cause to believe that the other

person will make use of the information for the purpose of dealing, or of counselling or procuring another person to deal, in the listed securities of the issuer or their derivatives (or those of a related corporation).

There are various defences available under the SFO for insider dealing such as the 'market information' defence, the 'Chinese wall' defence and where the use of inside information was not for the purpose of securing or increasing a profit or avoiding or reducing a loss, whether for himself or herself, or another person.

In addition to insider dealing, the SFO also contains provisions relating to other forms of market misconduct including false trading, price rigging, stock market manipulation, disclosure of information about prohibited transactions and disclosure of false and misleading information inducing transactions.

Law stated - 15 May 2025

Legal issues

11 | What additional legal issues arise if a counterparty to an OTC equity derivatives transaction is the issuer of the underlying shares or an affiliate of the issuer?

An OTC equity derivatives transaction entered into between an issuer of the underlying shares and an affiliate of the issuer over the issuer's shares may also give rise to 'connected transaction' issues. A connected transaction is a transaction entered into between the listed company and its 'connected person' (which includes, among others, a director, chief executive or substantial shareholder of the listed company or any of its subsidiaries as well as any connected subsidiary of the issuer). Unless such transaction falls within certain exemptions that are available under Chapter 14A of the SEHK Listing Rules, disclosure requirements may apply to such transaction and approvals of the shareholders of the listed company may be required.

Law stated - 15 May 2025

Tax issues

12 | What types of taxation issues arise in issuer OTC equity derivatives transactions and third-party OTC equity derivatives transactions?

Stamp duty will be payable upon physical settlement of an equity derivatives transaction in respect of Hong Kong stock. Since 17 November 2023, the rate of stamp duty payable by each of the seller and purchaser has been 0.1 per cent on the higher of the consideration or the value of shares. In other words, a total of 0.2 per cent on the higher of the consideration or the value of the shares is currently payable in respect of the transfer of Hong Kong stock. An additional amount of HK$5 is payable on each instrument of transfer.

Law stated - 15 May 2025

Liability regime

13 Describe the liability regime related to OTC equity derivatives transactions. What transaction participants are subject to liability?

Issuances and marketing of structured products are subject to the SFO. Under section 103 of the SFO, a person commits an offence if he or she issues, or has in his or her possession for the purposes of issue, whether in Hong Kong or elsewhere, an advertisement, invitation or document that to his or her knowledge is, or contains, an invitation to the public to enter into or offer to enter into an agreement to acquire, dispose of, subscribe for or underwrite any structured products, unless the issue is authorised by the SFC under section 105 of the SFO or an exemption applies (eg, offers solely to persons outside of Hong Kong and offers to professional investors).

For unlisted structured investment products offered to the public in Hong Kong, the Code on Unlisted Structured Investment Products (including the content requirements for offering documents in respect of an offering of Unlisted Structured Investment Products) must also be complied with.

Various offences and civil liabilities set out in the SFO are also relevant to the issuance of structured products. Examples are given below.

Civil liability

- Section 108: civil liability for inducing others to invest money;
- section 277: disclosure of false or misleading information inducing transactions;
- section 281: civil liability for market misconduct;
- section 305: civil liability for contravention of Part XIV of the SFO; and
- section 391: civil liability for false or misleading public communications concerning securities and futures contracts.

Criminal offences

- Section 107: offence to fraudulently or recklessly induce others to invest money;
- section 298: offence of disclosure of false or misleading information inducing transactions;
- section 300: offence involving fraudulent or deceptive devices;
- section 384: provision of false or misleading information; and
- section 390: liability of officers of corporations for offences by corporations, and of partners for offences by other partners.

Liability for an issuer of structured products may also arise under common law, for example, on the basis of misrepresentations.

Law stated - 15 May 2025

Stock exchange filings

14 What stock exchange filings must be made in connection with OTC equity derivatives transactions?

Listed issuers are required to disclose certain ‘notifiable transactions’ and ‘connected transactions’ under the SEHK Listing Rules.

Under Part XV of the SFO, directors, chief executives and substantial shareholders of a listed issuer are required to disclose their interests in voting rights in the listed company. Generally speaking, a director or a chief executive of the listed company must disclose all interests and short positions in any shares of the listed company as well as all dealings in respect of such interests and positions. In contrast, the disclosable obligations of a shareholder are triggered when such person holds a long interest of 5 per cent or above and applies to any changes in such interest that cross a whole percentage point above the 5 per cent threshold. More generally, the disclosure obligations:

- take into account parties acting in concert;
- are applicable to OTC equity derivatives transactions on a gross basis (no netting of long and short positions); and
- apply regardless of whether a transaction is cash or physically settled.

Law stated - 15 May 2025

Typical document types

15 What types of documents are typical in an OTC equity derivatives transaction?

For OTC equity derivatives transactions, parties typically use standard derivatives documentation published by ISDA, being either the 1992 or the 2002 ISDA Master Agreement (entered separately or incorporated via a long-form confirmation) and its related credit support documentation, the 2002 ISDA Equity Derivatives Definitions and other ISDA definitional booklets (as relevant).

For stock borrowing and lending transactions, the standard form Global Master Securities Lending Agreement is commonly used in Hong Kong.

Institutional lenders typically document margin loan transactions using their internal form of loan documentation. Such documentation is usually based on the standard forms published by the Loan Market Association or the Asia Pacific Loan Market Association.

Law stated - 15 May 2025

Legal opinions

16 For what types of OTC equity derivatives transactions are legal opinions typically given?

Opinions relating to capacity and authority of the counterparties are typically given for OTC derivatives transactions. Enforceability opinions are also typically given for transactions that are not based on ISDA documentation (for transactions that are based on ISDA documentation, enforceability opinions are generally only given in relation to material bespoke aspects that are not covered by the ISDA commissioned opinions). Additional opinions and memoranda may also be given regarding specific regulatory issues and enforcement scenarios.

Law stated - 15 May 2025

Hedging activities

17 May an issuer lend its shares or enter into a repurchase transaction with respect to its shares to support hedging activities by third parties in the issuer's shares?

It is not possible for an issuer to lend its own shares in Hong Kong and any repurchase of shares carried out by an issuer must comply with the laws and regulations relating to share repurchases.

Law stated - 15 May 2025

Securities registration

18 What securities registration or other issues arise if a borrower pledges restricted or controlling shareholdings to secure a margin loan or a collar loan?

Rule 10.07 of the SEHK Listing Rules prohibits a 'controlling shareholder' from, among other things:

- within six months of listing, creating security over any shares of such listed company; and
- in the subsequent six months, creating security over shares of such listed company if, immediately following the enforcement of such security, that person would cease to be a controlling shareholder.

A 'controlling shareholder' is any person who is or group of persons:

- entitled to exercise or control the exercise of 30 per cent or more of the voting power at general meetings of the issuer; or
- in a position to control the composition of a majority of the board of directors of the issuer.

Certain exemptions apply to Rule 10.07. For example, a 'controlling shareholder' may pledge the shares of such listed company owned by him or her in favour of an authorised institution for a bona fide commercial loan, provided that certain conditions and disclosure requirements are complied with.

Separately, under Rule 13.17 of the SEHK Listing Rules, where a 'controlling shareholder' has pledged all or part of its interest in the shares of the listed company to secure such company's debts or to secure guarantees or other support of its obligations, such company must announce certain information including:

- the number and class of shares being pledged;
- the amounts of debts, guarantees or other support for which the pledge is made; and
- any other details that are considered necessary for an understanding of the arrangements.

Law stated - 15 May 2025

Borrower bankruptcy

19 | If a borrower in a margin loan files for bankruptcy protection, can the lender seize and sell the pledged shares without interference from the bankruptcy court or any other creditors of the borrower? If not, what techniques are used to reduce the lender's risk that the borrower will file for bankruptcy or to prevent the bankruptcy court from staying enforcement of the lender's remedies?

Broadly, yes. An enforceable and properly perfected first ranking Hong Kong law governed fixed security interest created by a Hong Kong incorporated borrower over shares located in Hong Kong can be enforced by the secured party (eg, by exercising its out-of-court power of sale) notwithstanding the commencement of Hong Kong law governed insolvency proceedings in respect of the borrower. Under Hong Kong law, a secured party cannot exercise a right of foreclosure in respect of secured property without a court order.

Law stated - 15 May 2025

Market structure

20 | What is the structure of the market for listed equity options?

All listed equity options in Hong Kong are traded on the SEHK (by or through an exchange participant) and are cleared through The SEHK Options Clearing House Limited (SEOCH), a wholly owned subsidiary of Hong Kong Exchanges and Clearing Limited (HKEX).

Listed equity options (both puts and calls) are US-style and physically settled.

Law stated - 15 May 2025

Governing rules

21 | Describe the rules governing the trading of listed equity options.

The trading of listed equity options are governed by the Rules of the SEHK, the Options Trading Rules of the SEHK and the Operational Trading Procedures for Options Trading Exchange Participants of the SEHK. The clearing of listed equity options is governed by the Options Clearing Rules and the Operational Clearing Procedures of SEOCH.

Law stated - 15 May 2025

TYPES OF TRANSACTION

Clearing transactions

22 What categories of equity derivatives transactions must be centrally cleared and what rules govern clearing?

All equity derivatives traded on The Stock Exchange of Hong Kong Limited and Hong Kong Futures Exchange Limited are centrally cleared through SEHK Options Clearing House Limited (SEOCH) and HKFE Clearing Corporation Limited (HKCC), respectively.

OTC equity derivatives are currently not subject to mandatory clearing in Hong Kong.

Law stated - 15 May 2025

Exchange-trading

23 What categories of equity derivatives must be exchange-traded and what rules govern trading?

All listed equity derivatives are traded on The Stock Exchange of Hong Kong Limited or Hong Kong Futures Exchange Limited.

There are currently no requirements for OTC equity derivatives to be traded on an exchange. The Securities and Futures Ordinance (Cap 571 of the laws of Hong Kong) includes a (not yet in force) general framework for a platform trading obligation and, following a 2018 consultation, a trading determination process has been adopted by the Hong Kong Monetary Authority (HKMA) and the Securities and Futures Commission (SFC) to determine the products that may in the future be subject to a platform trading obligation.

Law stated - 15 May 2025

Collateral arrangements

24 Describe common collateral arrangements for listed, cleared and uncleared equity derivatives transactions.

For exchange-traded equity derivatives, the rules of SEOCH and HKCC (as applicable) require participants to provide margin (cash and/or securities) and reserve fund contributions. The types of eligible margin are specified in the rules and procedures of

SEOCH and HKCC, and haircuts may vary for each type of eligible margin. Collateral arrangements between participants and their respective clients are negotiated bilaterally.

OTC equity derivative transactions are currently not subject to mandatory clearing in Hong Kong and are therefore typically entered into under standard (non-centrally cleared) International Swaps and Derivatives Association (ISDA) documentation. In particular, an ISDA Master Agreement is generally entered into (either separately or incorporated via a long-form confirmation) together with credit support documents in the form of an ISDA Credit Support Annex (title transfer arrangement) and, in certain cases, a security interest arrangement (in the form of an ISDA Credit Support Deed or bespoke documentation).

Law stated - 15 May 2025

Exchanging collateral

25 Must counterparties exchange collateral for some categories of equity derivatives transactions?

Yes. Pursuant to module CR-G-14 of the Supervisory Policy Manual of the HKMA, authorised institutions facing a 'covered entity' (broadly, subject to certain thresholds and exclusions, a financial counterparty, a significant non-financial counterparty or other designated entity) are subject to mandatory margining requirements in respect of, among other things, non-centrally cleared equity derivatives (with non-centrally cleared single-stock options, equity basket options and equity index options being exempt until further notice). These requirements include variation margin and (subject to a phase-in based on average aggregate notional amount thresholds) initial margin (IM).

Separately, the SFC has introduced similar mandatory margining requirements for licensed corporations. Variation margin requirements became effective on 1 September 2020 (with non-centrally cleared single-stock options, equity basket options and equity index options being exempt until 4 January 2026). With effect from 1 September 2022, the exchange of IM by a licensed corporation is required in a one-year period where both the licensed corporation and the covered entity have an average aggregate notional amount of non-centrally cleared OTC derivatives exceeding HK$60 billion on a group basis.

Law stated - 15 May 2025

LIABILITY AND ENFORCEMENT

Territorial scope of regulations

26 What is the territorial scope of the laws and regulations governing listed, cleared and uncleared equity derivatives transactions?

As the Securities and Futures Ordinance (Cap 571 of the laws of Hong Kong) (SFO) does not contain a general restriction on territorial scope, the territorial application of each provision must be considered on its own terms. For example, while the SFO general prohibition on marketing can apply irrespective of the jurisdiction of incorporation of the person marketing, the prohibition does not apply to offers made solely to persons outside of Hong Kong. The Securities and Futures Commission (SFC) proposed amendments to the SFO in August 2023 to expand the territorial scope of the insider dealing regime to include overseas-listed securities or their derivatives, but has not (as of April 2025) set a timeline for introducing the draft text of the amendments to the Legislative Council.

In addition, certain laws and regulations relating specifically to non-centrally cleared OTC equity derivatives have extraterritorial application, including:

- mandatory margining provisions, which, for example, apply to non-centrally cleared derivatives that an overseas incorporated authorised institution (AI) enters into with a covered entity that are booked in the Hong Kong branch of the AI (with provision of substituted compliance); and
- mandatory reporting requirements, which, for example, apply to OTC derivative transactions entered into by an overseas incorporated AI and booked in Hong Kong.

As regards exchange-traded derivatives, the rules and procedures of the Stock Exchange of Hong Kong Limited (SEHK), the Hong Kong Futures Exchange Limited, SEHK Options Clearing House Limited (SEOCH) and HKFE Clearing Corporation Limited (HKCC) apply to all of their respective participants.

Law stated - 15 May 2025

Registration and authorisation requirements

27 What registration or authorisation requirements apply to market participants that deal or invest in equity derivatives, and what are the implications of registration?

The SFO prohibits a person from carrying on a business in a regulated activity (or holding himself or herself out as carrying on such a business) unless the person is a licensed corporation or is an authorised institution that is appropriately registered. The regulated activities 'dealing in OTC derivative products or advising on OTC derivative products' (Type 11) and 'providing client clearing services for OTC derivative transactions' (Type 12) in Schedule 5 to the SFO are not yet in operation. However, dealing in and/or advising on equity derivatives may constitute the regulated activities of 'dealing in securities' (Type 1), 'dealing in futures contracts' (Type 2), 'advising on securities' (Type 4), 'advising on futures contracts' (Type 5) and 'securities margin financing' (Type 8), unless an exception can be relied upon.

As regards exchange-traded derivatives, the rules and procedures of the SEHK, the Hong Kong Futures Exchange Limited, SEOCH and HKCC impose requirements and obligations on their respective participants.

Law stated - 15 May 2025

Reporting requirements

28

What reporting requirements apply to market participants that deal or invest in equity derivatives?

The mandatory reporting and related record-keeping obligations under the Securities and Futures (OTC Derivative Transactions – Reporting and Record Keeping Obligations) Rules apply to AIs, approved money brokers (AMBs), licensed corporations (LCs), recognised clearing houses (RCHs) and automated trade services – central counterparties (ATS-CCPs), subject to:

- an exempt person relief for certain AIs, AMBs and LCs with small positions in OTC derivative transactions; and
- relief for a Type 13 intermediary that is a counterparty to the transaction in its capacity as a trustee of a relevant collective investment scheme.

An AI, AMB, LC, RCH or ATS-CCP is required to report (to the trade repository of the Hong Kong Monetary Authority) OTC derivative transactions (as defined in the SFO) under all five asset classes (interest rates, foreign exchange, equities, credit and commodities) on a T+2 basis if:

- it is a counterparty to the transaction (for an overseas incorporated AI, the transaction must be booked in Hong Kong and for any ATS-CCP, the counterparty must be a Hong Kong incorporated entity); or
- the transaction is conducted in Hong Kong by:

- an AI, AMB or LC on behalf of an affiliate; or
- by the Hong Kong branch of an overseas incorporated AI on behalf of an overseas office.

Law stated - 15 May 2025

Legal issues

29 What legal issues arise in the design and issuance of structured products linked to an unaffiliated third party's shares or to a basket or index of third-party shares? What additional disclosure and other legal issues arise if the structured product is linked to a proprietary index?

The analysis in 'Liability regime' regarding sections 103 and 105 of the SFO also applies to structured products linked to an unaffiliated third party's shares or to a basket or index of third-party shares. Therefore, in the case of an offering of such products to the public in Hong Kong, authorisation by the SFC of any advertisement, invitation or document in respect of the offering of such products is required.

For structured products linked to a proprietary index, the issuer should consider any licensing issues that may arise from the use of such index. The issuer may need to enter into a licensing agreement or obtain other forms of consent from the proprietary owner of the relevant index to reference such index and/or include information relating to such index in the product documentation and offering documents.

An issuer of structured products linked to an unaffiliated third party's shares or to a basket or index of third-party shares should also consider whether adequate disclosure has been provided in relation to underlying shares and, as the case may be, the index. It is also not uncommon for issuers and dealers of such products to include conflicts of interest disclaimers in the product documentation as well as other disclaimers relating to the disclosure and underlying shares or index.

Law stated - 15 May 2025

Liability regime

30 | Describe the liability regime related to the issuance of structured products.

Issuances and marketing of structured products are subject to the SFO. Under section 103 of the SFO, a person commits an offence if he or she issues, or has in his or her possession for the purposes of issue, whether in Hong Kong or elsewhere, an advertisement, invitation or document that to his or her knowledge is, or contains, an invitation to the public to enter into or offer to enter into an agreement to acquire, dispose of, subscribe for or underwrite any structured products, unless the issue is authorised by the SFC under section 105 of the SFO or an exemption applies (eg, offers solely to persons outside of Hong Kong and offers to professional investors).

For unlisted structured investment products offered to the public in Hong Kong, the Code on Unlisted Structured Investment Products (including the content requirements for offering documents in respect of an offering of Unlisted Structured Investment Products) must also be complied with.

Various offences and civil liabilities set out in the SFO are also relevant to the issuance of structured products. Examples are given below.

Civil liability

- Section 108: civil liability for inducing others to invest money;
- section 277: disclosure of false or misleading information inducing transactions;
- section 281: civil liability for market misconduct;
- section 305: civil liability for contravention of Part XIV of the SFO; and
- section 391: civil liability for false or misleading public communications concerning securities and futures contracts.

Criminal offences

- Section 107: offence to fraudulently or recklessly induce others to invest money;
- section 298: offence of disclosure of false or misleading information inducing transactions;
- section 300: offence involving fraudulent or deceptive devices;

- section 384: provision of false or misleading information; and
- section 390: liability of officers of corporations for offences by corporations, and of partners for offences by other partners.

Liability for an issuer of structured products may also arise under common law, for example, on the basis of misrepresentations.

Law stated - 15 May 2025

Other issues

31 What registration, disclosure, tax and other legal issues arise when an issuer sells a security that is convertible for shares of the same issuer?

The offering of convertible bonds to the public in Hong Kong is subject to the prospectus regime under Part 2 Division 1 of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap 32 of the laws of Hong Kong) (C(WUMP)O). Unless certain exemptions are available, any documents issued by or on behalf of the convertible bond issuer must be:

- authorised by the SFC for registration; and
- registered with the Hong Kong Registrar of Companies in accordance with the requirements under the C(WUMP)O.

Typically, convertible bonds are not offered to retail investors. Issuers often issue convertible bonds to institutional and/or high net-worth investors in reliance of the professional investor exemption under the SFO. In addition, issuers may also rely on other exemptions set out in Schedule 17 to the C(WUMP)O, such as:

- the total consideration payable in respect of the issuance is less than HK$5 million;
- the minimum denomination of the convertible bonds being not less than HK$500,000; and
- the convertible bonds are being offered to no more than 50 persons.

In terms of public disclosure, the issuance of convertible bonds by a listed issuer is often considered as material non-public price-sensitive information of the listed issuer. As such, it is common practice for a convertible bond issuer that is listed on the SEHK to publish announcements on the SEHK at the time of pricing and closing of the convertible bonds. Issuers of convertible bonds that are listed on the SEHK pursuant to Chapter 37 of the SEHK Listing Rules are required to publish the listing documents (eg, the offering circular) on the SEHK website on the listing date.

For Hong Kong dollar-denominated convertible bonds in registered form issued by a Hong Kong incorporated company, stamp duty would be payable in respect of the transfer of such bonds. Hong Kong stamp duty is also payable on any purchase and sale of shares delivered to the investors upon conversion of the convertible bonds for as long as the transfer thereof is required to be registered in Hong Kong.

Disclosure obligations under Part XV of the SFO would be applicable if an investor holds voting rights in the listed company beyond the applicable thresholds under Part XV of the SFO.

For convertible bond offerings to institutional investors, offering circulars are prepared using publicly available information, annual reports and financial statements of the issuer. Independent auditors of the issuer would typically provide comfort letters to give comfort on the financial information contained in the offering circular.

Law stated - 15 May 2025

32 | What registration, disclosure, tax and other legal issues arise when an issuer sells a security that is exchangeable for shares of a third party? Does it matter whether the third party is an affiliate of the issuer?

The issues relating to convertible bonds are equally applicable to exchangeable bonds. Where the underlying shares are shares of a third party that is not an affiliate of the issuer, the relevant offering circular usually only contains limited information on such third party. The investors typically rely on publicly available information of the third party.

Law stated - 15 May 2025

UPDATE AND TRENDS

Recent developments

33 | Are there any current developments or emerging trends that should be noted?

In July 2024, the Securities and Futures Commission (SFC) released the consultation conclusions for implementing the uncertificated securities market (USM) in Hong Kong, and proposed a five-year timeline as follows:

- Subject to completing the legislative process, the USM regime will be implemented towards the end of 2025.
- All 'eligible' prescribed securities (securities whose home laws are compatible with the USM regime), other than subscription warrants and rights under a rights issue, existing at the time of the USM implementation must become participating securities by the end of 2030.
- All eligible prescribed securities (other than subscription warrants and rights under a rights issue) that are first listed after the USM is implemented must be in uncertificated form from the time of their listing, unless specific exemption is granted by the Stock Exchange of Hong Kong Limited (SEHK).
- A more detailed timeline will be set to ensure an orderly transition.

On 2 October 2024, the Hong Kong Exchanges and Clearing Limited (HKEX) published an information paper for intermediaries on the implementation of the USM in Hong Kong. The paper aims to provide an overview of the USM to Hong Kong Securities Clearing Company

Limited (HKSCC) participants and explains the process by which prescribed securities become participating securities, the operational procedures for transferring participating securities to and from HKSCC Nominees Limited, and technical changes under the USM.

On 14 February 2025, six pieces of subsidiary legislation setting out operational and regulatory matters of the USM regime were gazetted (supplementing the existing framework for implementing the USM established under the Securities and Futures and Companies Legislation (Amendment) Ordinance in June 2021):

- the Securities and Futures (Uncertificated Securities Market) Rules, which set out certain operational, technical and procedural matters under the USM regime;
- the Securities and Futures (Approved Securities Registrars) Rules, which provide for the responsibilities, compliance requirements and regulatory arrangements in respect of approved securities registrars (ASRs); and
- various ancillary amendments to existing subsidiary legislation (the Securities and Futures (Stock Market Listing) (Amendment) Rules 2025, the Securities and Futures (Open-ended Fund Companies) (Amendment) Rules 2025, the Securities and Futures Ordinance (Amendment of Schedule 8) Order 2025, and the Securities and Futures (Amendment of Schedule 5) Notice 2025).

The subsidiary legislation above has not yet come into operation. The most recent update (as of April 2025) is that the Hong Kong administration is targeting implementation of the USM regime by early 2026.

Revised stamp duty collection arrangement for USM and waiver of stamp duty for certain transactions

The Stamp Duty Legislation (Miscellaneous Amendments) Ordinance 2024 (Amendment Ordinance) was enacted on 20 December 2024. Among other things, the Amendment Ordinance provides for a revised stamp duty collection arrangement for off-exchange transactions upon the implementation of the USM regime in Hong Kong. Under the revised arrangement, upon receiving transfer instructions from investors, the relevant ASR will facilitate the stamping and stamp duty collection process by directing the investors to the Stamp Office’s e-platform to complete the stamping and stamp duty payment process.

HKMA and SFC’s consultation conclusions on enhancements to Hong Kong’s OTC derivatives reporting regime and subsequent publications

On 22 March 2024, the Hong Kong Monetary Authority (HKMA) and the SFC launched a joint further consultation on enhancements to the OTC derivatives reporting regime in Hong Kong, following an earlier consultation in April 2019. In September 2024, the related consultation conclusions were published.

In summary, the following proposals from the consultation will become effective on 29 September 2025:

- Unique trade identifiers (UTIs): the HKMA and the SFC will mandate the requirement to generate and report standardised UTI according to the steps that are based on the waterfall of factors as set out in the UTI Technical Guidance.
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Unique product identifiers (UPIs): the HKMA and the SFC will mandate the use of UPI for the underlying derivatives of each transaction submitted to the Hong Kong Trade Repository and the full adoption of the UPI Technical Guidance and the International Organization for Standardization (ISO) 4914 standard for the structure and format of UPI.

- Critical Data Elements: the HKMA and the SFC will require reporting entities to report all new transactions and their lifecycle events based on updated data fields and supportable value.
- ISO 20022 XML message standard: the HKMA and the SFC will require reporting entities to adopt the ISO 20022 XML message standard.

In furtherance of the consultation conclusions above, on 20 December 2024, the HKMA and the SFC jointly published a revised version of Frequently Asked Questions on the Securities and Futures (OTC Derivative Transactions – Reporting and Record Keeping Obligations) Rules (FAQs). The HKMA also issued a revised version of Supplementary Reporting Instructions for OTC Derivative Transactions (SRI) to provide further guidance and reporting instructions for OTC derivatives trade reporting. Both the revised FAQs and revised SRI will take effect from 29 September 2025.

SEHK implements severe weather trading for Hong Kong's securities and derivatives markets

The Severe Weather Trading arrangements were implemented on 23 September 2024 for Hong Kong's securities and derivatives markets, including Southbound and Northbound Stock Connect, derivatives holiday trading and afterhours trading. Severe weather conditions will no longer have automatic consequential impact on the continuity of trading. Instead, during a severe weather event, the trading, post-trade and listing arrangements will be substantially the same as those during regular trading days, with some necessary adjustments to, among other things, allow for the continuation of market operations.

SEHK implements amendments to SEHK Listing Rules relating to treasury shares

The amendments to the SEHK Listing Rules became effective on 11 June 2024, which adopted a new framework for treasury shares. In summary, the amended SEHK Listing Rules:

- remove the requirement for issuers to cancel repurchased shares, so that issuers may hold the repurchased shares in treasury subject to the laws of their places of incorporation and their constitutional documents. This will include allowing new listing applicants to retain their treasury shares upon listing;
- require an issuer on resale of treasury shares to follow the SEHK Listing Rules that currently apply to an issue of new shares;
- aim to maintain fair and orderly market by mitigating the risk of stock market manipulation and insider dealing through:

- imposing a 30-day moratorium period to restrict:

-

a resale of treasury shares after a share repurchase (subject to certain carve-out provisions); and

- an on-exchange share repurchase after an on-exchange resale of treasury shares; and
- prohibiting a resale of treasury shares on the SEHK:
- when there is undisclosed inside information;
- during the 30-day period preceding the results announcement; or
- if it is knowingly made with a core connected person; and
- require issuers (being holders of treasury shares) to abstain from voting on matters that require shareholders' approval under the SEHK Listing Rules;
- exclude treasury shares from an issuer's issued or voting shares under various parts of the SEHK Listing Rules (eg, public float and size test calculations); and
- require an issuer to disclose in the explanatory statement its intention as to whether any shares to be repurchased will be cancelled or kept as treasury shares.

The SEHK published a set of frequently asked questions on rule amendments relating to treasury shares on 12 April 2024, which was further updated on 23 April 2024.

Law stated - 15 May 2025

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Summary

UPDATE AND TRENDS

Recent developments

OVERVIEW

Typical types of transactions

1 Other than transactions between dealers, what are the most typical types of over-the-counter (OTC) equity derivatives transactions and what are the common uses of these transactions?

Typical issuer equity derivatives products include the following:

- options and forwards pursuant to which an issuer repurchases its shares, by way of capital reduction or to hedge an employee share option programme;
- call options purchased by the issuer of convertible debt, to create equity neutral or non-dilutive convertible debt; and
- convertible bonds allow an issuer to raise capital in the most effective way from the tax, accounting, cash flow, corporate or regulatory perspective.

Typical equity derivatives products that allow a shareholder to acquire a substantial position in a publicly traded equity or to monetise or hedge an existing equity position include the following:

- margin loans allow a borrower to finance an acquisition of shares or to monetise an existing shareholding;
- calls, puts, collars, funded collars and variable prepaid forwards allow a holder to both finance and hedge an acquisition of shares or to hedge and monetise an existing shareholding;
- put and call pairs, cash-settled or physically settled forwards and swaps allow a holder to acquire synthetic long exposure to the underlying shares, which may be transformed into physical ownership of the shares at settlement;
- reverse accelerated share repurchases and other structured forwards allow shareholders to accelerate dispositions of shares in a manner that minimises its impact on the market price;
- sales of shares combined with a purchase of a capped call from the dealer allow a shareholder to dispose of its shareholding at a smaller discount to the market price and retain some upside in the stock; and
- mandatory exchangeable bonds allow a shareholder to monetise and hedge a large equity position while minimising any negative impact on the market price of the shares.

Law stated - 27 May 2025

Borrowing and selling shares

2 May market participants borrow shares and sell them short in the local market? If so, what rules govern short selling?

Short selling of shares is permissible and is governed by the Short Selling Regulation (Regulation (EU) No. 236/2012) and the Commission Delegated Regulation (Regulation (EU) No. 918/2012), each as assimilated into the domestic law of the United Kingdom and as amended by the Short Selling (Amendment) (EU Exit) Regulations 2018 and the Short Selling Regulations 2025 (collectively, the SSR). The SSR applies to shares (and other financial instruments) that are admitted to trading on a trading venue in the United Kingdom, including certain OTC derivatives referencing such shares and other financial instruments. Shares whose principal trading venue is located in a country other than the United Kingdom are generally exempt from the obligations and restrictions imposed by the SSR. The Financial Conduct Authority (FCA) maintains on its website a list of such exempted shares.

Uncovered short selling is prohibited by the SSR, subject to certain exemptions for market-making activities and stabilisation activities.

The SSR imposes notification requirements in respect of net short positions (that is, the position remaining after deducting any long position that a person holds in relation to securities from any short position that that person holds in relation to those securities). For example:

- where the net short position is equal to at least 0.2 per cent of the issued share capital of the company (and every subsequent change of 0.1 per cent) must be notified to the FCA; and
- where the net short position is equal to at least 0.5 per cent of the issued share capital of the company (and every subsequent change of 0.5 per cent) must be notified to the FCA and the FCA will make this notification public via its website.

The SSR provides the FCA with the authority to temporarily prohibit or impose conditions on short selling where there are adverse developments that constitute a threat to financial stability or market confidence.

The Short Selling Regulations 2025 were published in January 2025 but have not yet come into full effect; this will occur upon the revocation of Short Selling Regulation (Regulation (EU) No. 236/2012), as assimilated into the domestic law of the United Kingdom and as amended by the Short Selling (Amendment) (EU Exit) Regulations 2018. Once this occurs, short selling will be governed solely by the Short Selling Regulations 2025 and the new rules to be made thereunder by the FCA. No date has yet been set for this to occur, but the FCA has announced that it intends to consult on the new short selling rules in the third quarter of 2025.

Law stated - 27 May 2025

Applicable laws and regulations for dealers

3 Describe the primary laws and regulations surrounding OTC equity derivatives transactions between dealers. What regulatory authorities are primarily responsible for administering those rules?

The principal English laws and regulations (including EU laws and regulations that form part of English law) surrounding OTC derivatives transactions (including equity derivatives) are:

- the Financial Services and Markets Act 2000 (FSMA 2000);
- the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (SI 2001/544) (as amended) (RAO);
- the Markets in Financial Instruments Directive (Directive 2014/65/EU)) (MiFID II);
- the Markets in Financial Instruments Regulation (Regulation (EU) No. 600/2014) (MiFIR);
- the Regulation (EU) No. 648/2012 on OTC derivatives, central counterparties and trade repositories (UK EMIR); and
- the Market Abuse Regulation (Regulation (EU) No. 596/2014) (UK MAR).

The FCA is the UK regulatory authority with primary responsibility for all of these laws and regulations.

The two principal restrictions under FSMA 2000 that have general application to derivatives (including equity derivatives) are the restriction on carrying on a regulated activity under section 19 of FSMA 2000 and the restriction on financial promotions under section 21 of FSMA 2000. These two restrictions provide that, unless an exemption or exclusion applies:

- a person entering into derivatives transactions by way of business in the United Kingdom will ordinarily have to be authorised under FSMA 2000 if the derivative constitutes an option, a future, a contract for differences or rights to or interests in investments as defined in Part III of the RAO; and
- a person must not, in the course of business, communicate an invitation or inducement to engage in investment activity unless that person is authorised, or the content of the communication is approved by an authorised person, or the communication is covered by an exemption.

MiFID II and MiFIR introduced a requirement for certain declared types of the most liquid and standardised derivatives to be traded on a trading venue in the United Kingdom, rather than OTC. In addition, where this requirement applies to a class of derivatives, certain price transparency obligations will also apply. The requirement applies to financial counterparties and certain types of non-financial counterparties, as defined in UK EMIR; however, to date, only certain types of interest rate and credit derivatives have been declared to be subject to this obligation.

Unless an exemption or exclusion applies, UK EMIR applies to all OTC derivative transactions (including equity derivatives) and imposes requirements for transactions to be reported to regulators and either cleared or, if the clearing obligation does not apply to a particular class of derivative transaction, subject to other risk mitigation techniques (including trade confirmation, portfolio reconciliation, daily marking-to-market, exchanging initial or variation margin and capital requirements for financial counterparties). The extent to which these obligations apply depends in part upon the nature of parties to the derivative transaction. UK EMIR distinguishes between financial counterparties (broadly, regulated entities, which would include most dealers) and non-financial counterparties (broadly, any undertaking established in the United Kingdom that is not a financial counterparty). UK EMIR further divides financial counterparties and non-financial counterparties into two sub-categories, depending on whether the derivative trading activity of the entity is above or below a prescribed notional value. The most onerous obligations apply where OTC derivatives transactions are entered into between financial counterparties or between a financial counterparty and a non-financial counterparty, in each case, whose derivative trading activity exceeds the prescribed notional value, unless an exemption or exclusion applies. UK EMIR also applies where a financial counterparty or a non-financial counterparty (in each case, whose derivative trading activity exceeds the prescribed notional value) enters into an OTC derivative transaction with an entity established outside of the United Kingdom if that entity would be an equivalent financial counterparty or non-financial counterparty if it were established within the United Kingdom. EMIR can also apply to OTC derivative transactions between two such non-UK entities if that transaction has a 'direct, substantial and foreseeable effect' within the United Kingdom or where necessary to prevent evasion of any provision of UK EMIR.

UK MAR established a regulatory framework on market abuse and prohibits insider dealing, unlawful disclosure of inside information and market manipulation. It applies to conduct anywhere in the world if it relates to financial instruments within the scope of UK MAR. The financial instruments to which UK MAR applies are very broad and include (without limitation) securities (including depository receipts) that are admitted to trading on a trading venue in the United Kingdom and other instruments the price or value of which depends on or has an effect on the price or value of such securities. Accordingly, broadly speaking, equity derivatives are within the scope of UK MAR.

Law stated - 27 May 2025

Entities

4 In addition to dealers, what types of entities may enter into OTC equity derivatives transactions?

There are no general exclusions on the types of legal or natural persons who can enter into OTC equity derivative transactions.

Law stated - 27 May 2025

Applicable laws and regulations for eligible counterparties

5 Describe the primary laws and regulations surrounding OTC equity derivatives transactions between a dealer and an eligible counterparty that is not the issuer of the underlying shares or an affiliate of the issuer? What regulatory authorities are primarily responsible for administering those rules?

The FSMA 2000, RAO, MiFID II, MiFIR and UK MAR apply equally to OTC derivative transactions between dealers as between a dealer and an eligible counterparty that is not the issuer of the underlying shares or an affiliate of the issuer.

However, UK EMIR may apply differently to transactions between dealers to transactions between a dealer and an entity that is not a dealer. Unless an exemption or exclusion applies, UK EMIR applies to all OTC derivative transactions (including equity derivatives) and imposes requirements for transactions to be reported to regulators and either cleared or, if the clearing obligation does not apply to a particular class of derivative transaction, subject to other risk mitigation techniques (including trade confirmation, portfolio reconciliation, daily marking-to-market, exchanging initial or variation margin and capital requirements for financial counterparties). The extent to which these obligations apply depends in part upon the nature of parties to the derivative transaction.

In addition, if a party to an OTC equity derivative is (or is closely associated with) a member of the administrative, management or supervisory board or is a certain type of senior executive of the issuer of the underlying shares, UK MAR requires that party to notify the issuer and the FCA of that transaction within three business days of entering into the transaction if the total amount of transactions by that party has reached €5,000 in the calendar year. MAR also prohibits such a person from entering into transactions in the issuer's securities or derivatives in respect of such securities in the 30 days prior to the announcement of interim or year-end financial statements that the issuer is obliged to make public.

If the counterparty to an OTC equity derivative transaction is not a professional client for the purposes of MiFID II, then before trading the dealer may be required to provide a standalone key information document (KID) to the counterparty and publish it on the dealer's website in accordance with the Packaged Retail and Insurance-based Investment Products Regulation (Regulation (EU) No. 1286/2014) on KIDs.

The UK regulatory authority with primary responsibility for all of these laws and regulations is the FCA.

Law stated - 27 May 2025

Securities registration issues

6 | Do securities registration issues arise if the issuer of the underlying shares or an affiliate of the issuer sells the issuer's shares via an OTC equity derivative?

There are no securities registration issues that arise if the issuer of the underlying shares or an affiliate of the issuer sells the underlying shares via an OTC equity derivative.

Law stated - 27 May 2025

Repurchasing shares

7 | May issuers repurchase their shares directly or via a derivative?

An English public company is not permitted to repurchase its shares, other than as expressly permitted by and in accordance with the Companies Act 2006 (CA 2006) and any restriction or prohibition in the company's constitutive documents. It is possible for such a company to purchase its shares directly or via derivative; however, the relevant provisions of the CA 2006 apply differently depending upon whether the repurchase is to take place 'on market' (ie, by the company purchasing shares on the London Stock Exchange or certain other designated recognised investment exchanges) or 'off-market' (ie, by the company purchasing its shares in some other way). An English public company must comply with the CA 2006 when repurchasing its shares, irrespective of whether its shares are listed on the London Stock Exchange or on another exchange anywhere in the world.

A failure to comply with the relevant provisions of the CA 2006 is a criminal offence and renders the repurchase transaction void.

While a repurchase of shares that is conducted in accordance with the relevant provisions of the CA 2006 is itself exempt from the prohibition in the CA 2006 on financial assistance, this prohibition may be relevant in relation to other conduct of the issuer or its subsidiaries in connection with the repurchase.

If the issuer is a company with shares admitted to trading on the London Stock Exchange, any repurchase of shares by that issuer must also comply with the rules of the London Stock Exchange. The rules of the London Stock Exchange include restrictions on the number of and price at which shares can be repurchased by the issuer, as well as disclosure and notification requirements. In addition, if such an issuer is contemplating a transaction that would have an effect similar to that of such a repurchase, the issuer is obliged by the rules of the London Stock Exchange to consult with the FCA to discuss the application of those rules.

In addition, UK MAR contains a safe harbour from the prohibitions on market abuse for issuers conducting repurchases of their own securities, provided that the purpose, disclosure and reporting requirements and various price, volume and other trading restrictions are adhered to when conducting such repurchases. However, the safe harbour does not apply to repurchases conducted via derivatives.

Law stated - 27 May 2025

Risk

8 What types of risks do dealers face in the event of a bankruptcy or insolvency of the counterparty? Do any special bankruptcy or insolvency rules apply if the counterparty is the issuer or an affiliate of the issuer?

If the counterparty is an English company, then the risks faced by a dealer in the event of the counterparty's insolvency are the same as for any other commercial transaction with such counterparty. There are no additional insolvency laws applicable solely due to the transaction being an OTC equity derivative transaction entered into with a counterparty that is the issuer or an affiliate of the issuer of the shares to which the derivative relates.

Under English insolvency laws, it is generally the case that contracts and rights that were validly entered into or granted prior to insolvency remain valid and enforceable in the insolvency of an English party to that contract. This means that, generally speaking, the typical close-out netting rights found in OTC equity derivative contracts should be enforceable in the event that a counterparty enters insolvency under English law.

If an English company enters administration, there is an automatic moratorium on the enforcement of security over the assets of that company. In addition, if a company is, or is likely to become, unable to pay its debts it may be able to obtain a moratorium on enforcement of security over its assets. However, in either case, if the security is structured as a 'security financial collateral arrangement' under the Financial Collateral Arrangements (No. 2) Regulations 2003, this moratorium will not apply.

However, transactions entered into prior to insolvency can be challenged in an insolvency in certain circumstances, for example, where those transactions are found to have involved:

- a transfer of an asset to another party for no or insufficient consideration;
- a desire to put a creditor in a better position than it would have otherwise been in an insolvency;
- extortionate credit terms; and
- an intention to put assets beyond the reach of a creditor.

In addition, if the counterparty is a financial institution and becomes subject to special resolution or recovery proceedings under the Banking Act 2009, restrictions on the exercise of close-out netting rights may apply and the Prudential Regulatory Authority or the Bank of England will have various rights to suspend payment and delivery obligations of the counterparty, to impose a short stay on the exercise of termination rights or the enforcement of security (typically 24 to 48 hours) and to bail in or impose loss sharing on contractual counterparties.

Law stated - 27 May 2025

Reporting obligations

9 What types of reporting obligations does an issuer or a shareholder face when entering into an OTC equity derivatives transaction on the issuer's shares?

There are a number of reporting obligations for an issuer or shareholder of an issuer when entering into OTC equity derivatives transactions in respect of the shares in the issuer. These include:

- trade reporting obligations under MiFID II, MiFIR and UK EMIR;
- notifications of any dealings in shares of an issuer by a person who discharges managerial responsibilities within that issuer (and persons closely associated with them) under UK MAR;
- notifications when an issuer repurchases its own shares; and
- disclosure of substantial shareholdings, control of voting rights and economic long positions as required by the Disclosure and Transparency Rules (DTRs).

Additional disclosure obligations may apply in specific circumstances, including when a public offer is or has been made in relation to the shares of the issuer and where the issuer is a regulated institution or part of a sensitive industry.

An issuer that has financial instruments admitted for trading on a regulated market (or for which a request for admission for trading has been made) is further required to disclose, as soon as possible, all inside information that directly concerns the issuer.

Law stated - 27 May 2025

Restricted periods

10 Are counterparties restricted from entering into OTC equity derivatives transactions during certain periods? What other rules apply to OTC equity derivatives transactions that address insider trading?

There are no specific restrictions of general application on entering into OTC equity derivative transactions during particular periods; however, MAR prohibits a person using inside information to acquire or dispose of, or cancel or amend an order concerning, a financial instrument within the scope of MAR (which will include most equity derivatives). MAR also prohibits certain insiders from dealing in financial instruments of the issuer during prescribed closed periods.

Law stated - 27 May 2025

Legal issues

11 What additional legal issues arise if a counterparty to an OTC equity derivatives transaction is the issuer of the underlying shares or an affiliate of the issuer?

If the counterparty is the issuer of the underlying shares and is an English company then it must comply with the maintenance of capital and financial assistance rules set out in the CA 2006.

An English company may only make a distribution of its assets (in cash or otherwise) to its shareholders out of distributable profits. Thus, an arrangement pursuant to which a shareholder (in its capacity as such) receives or is entitled to receive, directly or indirectly, a financial benefit from the issuer of the shares at a time when the issuer has insufficient distributable reserves is likely to be unlawful unless an exemption applies.

In addition, subject to certain exceptions, it is unlawful for an English public company or its subsidiaries to give financial assistance directly or indirectly for the purpose of a person acquiring shares in that company. It is also unlawful for an English public company or its subsidiaries to give financial assistance for the purpose of reducing or discharging any liability incurred by a person for the purpose of the acquisition of shares, unless an exemption applies.

The prohibition on financial assistance is subject to a number of exemptions. These include arrangements under which the assistance is given in good faith in the interests of the company where either the company's principal purpose is not to give assistance for the purpose of the acquisition of its shares (or those of its holding company) or the giving of the assistance is incidental to some larger purpose that it has. Where the shares have already been acquired, the exemption applies if the company's principal purpose is not to reduce or discharge any liability a person has incurred for the purpose of the acquisition or the reduction or discharge of the liability is incidental to some larger purpose of the company (provided, in each case, that it is acting in good faith and in its own interests).

The above rules are complex and need to be considered in the context of both physically settled and cash-settled OTC equity derivatives transactions.

In addition, if a counterparty to an OTC equity derivatives transaction is a subsidiary of the issuer of the underlying shares, the transaction cannot lawfully provide for the delivery of shares to the counterparty. This is because it is unlawful for a subsidiary of an English company to be a shareholder in its parent, subject to certain exemptions applicable to subsidiaries acting as nominee or trustee and to authorised dealers in securities acting in the ordinary course of its business of dealing in securities.

Law stated - 27 May 2025

Tax issues

12 What types of taxation issues arise in issuer OTC equity derivatives transactions and third-party OTC equity derivatives transactions?

There are complex rules that dictate the UK corporation tax treatment of derivatives transactions, but broadly speaking the rules (set out in Part 7 of the Corporation Tax Act 2009) are aimed at taxing transactions in accordance with their accounting treatment.

The application of stamp duty and stamp duty reserve tax (SDRT) should also be considered; however, OTC derivatives transactions can usually be structured so as not to attract stamp taxes on sale, either because the transactions fall outside of the ambit of stamp taxes or owing to the availability of specific reliefs and exemptions. For example, cash-settled options and forwards will not attract stamp duty or SDRT, as there is no underlying transfer of (or agreement to transfer) securities. Relevant exemptions include intermediary relief (which provides that no stamp taxes are payable on transfers or agreements to transfer securities to an intermediary or market maker) and stock lending relief.

Law stated - 27 May 2025

Liability regime

13 Describe the liability regime related to OTC equity derivatives transactions. What transaction participants are subject to liability?

OTC equity derivatives transactions may attract contractual, statutory and common law liability. Breaches of statutory requirements, such as the CA 2006, can carry criminal or civil liability for a company and its directors, as well as for involved third parties.

Law stated - 27 May 2025

Stock exchange filings

14 | What stock exchange filings must be made in connection with OTC equity derivatives transactions?

Subject to certain exemptions, the DTRs require a person to notify the issuer and the FCA of any active or passive acquisition or disposal of voting rights (or deemed acquisition or disposal of voting rights) that results in that person's holding (or deemed holding) of voting rights reaching, exceeding or falling below certain threshold percentages of the total voting rights attaching to the issuer's issued share capital. As a practical matter, this notification obligation applies to acquisitions and disposals of already issued shares (to which voting rights are attached) and also to acquisitions and disposals of derivatives (and other instruments) that create either an unconditional entitlement to receive shares (to which voting rights are attached) or an economically equivalent position. As a consequence, long positions via derivatives – whether cash or physically settled – are potentially notifiable.

The notification thresholds apply when holdings of voting rights reach, exceed or fall below:

- in the case of UK issuers: 3 per cent and each 1 per cent thereafter; and
- in the case of non-UK issuers: 5, 10, 15, 20, 25, 30, 50 and 75 per cent.

To calculate the notification threshold, all holdings of shares and other relevant instruments are aggregated. Long positions held via cash-settled options are calculated on a delta-adjusted basis, but otherwise long positions held via derivatives are calculated on the full number of underlying shares.

The notification requirement may also be triggered by passive movements through these thresholds (eg, where a company purchases its own shares and the person's shareholding is concentrated as a result). The obligation on the person dealing in the shares is to notify the issuer and this creates an obligation on the issuer to notify the market.

The notification requirement is subject to a number of exemptions. The exemptions most commonly relied upon by dealers in the context of OTC equity derivatives are the market-maker exemption (which, subject to certain conditions, allows the dealer to disregard its holdings until they reach 10 per cent) and the trading book exemption (which, subject to certain conditions, allows the dealer to disregard holdings in its trading book until they exceed 5 per cent).

Law stated - 27 May 2025

Typical document types

15 | What types of documents are typical in an OTC equity derivatives transaction?

An OTC equity derivatives transaction is typically documented in a confirmation forming part of an International Swaps and Derivatives Association (ISDA) Master Agreement. The confirmation would incorporate the relevant equity definitions, typically the ISDA 2002 Equity Derivatives Definitions. Although ISDA has published a new set of definitions, the

2011 ISDA Equity Derivatives Definitions, these are not currently commonly used by the market.

Depending on the type of transaction, security is taken over shares held in custody by the counterparty. It is common to have bespoke security documentation and standard form custody agreements.

Margin loans are commonly drafted using Loan Market Association documentation as a base, before being customised to take into account the security over listed shares. As is the case for OTC equity derivative transactions, margin loans have typically bespoke security documentation and standard-form custody agreements.

Law stated - 27 May 2025

Legal opinions

16 | For what types of OTC equity derivatives transactions are legal opinions typically given?

Legal counsel will typically render opinions on the enforceability of security granted for margin loans and structured equity derivatives, where bespoke security and collateral arrangements are being used.

If the counterparty is not a dealer, then it is common for a dealer to request a legal opinion addressing the counterparty's corporate power, capacity and authorisation to enter into the transaction.

In addition, in most jurisdictions, the parties rely on opinions provided to the industry by ISDA, which primarily address the enforceability of close-out netting and collateral under standard form documentation published by ISDA.

Law stated - 27 May 2025

Hedging activities

17 | May an issuer lend its shares or enter into a repurchase transaction with respect to its shares to support hedging activities by third parties in the issuer's shares?

Under the CA 2006, an English company is limited in what it can do with any shares that it has issued and which it holds in its own name. The company can only hold those shares, sell those shares for cash consideration, transfer those shares for the purposes of an employee share scheme or cancel those shares. In addition, an English company must only acquire its own shares in compliance with the buy-back rules of the CA 2006. For these reasons, an English company will be unlikely to lend its shares or enter into a sale and repurchase transaction with respect to its shares to support hedging activities of third parties.

Law stated - 27 May 2025

Securities registration

18 What securities registration or other issues arise if a borrower pledges restricted or controlling shareholdings to secure a margin loan or a collar loan?

The United Kingdom does not have a concept of restricted or controlling shareholdings; however, registration of the share security will be required under the CA 2006 where an English company grants security (including over shares). There is an exception to the registration requirement where the pledge would constitute a 'security financial collateral arrangement' under the Financial Collateral Arrangements (No. 2) Regulations 2003, but in practice this exception is not often relied upon.

If the borrower is a person discharging managerial responsibilities (or a person closely associated with such a person) at the issuer of the shares that are subject to security, then the grant of that security is notifiable under article 19 of UK MAR.

Law stated - 27 May 2025

Borrower bankruptcy

19 If a borrower in a margin loan files for bankruptcy protection, can the lender seize and sell the pledged shares without interference from the bankruptcy court or any other creditors of the borrower? If not, what techniques are used to reduce the lender's risk that the borrower will file for bankruptcy or to prevent the bankruptcy court from staying enforcement of the lender's remedies?

If an English company enters administration, there is an automatic moratorium on the enforcement of security over the assets of that company. In addition, if a company is, or is likely to become, unable to pay its debts it may be able to obtain a moratorium on enforcement of security over its assets. However, in either case, if the security is structured as a 'security financial collateral arrangement' under the Financial Collateral Arrangements (No. 2) Regulations 2003, this moratorium will not apply.

It is not uncommon for the borrower under a margin loan to be a special purpose vehicle that is set up for the purposes of holding the shares and entering into the margin loan. The corporate structure and documentation typically limit the activities that the borrower can carry on in an attempt to reduce the risk of the borrower entering into administration or any other insolvency proceedings.

Law stated - 27 May 2025

Market structure

20 What is the structure of the market for listed equity options?

There is no centralised exchange for UK-listed equity options. There are three major exchanges on which listed equity options can be traded: the London Stock Exchange, Eurex and the Intercontinental Exchange. Listed equity options can also be traded on many other trading venues.

Law stated - 27 May 2025

Governing rules

21 | Describe the rules governing the trading of listed equity options.

Each exchange is responsible for making and enforcing the rules applicable to trading on it. The exchanges will provide standardised option contracts that set out the terms of the options.

Law stated - 27 May 2025

TYPES OF TRANSACTION

Clearing transactions

22 | What categories of equity derivatives transactions must be centrally cleared and what rules govern clearing?

Unless an exemption or exclusion applies, Regulation (EU) No. 648/2012 on OTC derivatives, central counterparties and trade repositories (forming part of English law) (UK EMIR) applies to all over-the-counter (OTC) derivative transactions (including equity derivatives) and imposes requirements for such transactions to be reported to regulators and either cleared or, if the clearing obligation does not apply to a particular class of derivative transaction, subject to other risk mitigation techniques (including, trade confirmation, portfolio reconciliation, daily marking-to-market, exchanging initial or variation margin and capital requirements for financial counterparties).

Currently, OTC equity derivatives are not a class of derivative to which the clearing obligation applies.

Law stated - 27 May 2025

Exchange-trading

23 | What categories of equity derivatives must be exchange-traded and what rules govern trading?

In the United Kingdom, equity derivatives are not currently required to be traded on an exchange. In line with the clearing obligation under UK EMIR, the Markets in Financial Instruments Directive (Directive 2014/65/EU) and the Markets in Financial Instruments Regulation (Regulation (EU) No. 600/2014) (as each forms part of English law) introduced a mandatory trading obligation for certain derivatives transactions. The mandatory trading obligation applies under similar circumstances to the clearing obligation and does not currently apply to equity derivatives.

Law stated - 27 May 2025

Collateral arrangements

24 Describe common collateral arrangements for listed, cleared and uncleared equity derivatives transactions.

In respect of listed and cleared equity derivatives transactions, the parties will usually post both initial and variation margin.

Unless an exemption or exclusion applies, UK EMIR applies to all OTC derivative transactions (including equity derivatives) and imposes requirements for such transactions to be reported to regulators and either cleared or, if the clearing obligation does not apply to a particular class of derivative transaction, subject to other risk mitigation techniques (including, trade confirmation, portfolio reconciliation, daily marking-to-market, exchanging initial or variation margin and capital requirements for financial counterparties).

The International Swaps and Derivatives Association (ISDA) has published standard collateral documentation governing the provision of initial margin and variation margin, which are customarily used by market participants. Initial margin is provided by way of the grant of a security interest over securities held in custody in the name of the grantor, whereas variation margin is provided by way of title transfer collateral arrangement from one party to the other.

Law stated - 27 May 2025

Exchanging collateral

25 Must counterparties exchange collateral for some categories of equity derivatives transactions?

In respect of listed and cleared equity derivatives transactions, the parties will usually post both initial and variation margin.

Unless an exemption or exclusion applies, UK EMIR applies to all OTC derivative transactions (including equity derivatives) and imposes requirements for such transactions to be reported to regulators and either cleared or, if the clearing obligation does not apply to a particular class of derivative transaction, subject to other risk mitigation techniques (including, trade confirmation, portfolio reconciliation, daily marking-to-market, exchanging initial or variation margin and capital requirements for financial counterparties).

ISDA has published standard collateral documentation governing the provision of initial margin and variation margin, which are customarily used by market participants. Initial margin is provided by way of the grant of a security interest over securities held in custody in the name of the grantor, whereas variation margin is provided by way of title transfer collateral arrangement from one party to the other.

Law stated - 27 May 2025

LIABILITY AND ENFORCEMENT

Territorial scope of regulations

26 What is the territorial scope of the laws and regulations governing listed, cleared and uncleared equity derivatives transactions?

The UK laws and regulations applicable to trading in equity derivatives typically apply to participants irrespective of their location, if their conduct or the financial instrument has a nexus with the United Kingdom.

The UK laws and regulations applicable to issuers of shares apply by virtue of such issuer being incorporated under the Companies Act 2006 or such shares being admitted to trading on a trading venue in the United Kingdom.

Law stated - 27 May 2025

Registration and authorisation requirements

27 What registration or authorisation requirements apply to market participants that deal or invest in equity derivatives, and what are the implications of registration?

The Markets in Financial Instruments Directive (Directive 2014/65/EU)) (MiFID II) and the Markets in Financial Instruments Regulation (Regulation (EU) No. 600/2014) (MiFIR) introduced a requirement for certain declared types of the most liquid and standardised derivatives to be traded on a trading venue in the European Union, rather than OTC. In addition, where this requirement applies to a class of derivatives, certain price transparency obligations will also apply. The requirement applies to certain types of financial counterparties and non-financial counterparties, as defined in Regulation (EU) No. 648/2012 on OTC derivatives, central counterparties and trade repositories (UK EMIR); however, to date, only certain types of interest rate and credit derivatives have been declared to be subject to this obligation.

Unless an exemption or exclusion applies, UK EMIR applies to all OTC derivative transactions (including equity derivatives) and imposes requirements for transactions to be reported to regulators and either cleared or, if the clearing obligation does not apply to a particular class of derivative transaction, subject to other risk mitigation techniques (including trade confirmation, portfolio reconciliation, daily marking-to-market, exchanging initial or variation margin and capital requirements for financial counterparties). The extent to which these obligations apply depends in part upon the nature of parties to the derivative transaction, as discussed above.

The Market Abuse Regulation (Regulation (EU) No. 596/2014) (UK MAR) established a regulatory framework on market abuse and prohibits inside dealer, unlawful disclosure of inside information and market manipulation. It applies to conduct anywhere in the world if it relates to financial instruments within the scope of UK MAR. The financial instruments to which UK MAR applies are very broad and include (without limitation) securities (including depository receipts) that are admitted to trading on a trading venue in the United Kingdom and other instruments the price or value of which depends on or has an effect on the price or value of such securities. Accordingly, broadly speaking, equity derivatives are within the scope of UK MAR.

Law stated - 27 May 2025

Reporting requirements

28 What reporting requirements apply to market participants that deal or invest in equity derivatives?

There are a number of reporting obligations for an issuer or shareholder of an issuer when entering into OTC equity derivatives transactions in respect of the shares in the issuer. These include:

- trade reporting obligations under MiFID II, MiFIR and UK EMIR;
- notifications of any dealings in shares of an issuer by a person who discharges managerial responsibilities within that issuer (and persons closely associated with them) under UK MAR;
- notifications when an issuer repurchases its own shares; and
- disclosure of substantial shareholdings, control of voting rights and economic long positions as required by the Disclosure and Transparency Rules (DTRs).

Additional disclosure obligations may apply in specific circumstances, including when a public offer is or has been made in relation to the shares of the issuer and where the issuer is a regulated institution or part of a sensitive industry.

An issuer that has financial instruments admitted for trading on a regulated market (or for which a request for admission for trading has been made) is further required to disclose, as soon as possible, all inside information that directly concerns the issuer.

Subject to certain exemptions, the DTRs require a person to notify the issuer and the Financial Conduct Authority (FCA) of any active or passive acquisition or disposal of voting rights (or deemed acquisition or disposal of voting rights) that results in that person's holding (or deemed holding) of voting rights reaching, exceeding or falling below certain threshold percentages of the total voting rights attaching to the issuer's issued share capital. As a practical matter, this notification obligation applies to acquisitions and disposals of already issued shares (to which voting rights are attached) and also to acquisitions and disposals of derivatives (and other instruments) that create either an unconditional entitlement to receive shares (to which voting rights are attached) or an economically equivalent position. As a consequence, long positions via derivatives – whether cash or physically settled – are potentially notifiable.

The notification thresholds apply when holdings of voting rights reach, exceed or fall below:

- in the case of UK issuers: 3 per cent and each 1 per cent thereafter; and
- in the case of non-UK issuers: 5, 10, 15, 20, 25, 30, 50 and 75 per cent.

To calculate the notification threshold, all holdings of shares and other relevant instruments are aggregated. Long positions held via cash-settled options are calculated on a delta-adjusted basis, but otherwise long positions held via derivatives are calculated on the full number of underlying shares.

The notification requirement may also be triggered by passive movements through these thresholds (eg, where a company purchases its own shares and the person's shareholding is concentrated as a result). The obligation on the person dealing in the shares is to notify the issuer and this creates an obligation on the issuer to notify the market.

The notification requirement is subject to a number of exemptions. The exemptions most commonly relied upon by dealers in the context of OTC equity derivatives are the market-maker exemption (which, subject to certain conditions, allows the dealer to disregard its holdings until they reach 10 per cent) and the trading book exemption (which, subject to certain conditions, allows the dealer to disregard holdings in its trading book until they exceed 5 per cent).

Law stated - 27 May 2025

Legal issues

29 What legal issues arise in the design and issuance of structured products linked to an unaffiliated third party's shares or to a basket or index of third-party shares? What additional disclosure and other legal issues arise if the structured product is linked to a proprietary index?

Certain entities that manufacture (ie, create, develop, design or issue) or distribute (ie, offer, recommend, or sell) financial instruments and structured products such as securitised derivatives and structured notes from an establishment or appointed representative in the United Kingdom must comply with MiFID II and MiFIR (each as forming part of English law)-derived product governance, namely, rules set out in the Product Intervention and Product Governance Sourcebook (PROD) and the Conduct of Business Sourcebook (COBS). The PROD and COBS comprise part of the FCA Handbook.

The product governance rules apply to MiFID investment firms (ie, regulated entities to which MiFID II and MiFIR applies) and branches of third-country investment firms that would be a MiFID investment firm if they were headquartered in the United Kingdom. In addition, other firms that manufacture or distribute financial instruments or structured products (but are not MiFID investment firms) must take into account the product governance rules as if they were guidance in the Principles for Businesses in the FCA Handbook.

The product governance rules apply proportionately and may be more onerous if structured products are offered to retail investors, as defined in MiFID II. The product governance rules apply to UK MiFID-investment firms' business activities in the United Kingdom, irrespective of whether the investors are in the United Kingdom or elsewhere. If a manufacturer or distributor is involved in marketing the products, then it may also need to be authorised under the Financial Services and Markets Act 2000 (FSMA 2000).

The product governance rules require manufacturers to have product approval and review processes in place to, among other things:

- identify with sufficient granularity a target market with the end client in mind;
- ensure that the product is designed to meet the needs of the identified target market;
- ensure that the distribution strategy is compatible with the target market;
- communicate target market and distribution strategies to distributors; and
- conduct regular reviews (at least annually) during the life of the product to ensure that the product and distribution channels remain appropriate for the identified target market.

Distributors must obtain target market and distribution information from manufacturers and assess the appropriateness of financial instruments or structured products for their individual clients and communicate any changes to their distribution strategies.

If financial instruments or structured products are admitted to trading on a regulated market in the United Kingdom or offered to the public, the issuer must prepare a prospectus (subject to limited exceptions) in accordance with the Prospectus Regulation (Regulation (EU) 2017/1129) (as forms part of English law). Manufacturers and distributors must also provide a key information document (KID) before structured products can be offered to retail investors in the United Kingdom. The form and content of a KID are highly prescriptive and must meet the requirements of the Packaged Retail and Insurance-based Investment Products Regulation (Regulation (EU) No. 1286/2014). The obligation to provide a KID to retail investors in the United Kingdom applies to all manufacturers and distributors, including third-country entities and entities that are not MiFID investment firms.

If the structured product references a proprietary index and the product is traded on a trading venue or via a systematic internaliser, the product manufacturer must comply with the Benchmarks Regulation (Regulation (EU) 2016/1011) (BMR), which regulates the provision and use of benchmarks, as well as the contribution of input data to benchmarks. In this context, 'use of a benchmark' includes issuance of a financial instrument that references an index or a combination of indices, or determination of the amount payable under a financial instrument by referencing an index or combination of indices. In addition, recent amendments to the BMR impose specific requirements in respect of 'UK Climate Transition' and 'UK Paris-aligned' benchmarks relating to climate change and sustainability. The BMR only applies to financial instruments that are traded on a trading venue (or in respect of which a request for admission has been made) or via a systematic internaliser, as well as certain credit agreements and investment funds.

The BMR contains transition provisions, under which benchmark administrators may continue to provide, and supervised entities may continue to use, certain non-compliant benchmarks. In the case of critical and third-country benchmarks, the transition period applied until 31 December 2021.

Law stated - 27 May 2025

Liability regime

30 Describe the liability regime related to the issuance of structured products.

There is a range of statutes containing provisions relating to misleading statements made in offering documentation. There may also be additional common law liability. The relevant statutes include the following:

- the Fraud Act 2006 provides that fraud will be a criminal offence, and this includes dishonestly making a false representation with an intention of making a gain or causing a loss, and dishonestly failing to disclose information where there is a duty to disclose it (with an intention of making a gain or causing a loss);
- section 89 of the Financial Services Act 2012 provides that it is a criminal offence to make statements that are false or misleading in a material respect, which section 90 contains prohibitions on giving misleading impressions;
- FSMA 2000 sets out criminal and administrative sanctions and enforcement procedures for failing to comply with FSMA 2000's requirements, along with obligations arising under other statutes such as the Prospectus Regulation, the UK MAR and the Securitisation Regulation;
- the Enforcement Guidance (EG) Manual in the FCA Handbook describes the FCA's approach to exercising its main enforcement powers under FSMA 2000 and other legislation; and
- the EG Manual also grants the FCA the power to require restitution to remedy harm to investors caused by non-compliance of their statutory obligations.

FSMA 2000 also provides a scheme of civil liability, which includes matters such as the standard of conduct and defences. For example, sections 20(3), 71(1) and 71(2) of FSMA 2000 include potential civil remedies under breach of statutory duty in respect of the carrying out of controlled activities under the Act. Section 90 of FSMA 2000 creates a civil liability regime in respect of statements in listing particulars or prospectuses by creating a right to obtain compensation for any person who has acquired securities to which the particulars apply and suffered a loss as a result of any untrue or misleading statement in the particulars or the omission of any required information. Under section 138(D)(2) of FSMA 2000, a contravention by an authorised person of a rule made by the FCA is actionable at the suit of a private person who suffers loss as a result of the contravention, subject to the defences and other incidents applying to actions for breach of statutory duty.

Law stated - 27 May 2025

Other issues

31 What registration, disclosure, tax and other legal issues arise when an issuer sells a security that is convertible for shares of the same issuer?

A number of issues arise in the context of a convertible bond issue, some of which are applicable to the issuer and some to investors.

The issuer needs to ensure it has the necessary authority to allot new shares and consider whether any restrictions exist on its ability to do so, whether in its articles of association or at law. In addition, the issuer must consider how it intends to deal with pre-emption rights given to existing shareholders, which allow them what is effectively a right of first refusal over any new shares being issued. There are a number of structural methods of dealing with pre-emption rights, which generally depend upon the intended number of new shares to be allotted in connection with the issuance of convertible bonds.

Convertible bonds are usually listed eurobonds, so the FCA listing rules for convertible securities will need to be complied with in addition to the rules of the exchange on which the underlying shares are listed to achieve and maintain the listing of the convertible bonds and the underlying shares. If the convertible bonds or the underlying shares are offered to the public and admitted to trading on a regulated market (such as the London Stock Exchange Main Market) or another relevant trading venue (such as the London Stock Exchange Professional Securities Market), then FSMA 2000, MiFID II, MiFIR and UK MAR will all be applicable. In addition, the disclosure obligations will differ depending upon the exchange on which the convertible bonds are listed. For example, if the convertible bonds are to be listed and traded on the Main Market, the FCA's Prospectus Regulation Rules will require the issuer to publish a prospectus. The level of disclosure required in the prospectus depends on the denomination of the convertible bonds and whether the issue falls under the wholesale regime or retail regime. By contrast, the Professional Securities Market does not require a prospectus to be issued but will require listing particulars to be prepared and approved by the FCA.

A number of tax issues arise in the context of a convertible bond. Withholding tax and capital gains tax will be a consideration, as will the application of stamp duty and stamp duty reserve tax. The nature, location and identity of the bondholders (and whether the bondholder is considered to be connected to the issuer for tax purposes) will also be relevant to the assessment of direct taxes for both the issuer and the investors.

Law stated - 27 May 2025

32 What registration, disclosure, tax and other legal issues arise when an issuer sells a security that is exchangeable for shares of a third party? Does it matter whether the third party is an affiliate of the issuer?

Exchangeable bonds typically involve the bonds being exchangeable into shares that are owned by the bond issuer but were issued by a company that is not a bond issuer. As a consequence, because the bond issuer will not be allotting or issuing new shares in itself, some issues are not relevant, such as the requirements for authorisation for and restrictions on allotting new shares and pre-emption rights.

However, as most exchangeable bonds will be listed eurobonds, the FCA's requirements regarding listing and disclosure will need to be complied with if the bonds are to be listed on the London Stock Exchange.

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Law stated - 27 May 2025

UPDATE AND TRENDS

Recent developments

33 | Are there any current developments or emerging trends that should be noted?

The Prudential Regulation Authority and the Financial Conduct Authority have published a joint consultation paper in respect of certain proposals for amendments to Regulation (EU) No. 648/2012 on over-the-counter derivatives, central counterparties and trade repositories, including to make permanent the currently temporary exemption from bilateral margining requirements that exists for single stock equity options and equity index options. The consultation expires in 27 June 2025.

Law stated - 27 May 2025

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Summary

UPDATE AND TRENDS

Recent developments

OVERVIEW

Typical types of transactions

1 Other than transactions between dealers, what are the most typical types of over-the-counter (OTC) equity derivatives transactions and what are the common uses of these transactions?

Typical issuer equity derivatives products include the following:

- accelerated share repurchase (ASR) products allow an issuer to accelerate the purchase of its shares by entering into a forward on its own stock with a dealer in connection with which the dealer borrows shares in the stock lending market, shorts them back to the issuer and covers its short position over a calculation period by buying shares in the open market;
- bifurcated call spread and unitary capped call products allow an issuer of convertible debt to raise the effective strike price of the convertible debt's embedded call option;
- bond hedge and tax-integrated capped call products allow an issuer of convertible debt to issue synthetic debt through the combination of the bond hedge (or the capped call) and convertible debt;
- a variety of share repurchase products entered into at the time of pricing a convertible debt issuance, including all the above-listed products, allow the underwriter to facilitate hedging by convertible debt investors and the issuer to repurchase its stock;
- issuer borrow facilities, structured as issuer share loans or zero strike call options between an issuer and the underwriter of the issuer's convertible debt allow the underwriter to facilitate hedging by convertible debt investors;
- registered forwards between an issuer and the underwriter of its common equity allow the issuer to lock in equity financing for future acquisitions or other purposes, while retaining flexibility to cash settle the forward with the underwriter rather than issuing stock;
- convertible notes, convertible preferred stock and tangible equity units allow an issuer to raise capital in the most effective way from the tax, accounting, cash flow, corporate or regulatory perspective; and
- sales of shares combined with a purchase of a capped call from the underwriter allow an issuer to raise equity financing at a smaller discount to the market price and limit dilution.

Typical equity derivatives products that allow a shareholder to acquire a substantial position in a publicly traded equity or to monetise or hedge an existing equity position include the following:

- structured margin loans allow a borrower to finance an acquisition of shares or to monetise an existing shareholding;
-

calls, puts, covered calls, collars, collar loans and variable prepaid forwards allow a holder to both finance and hedge an acquisition of synthetic long exposure to a stock or to hedge and monetise an existing shareholding;

- put and call pairs, cash-settled or physically settled forwards and swaps allow a holder to acquire synthetic long exposure to the underlying stock, which may be transformed into physical ownership of the stock at settlement;
- ‘reverse ASRs’ allow shareholders to accelerate dispositions of shares in a manner that minimises its impact on the market price;
- sales of shares combined with a purchase of a capped call from the underwriter allow a shareholder to dispose of its shareholding at a smaller discount to the market price and retain some upside in the stock; and
- mandatory exchangeables, such as trust-issued mandatories, holder’s own balance sheet mandatories or borrowed balance sheet mandatories, allow a shareholder to monetise and hedge a large equity position while minimising a negative impact on the share market price.

Law stated - 15 May 2025

Borrowing and selling shares

2 May market participants borrow shares and sell them short in the local market? If so, what rules govern short selling?

Many equity derivative transactions depend on a liquid stock borrow market to allow participants to hedge their exposure under the transaction. For example, arbitrage funds investing in convertible notes and dealers hedging the upper warrant in a call spread may both need at certain points during the transaction to establish a hedge position by short selling shares borrowed from stock lenders. The convertible notes indenture and warrant agreement almost always have certain protections for those arbitrage funds and dealers to handle situations in which the stock borrow market becomes illiquid or shares may be borrowed only at a high cost. Such situations may occur where M&A activity has been announced and has increased demand for borrowed shares, or where issuers have conducted significant repurchase activity and reduced the available free float.

To sell short in the United States, the seller’s broker must locate a security to borrow to cover the sale, as ‘naked’ short selling is prohibited. Short sales of securities in the United States are subject to the general anti-manipulation rules under the Securities Exchange Act of 1934 (the Exchange Act) and Regulation SHO. As the Securities and Exchange Commission (SEC) has noted, the vast majority of short sales are legal, but abusive practices to create actual or apparent active trading in a security or to depress the price of a security for the purpose of inducing the purchase or sale of the security by others are prohibited. Regulation SHO requires generally that:

- short sale orders being placed with a broker-dealer be marked as such;
- subject to certain limited exceptions, if a stock on any trading day declines by 10 per cent or more from the stock’s closing price for the prior day, short sale orders may

be displayed or executed for the remainder of that day and the following day only if the order price is above the then-current national best bid;

- broker-dealers must have reasonable grounds to believe that a stock may be borrowed before executing a short sale order; and
- brokers and dealers that are participants in a registered clearing agency must close out any positions within a specified period after a seller fails to deliver securities to the buyer when due.

In addition, section 16(c) of the Exchange Act prohibits insiders from selling common stock that they do not own (section 16 of the Exchange Act does not apply to holders of equities in 'foreign private issuers', which are issuers listed in the United States filing their annual reports on Form 20-F). This prohibition not only covers traditional short selling, but also applies to derivative transactions that are 'put equivalent positions' (eg, sale of a call or purchase of a put, or both).

Finally, the SEC is considering amendments to the applicable short-selling rules in the wake of recent highly publicised short squeezes. While no amendments have been specified yet, it is possible that there will be further restrictions in the near future.

Law stated - 15 May 2025

Applicable laws and regulations for dealers

3 Describe the primary laws and regulations surrounding OTC equity derivatives transactions between dealers. What regulatory authorities are primarily responsible for administering those rules?

The primary laws surrounding OTC equity derivative transactions between dealers (and between market participants generally) have traditionally been the Securities Act of 1933 (the Securities Act) and the Exchange Act, and in particular the registration requirements of section 5 of the Securities Act, the anti-fraud and anti-manipulation provisions of sections 9 and 10(b) of the Exchange Act and the short-swing profit rules applicable to insiders under section 16 of the Exchange Act. While the SEC administers the rules promulgated under those sections, private rights of action may attach, some of which are prosecuted by active plaintiffs' bars. Inter-dealer transactions must comply with these rules in the same manner as trades with non-dealer counterparties. For example, dealers must ensure that their long hedge positions do not cause them to become section 16 'insiders' by virtue of holding more than 10 per cent of an issuer's common stock. Section 16 is not applicable in the case of 'foreign private issuers'.

Since its passage in 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) has imposed additional requirements on market participants. Title VII of the Dodd-Frank Act established a regulatory regime for swaps and security-based swaps. Depending upon the type of equity derivative, such a trade may be a swap, a security-based swap, or both. Swaps are subject to the jurisdiction and regulatory oversight of the Commodity Futures Trading Commission (CFTC) and security-based swaps are subject to the jurisdiction and regulatory oversight of the SEC. Certain OTC equity derivatives, such as physically settled swaps and forwards and equity options, are excluded from the 'swap' and 'security-based swap' definitions and, as a result, are not subject to the Dodd-Frank Act requirements.

In addition to Title VII of the Dodd-Frank Act, the Volcker Rule, which is set forth in Title VI of the Dodd-Frank Act, generally prohibits 'banking entities' (as defined therein) from, among other things, engaging in proprietary trading in financial instruments, such as securities and derivatives, unless pursuant to an exclusion or exemption under the Volcker Rule. Accordingly, the Volcker Rule's proprietary trading prohibition may, in the absence of an applicable exclusion or exemption under the Volcker Rule, restrict certain underwriting, market-making and risk-mitigating hedging activities when a 'banking entity' is acting as dealer. The Bank Holding Company Act of 1956, as amended, may also place additional restrictions on banks acting as dealers that should also be taken into consideration.

Foreign broker-dealers that wish to transact with US entities without having to register under the Exchange Act may also need to comply with the 'chaperoning' requirements under Rule 15a-6 under the Exchange Act.

Other applicable regulations include those imposed by securities exchanges; rules enforced by the Financial Industry Regulatory Authority, Inc (FINRA), a self-regulatory organisation for its broker-dealer members; rules enforced by the National Futures Association, a self-regulatory organisation for swap dealers and certain other CFTC registrants; rules implemented by the International Swaps and Derivatives Association, Inc (ISDA); and, as applicable, various regulatory margin and capital requirements imposed by the SEC, the CFTC or a prudential regulator, such as the Federal Reserve Board or the Office of the Comptroller of the Currency.

Notwithstanding that most swap and security-based swap regulatory obligations fall on dealers, regulations do require that all counterparties obtain and maintain a 'legal entity identifier' prior to entering into, and throughout the life of, any OTC equity derivatives transaction that is a swap or a security-based swap.

Law stated - 15 May 2025

Entities

4 In addition to dealers, what types of entities may enter into OTC equity derivatives transactions?

The entities most commonly facing dealers in equity derivative trades are public company issuers and various types of counterparties holding or acquiring publicly traded shares (such counterparties generally have to own at least US$10 million of assets thereby satisfying the definition of 'eligible contract participant' as defined in the Commodity Exchange Act). Publicly traded issuers frequently utilise equity derivatives to hedge their equity-related obligations, such as call spreads and capped calls to hedge against potential dilution from conversions of convertible securities. Issuers may also be involved in setting up a stock borrowing facility to facilitate certain hedging activities by its convertible noteholders, or executing through a forward contract an accelerated share repurchase of its common stock to achieve certain financial and strategic goals. Counterparties with large equity stakes often enter into equity derivative transactions to monetise or hedge their holdings, or both. Examples of pure monetisation transactions include certain margin loan structures, while prepaid forward contracts and funded collars can be used to simultaneously monetise the position and hedge against future price fluctuations. Counterparties may also use equity derivatives to accumulate large equity stakes in public companies or to gain synthetic exposure to such equities.

Law stated - 15 May 2025

Applicable laws and regulations for eligible counterparties

5 Describe the primary laws and regulations surrounding OTC equity derivatives transactions between a dealer and an eligible counterparty that is not the issuer of the underlying shares or an affiliate of the issuer? What regulatory authorities are primarily responsible for administering those rules?

In practice, because most non-dealer counterparties to equity derivative transactions are typically listed issuers, hedge funds, private equity funds, and other sophisticated and well-funded market participants, there are few additional requirements for them to transact with the investment banks and their broker-dealer affiliates that normally act as dealers in such transactions. These non-dealer counterparties will normally easily qualify as ‘eligible contract participants’, as defined in the Commodity Exchange Act and ‘accredited investors’, as defined under the Securities Act. In certain instances, particularly where the counterparty is a wealthy natural person rather than an investment fund or other legal entity, the dealer may need to conduct additional due diligence to ensure that the counterparty meets those requirements. Dealers may also have to determine that a recommended transaction is ‘suitable’ for its customer under FINRA rules. Finally, antitrust rules may also come into play where a third party is using the derivative to accumulate a large stake in the issuer.

Law stated - 15 May 2025

Securities registration issues

6 Do securities registration issues arise if the issuer of the underlying shares or an affiliate of the issuer sells the issuer’s shares via an OTC equity derivative?

Yes. If the dealer in the OTC equity derivative sells the issuer’s shares into the public market in connection with an equity derivative to which either the issuer or any of its affiliates is a party, then that sale must either be registered or exempt from registration under the Securities Act. The procedures for registering a dealer’s short sales or conducting such sales pursuant to an exemption from registration are set out in a series of SEC no-action letters dealing with certain hedging and monetisation transactions.

Determining a party’s affiliate status is critical to structuring any OTC equity derivative. Under the Securities Act, an ‘affiliate’ of an issuer is a person that directly, or indirectly through one or more intermediaries or contractual arrangements, controls or is controlled by, or is under common control with, the issuer. Whether ‘control’ exists depends on the facts and circumstances, and typically involves an analysis of a person's aggregate shareholdings in the issuer, presence on the issuer's board of directors, veto rights over certain corporate actions, and other factors. 'Control' over an entity does not require a majority of the voting power over such entity; rather, market participants typically consider there to be a rebuttable presumption of 'control' at 10 per cent of the issuer's voting power, and a nearly irrefutable presumption of 'control' at 20 per cent of the issuer's voting power (although the presumption can be overcome based on certain facts and circumstances – for example, if the relationship between the issuer and the 20 per cent holder is openly hostile). The same general thresholds and presumptions apply to voting power on the board of directors. However, a combination of significant voting power as a shareholder and control of board seats may suggest 'control', even though both are below 10 per cent.

Law stated - 15 May 2025

Repurchasing shares

7 | May issuers repurchase their shares directly or via a derivative?

Yes, and both types of repurchase transactions are common. There are relatively few requirements for issuers to repurchase their own equity (although under state law, contracts by an issuer to repurchase its shares while insolvent are generally voidable or void), and US issuers tend to repurchase more of their own shares than do issuers in Europe and Asia. In addition to typical 'agency' transactions where a broker-dealer will repurchase shares in specified amounts at specified prices in the open market for a commission, ASR transactions are popular with US issuers. These transactions allow issuers to repurchase their shares at a discount to the average market price over a specified calculation period by 'selling' the volatility in their stock to the dealer. The issuer benefits by buying its shares back at a discount, and the dealer profits to the extent it is able to purchase the shares during the calculation period at less than the discounted price (which depends on the stock remaining volatile during the course of the trade). The issuer also benefits because the dealer typically delivers around 80 to 85 per cent of the shares underlying the transaction shortly following execution, which has an immediate impact on the issuer's earnings per share. Other structures, such as capped and collared forwards, capped calls and issuer put options are also common.

These transactions (including hedging activities of the dealer in connection with an ASR) are structured to avoid the anti-manipulation provisions of section 9 of the Exchange Act and the anti-fraud provisions of Rule 10b-5 under section 10(b) of the Exchange Act. Rule 10b-18 under the Exchange Act offers a safe harbour from certain types of manipulation claims for an issuer if the issuer repurchases its shares in accordance with certain manner, timing, price and volume conditions. ASRs are typically structured such that the dealer's hedging activity would comply with Rule 10b-18 if the safe harbour were available to it. Trades involving certain of the issuer's 'affiliated purchasers' (as defined in Rule 10b-18) may also be structured to meet the requirements of Rule 10b-18.

In addition, section 10(b) of the Exchange Act and Rule 10b-5 thereunder are anti-fraud provisions concerning purchases and sales of securities. Regulation M under the Exchange Act (Regulation M) addresses certain activities that could be viewed as artificially impacting the price of an offered security. It prohibits an issuer or selling security holder engaging in a ‘distribution’ of its securities, and participants in such distribution and affiliated purchasers, from bidding for or purchasing the securities being distributed or related securities during a ‘restricted period’ applicable to the distribution.

Issuers that have received financial assistance under the Coronavirus Aid, Relief and Economic Security Act (the CARES Act), passed on 27 March 2020, may be restricted from repurchasing their shares. Subtitle A of Title IV of the CARES Act prohibits certain companies (and their affiliates, in certain cases) that have received direct loans or loan guarantees under such programmes from repurchasing their own shares or shares of their parent entity that are listed on any national securities exchange. The prohibition exempts pre-existing contractual obligations, and is effective for as long as the loan remains outstanding and for a one-year period after the loan is repaid or loan guarantee expires. Prior to seeking any funding under the CARES Act, issuers who are party to or considering entering into share repurchase transactions, including ASRs and capped calls, should consider the implications of such funding on their share repurchase programmes.

On 14 December 2022, the SEC adopted amendments to Rule 10b5-1 insider trading plans and related disclosures under the Securities Act, and the amendment became effective on 27 February 2023. The amendments have imposed new conditions on the availability of the Rule 10b5-1 affirmative defence to insider trading and require enhanced disclosures regarding the adoption, modification and termination of Rule 10b5-1 plans and other trading arrangements, issuers’ insider trading policies and procedures, and certain equity awards granted close in time to the release of material non-public information, which would affect the manner US issuers conduct share repurchase programmes, including ASRs.

On 19 December 2023, the Fifth Circuit Court of Appeals vacated the SEC’s new share repurchase disclosure rules that were originally scheduled to apply to most issuers beginning with the first periodic report on either Form 10-Q or Form 10-K in respect of the first full fiscal quarter that began on or after 1 October 2023 and would have required public companies to disclose their reasons for repurchase shares, and to collect daily repurchase data and file it quarterly. As a result of the Court’s decision, issuers will not be required to comply with the now-vacated share repurchase disclosure rules in connection with their upcoming reports, and can continue to disclose on a quarterly basis their monthly (rather than daily) share repurchase information. The SEC may appeal the Court’s decision or propose a new share repurchase disclosure rule again.

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Law stated - 15 May 2025

Risk

8 What types of risks do dealers face in the event of a bankruptcy or insolvency of the counterparty? Do any special bankruptcy or insolvency rules apply if the counterparty is the issuer or an affiliate of the issuer?

The main risks that dealers face are the imposition of the 'automatic stay' under the US Bankruptcy Code that would prevent them from collecting against their counterparty; the inability to rely upon the bankruptcy default provisions (called ipso facto provisions) in the ISDA Master Agreement as the basis for terminating and closing out the transaction; and the counterparty's potential status as a 'bankruptcy affiliate' of the issuer. Under section 362 of the US Bankruptcy Code, if a bankruptcy petition is filed in respect of the counterparty, an automatic stay goes into effect that prevents other parties from collecting on pre-bankruptcy claims and taking other actions against the counterparty, including foreclosing on any collateral. The automatic stay is generally intended to help the debtor counterparty preserve its assets, to maximise the assets' value and to ensure that creditors are repaid in an orderly and equitable manner. In addition, under section 365 of the Bankruptcy Code, if a bankruptcy petition is filed in respect of the counterparty, parties to contracts with the counterparty are prevented from exercising contractual rights to terminate or modify such contracts based on the counterparty's bankruptcy or financial condition. If these provisions were applied to equity derivative contracts, the automatic stay and the inability to terminate the contract would expose the non-debtor dealer to the risk of price movements in the underlying stock, which could force non-debtor dealers into financial distress, causing them to default on their contracts with other parties. To mitigate the risk of a domino effect, certain classes of protected contracts are exempted from these provisions (both the automatic stay and the prohibition on the enforcement of ipso facto defaults), including 'securities contracts' (which term includes margin loans) and 'swap agreements'. In addition to concerns about the automatic stay and bankruptcy termination rights, dealers entering into transactions with certain large shareholders may face the risk that their counterparty could be a 'bankruptcy affiliate', meaning an 'affiliate' (as defined in the Bankruptcy Code) of the issuer of the equity that is the subject of the equity derivative contract. Under section 510 of the Bankruptcy Code, claims arising under a contract with the issuer of the subject equity or its affiliate (in this case a 20 per cent or more equity holder) for the purchase or sale of equities of the issuer could be subordinated to the level of equity in the issuer's or the affiliate's bankruptcy.

Law stated - 15 May 2025

Reporting obligations

9 What types of reporting obligations does an issuer or a shareholder face when entering into an OTC equity derivatives transaction on the issuer's shares?

On 10 October 2023, the SEC adopted amendments to the rules governing beneficial ownership reporting under the Exchange Act, sections 13(d) and 13(g). The amendments, among other things:

- shorten the filing deadlines for initial and amended beneficial ownership reports on Schedules 13D and 13G;
- clarify when holders of certain cash-settled derivatives (other than cash-settled security-based swaps) are 'deemed' to 'beneficially own' the underlying securities;
- provide guidance on when a group has been formed under section 13(d) or 13(g); and
- expressly require any Schedule 13D filer to disclose interests in all derivatives (including security-based swaps and other cash-settled derivatives) where issuer's equity securities are used as a reference.

The amendments generally become effective on 5 February 2024 (while the compliance with the revised Schedule 13G filing will be required beginning on 30 September 2024). For the avoidance of doubt, the description of the various reporting obligations set forth in the following paragraphs gives effect to such amendments.

Sections 13 and 16 of the Exchange Act are the typical sources of reporting obligations for OTC equity derivatives trades. Section 13(d) and (g) of the Exchange Act impose reporting requirements on beneficial owners of 5 per cent or more of any registered class of equity securities of a US-listed issuer, and section 16 of the Exchange Act imposes reporting requirements on insiders (beneficial owners of 10 per cent or more of any such class of equity securities or a director or executive officer of a US-listed issuer other than a foreign private issuer). Under Rule 13d-5 of the Exchange Act, if two or more persons agree to act together for the purpose of acquiring, holding, voting or disposing of equity securities, such persons will be considered a group and their holdings will be aggregated for the purpose of determining beneficial ownership. As part of the beneficial ownership rule amendments discussed above, the SEC reiterated its view that two or more persons taking concerted actions for the purpose of acquiring, holding or disposing of securities of an issuer, may be sufficient to constitute the formation of a group, even without an express agreement. Moreover, under Rule 13d-3, a person is deemed to beneficially own all shares that the person has the right to acquire within 60 days, including through the exercise or conversion of a derivative security. These sections are generally intended to provide the investing public notice when certain investors have accumulated large blocks of securities of an issuer but they also determine whether a person is an insider for the purposes of section 16 of the Exchange Act (eg, beneficially owns 10 per cent or more of any class of equity securities of a US-listed issuer other than a foreign private issuer).

A shareholder must disclose its ownership within five business days of becoming a 5 per cent beneficial owner on Schedule 13D, which requires the shareholder to disclose, among others, the source of the funds used to make the purchase and the purpose of the acquisition, and thereafter must report material changes to its ownership within two business days. In lieu of a Schedule 13D, certain investors without control intent (such as ‘passive investors’, ‘qualified institutional investors’ and ‘exempt investors’) may file a short form Schedule 13G. Depending on the type of investor, certain certification may be required in connection therewith (eg, that securities were acquired in the ordinary course of business or were not acquired for the purpose of changing or influencing the control of the issuer, or both).

Holders of certain cash-settled derivatives (other than cash-settled security-based swaps) are ‘deemed’ to ‘beneficially own’ the underlying securities and must disclose cash-settled derivatives in their Schedule 13D if such derivatives:

- provide a holder with voting or investment power over the underlying securities;
- are part of a plan or scheme to evade the section 13(d) or 13(g) reporting requirements; or
- were held in the context of changing or influencing control of the issuer of the underlying securities.

A shareholder must report its ownership on becoming a section 16 insider on a Form 3 and must report any subsequent changes to its ownership on a Form 4. Under Rule 16a-4 of the Exchange Act, the acquisition or disposition of any derivative security relating to equity securities of the issuer must be separately reported on a Form 4. Reporting is required even if the derivative security can be settled only in cash. Bona fide gifts of equity securities have to be reported on Form 4 and filed before the end of the second business day following the date of the gift. Form 4 and Form 5 filers are required to indicate by checkbox that a reported transaction was intended to satisfy the affirmative defence conditions of Rule 10b5-1(c).

An issuer selling options or warrants to acquire its shares or securities convertible into its shares in a transaction that is not registered under the Securities Act must report such sales in its quarterly and annual reports and on a current report on Form 8-K. The issuer’s quarterly and annual reports must also disclose its purchases of shares in connection with a derivatives transaction (eg, an ASR). In addition, if the issuer enters into a material contract in connection with an OTC derivatives transaction, the issuer must disclose certain information about the material contract on a Form 8-K.

Additionally, a US-listed issuer must disclose the use of Rule 10b5-1 and other trading arrangements by an issuer, and its directors and officers for the trading of the issuer’s security quarterly on a Form 10-Q. A US-listed issuer as well as a foreign private issuer also must disclose its insider trading policies and procedures annually on a Form 10-K or Form 20-F, as applicable, and also in proxy and information statements on Schedules 14A and 14C.

CFTC swap data reporting regulations may also apply to an issuer or a shareholder that is entering into an OTC equity derivatives transaction that is a swap with a non-US counterparty that is not itself registered with the CFTC as a swap dealer. Security-based swaps are subject to analogous requirements under the SEC’s recently implemented security-based swap data reporting regulations.

In addition, the Commodity Exchange Act and the rules promulgated by the CFTC thereunder require one counterparty to a derivatives transaction to report information relating to such transaction to a swap data repository (SDR). The entity that reports the trade (known as the 'reporting counterparty') is determined in accordance with CFTC

Regulation 45.8 and is typically the dealer. However, if the counterparty to the trade is not a swap dealer, major swap participant, derivatives clearing organisation, financial entity or US person (each as defined in relevant CFTC rules), then the reporting counterparty may be the issuer or shareholder. The Commodity Exchange Act and CFTC rules require that the reporting counterparty comply with two separate reporting requirements under the CEA for transactions that are 'swaps':

- regulatory reporting; and
- real-time reporting.

Regulatory reporting involves the reporting of the following:

- creation data (which includes the primary economic terms of the swap and the confirmation data reflecting the matched terms as confirmed by the counterparties to the swap); and
- continuation data (which relates to changes occurring during a swap's life cycle). Real-time reporting involves the reporting of a separate data set to the SDR for real-time public dissemination.

This real-time data is similar to the primary economic terms data reported as part of the creation data and must be reported to an SDR as soon as technologically practicable after execution. Post-execution events must also be reported in real-time if they are a termination, assignment, novation, exchange, transfer, amendment, conveyance or extinguishment of rights or obligations of the swap that changes the pricing of the swap.

Law stated - 15 May 2025

Restricted periods

10 Are counterparties restricted from entering into OTC equity derivatives transactions during certain periods? What other rules apply to OTC equity derivatives transactions that address insider trading?

Issuers and controlling shareholders avoid entering into transactions during certain 'blackout periods' when they may be in possession (or be thought to be in possession) of material non-public information regarding the issuer or its securities. The principal insider trading laws derive from section 10(b) of the Exchange Act and Rule 10b-5 thereunder. Issuers typically restrict insiders from trading during certain windows when the issuer is likely to be in possession of material non-public information, such as prior to release of earnings. Certain affiliates that may have access to inside information by virtue of holding board seats or through other means may also subject their personnel to the issuer's window period policies to avoid the potential appearance that they may be trading on material non-public information during 'blackout'. However, insiders often enter into Rule 10b5-1 'plans' while not in possession of material non-public information, which generally are structured to allow dealers to trade securities on the insider's behalf while the insider may be in possession of material non-public information, as long as the insider is not able to influence how those trades are effected at that time. Many OTC equity derivatives are themselves structured as 10b5-1 'plans'. Trading effected in compliance with a 10b5-1 plan provides an affirmative defence to a claim of insider trading, but is not a safe harbour.

Under the amended Rule 10b5-1, which became effective on 27 February 2023, insiders and issuers are subject to various limitations with respect to a 10b5-1 plan:

- directors and officers are subject to a cooling-off period of the later of (a) 90 days after the adoption or modification of the 10b5-1 plan and (b) the earlier of (i) two business days following a Form 10-Q or Form 10-K filing (or in a Form 20-F or Form 6-K filing for foreign private issuers) and (ii) 120 days after the adoption or modification of the 10b5-1 plan, and persons other than directors, officers or issuers are subject to a 30-day cooling-off period;
- multiple overlapping 10b5-1 plans are prohibited; and
- only one single-trade 10b-5 plan is allowed per 12-month period.

The amended Rule 10b5-1 does not require a cooling-off period for an issuer when it enters into or modifies a 10b5-1 plan to trade in its own securities. However, the SEC indicated that further consideration is warranted whether a cooling-off period should be required for issuers in the share repurchase context.

Additionally, the amended Rule 10b-5 requires directors and officers to include a representation in their Rule 10b5-1 plan certifying that they are not aware of any material non-public information and that they are adopting the plan in good faith. The amended Rule 10b-5 also requires the person who enters into the 10b5-1 plan to act in good faith throughout the operation of the plan (instead of just when adopting the plan).

Law stated - 15 May 2025

Legal issues

11 | What additional legal issues arise if a counterparty to an OTC equity derivatives transaction is the issuer of the underlying shares or an affiliate of the issuer?

Securities acquired directly or indirectly from an issuer or an affiliate of the issuer in a transaction not involving any public offering will be 'restricted securities' in the hands of the acquirer under Rule 144 under the Securities Act, and must be resold after specified holding periods to meet the safe harbour under Rule 144. In addition, any securities sold by an affiliate of an issuer or sold for the account of an affiliate of the issuer (even if the affiliate purchased them in the open market) become what are commonly known as 'control securities' for the purposes of Rule 144 (although the term is not defined in the rule). Additional volume, manner of sale and filing requirements apply to sales of control securities to meet the Rule 144 safe harbour requirements. Securities may be both restricted securities and control securities.

If a counterparty to an OTC equity derivatives transaction is an insider under section 16, then the insider must disgorge to the issuer any profits derived from any purchase and sale of any equity security of the issuer, any derivative security, or any security-based swap agreement involving any such security if the transactions occurred within a period of less than six months, subject to certain exemptions. Amendments, resets or extensions of derivative securities in many cases may be deemed purchases or sales that are subject to reporting obligations and profit disgorgement under section 16.

Law stated - 15 May 2025

Tax issues

12 What types of taxation issues arise in issuer OTC equity derivatives transactions and third-party OTC equity derivatives transactions?

OTC equity derivatives raise a number of tax issues. First, the Internal Revenue Service (IRS) may re-characterise the transaction in a manner that is different from its stated form, including by treating the transaction as a transfer of beneficial ownership of the underlying equity for US tax purposes. In addition, complex rules govern the timing and character of payments for tax purposes. Payments to a non-US party may also be subject to withholding. Additional issues, such as integration of instruments, may arise depending on the nature of the transaction.

Law stated - 15 May 2025

Liability regime

13 Describe the liability regime related to OTC equity derivatives transactions. What transaction participants are subject to liability?

Market participants are typically most concerned with section 10(b) of the Exchange Act and Rule 10b-5 thereunder. Derivative trades between dealers and issuers or controlling shareholders are often structured such that the dealer is acting as ‘principal’ for its own account, rather than as the agent of the counterparty. Nevertheless, market participants often deem the dealer’s hedging activity to be attributable in some form to the counterparty, as the dealer is engaged in the market activity to facilitate a transaction with the counterparty. Therefore, if the counterparty is in possession of material non-public information at the time of the trade, both counterparty and dealer may have liability for any resulting purchases and sales by the dealer in connection with its hedging activity. Similarly, trades will often be structured such that the dealer’s purchases would be made in compliance with Rule 10b-18 if the Rule 10b-18 safe harbour were available to it.

Dealers and counterparties must also ensure that the dealer’s hedging activities in connection with trades with issuers and their affiliates do not result in an unregistered offering of securities in violation of section 5 of the Securities Act. Questions may also arise as to whether the freely tradeable shares that a dealer purchases in the open market to hedge a transaction with an affiliate of the issuer may thereby become tainted as ‘control securities’ under Rule 144, as they were purchased to some degree for the benefit of an affiliate. This analysis flows from the paradigm under the US securities laws that transactions, rather than securities, are registered, and once freely tradeable securities may become tainted if repurchased by an affiliate. These issues require careful trade-by-trade analysis.

Corporate insiders entering into equity derivative transactions may also be forced to disgorge short-swing profits from trades within six months of one another, and dealers must be careful not to become section 16 insiders themselves in connection with their hedging activity.

Law stated - 15 May 2025

Stock exchange filings

14 What stock exchange filings must be made in connection with OTC equity derivatives transactions?

An issuer typically must file a listing application with the relevant stock exchange if it may issue new shares in connection with its entry into a derivative contract. This filing requirement arises most commonly in convertible note offerings, in which the shares deliverable to investors upon conversion of the convertible notes, as well as the shares deliverable to call spread dealers upon exercise of the upper warrants, must be approved for listing.

Law stated - 15 May 2025

Typical document types

15 What types of documents are typical in an OTC equity derivatives transaction?

OTC equity derivatives transactions are typically documented on a 'confirmation' that incorporates the terms of the ISDA Master Agreement and the ISDA 2002 Equity Definitions. While the Master Agreement is normally subject to minimal negotiation and is adopted as a 'form' without any schedule, the confirmations in complex OTC equity derivative trades are typically 'long-form' confirmations that make extensive modifications to the standard terms of the Equity Definitions. For example, the standard terms of the Equity Definitions will be inadequate for trades that are based on volume-weighted average prices rather than closing prices. For funded collars, variable prepaid forwards and other transactions in which the counterparty pledges securities, the confirmations may also contain the collateral terms.

Parties to OTC equity derivatives transactions that are swaps may also be required by their dealer counterparties to adhere to ISDA protocols or execute similar bilateral documentation for the purpose of complying with various CFTC swap regulatory requirements. Security-based swap dealers may also require that their security-based swap counterparties adhere to analogous ISDA protocols or enter into similar bilateral documentation to comply with the newly implemented SEC security-based swap regulatory regime.

Law stated - 15 May 2025

Legal opinions

16 For what types of OTC equity derivatives transactions are legal opinions typically given?

Legal counsel will typically render opinions for margin loans, call spreads and capped calls, prepaid forwards, registered forwards and zero-strike call options. Legal opinions are not typically given for ASR transactions, but may be given by local counsel where the counterparty is a foreign entity. For trades involving lending or pledging of restricted securities or securities held by affiliates of the issuer, counsel will typically be required to give 'de-legending' opinions to allow the securities to be transferred under contractually agreed conditions.

Law stated - 15 May 2025

Hedging activities

17 May an issuer lend its shares or enter into a repurchase transaction with respect to its shares to support hedging activities by third parties in the issuer's shares?

Yes. Registered borrow facilities in connection with convertible notes offerings are one example. Certain convertible note investors that are arbitrage funds will hedge by shorting the shares simultaneously with the purchase of the convertible bond and by purchasing credit protection on the bond through a credit default swap. If there is insufficient stock borrow available for short selling, issuers would have difficulty marketing the convertible notes to such investors. Therefore, in a registered borrow facility, the issuer issues a number of shares corresponding to the number of shares underlying the convertible bond and lends them to a dealer, which offers those shares in an SEC-registered offering, thereby creating a short position for the dealer. The dealer then transfers this short position to arbitrage funds via cash-settled total return swaps, which in turn allows the arbitrage funds to establish their short position for the convertible notes. For Delaware issuers, the loan fee paid to the issuer by the dealer will be equal to the par value of the shares to comply with state law requirements that the share lending fee for newly issued shares must cover the aggregate par value of the shares.

These transactions must be carefully structured to comply with Regulation M, Rule 10b-5, section 5 of the Securities Act and other applicable restrictions. Moreover, the impact of the market activity by the dealer and the convertible note investors needs to be adequately disclosed.

Law stated - 15 May 2025

Securities registration

18 What securities registration or other issues arise if a borrower pledges restricted or controlling shareholdings to secure a margin loan or a collar loan?

Most large, complex margin loans and collar loans must be structured around a number of issues relating to the character of the pledged securities and the pledgor. Controlling shareholders often acquire their holdings through private investment agreements rather than a public offering (making such securities ‘restricted securities’) and also may be affiliates of the issuer by virtue of their large shareholdings or right to board representation (making such securities ‘control securities’). Like any other person, a foreclosing lender that wishes to sell securities must either register the sales or comply with an exemption from registration. Although lenders may be able to sell the pledged securities pursuant to a registration statement or through other exit options, Rule 144 under the Securities Act is the key safe harbour that lenders seek to rely on to sell the pledged shares publicly without registration.

If the securities are restricted, the seller must satisfy the relevant holding period under Rule 144 prior to the sale – six months since the securities were acquired from the issuer or an affiliate (or in some cases 12 months if the issuer has not satisfied certain filing requirements). If an affiliate pledges restricted securities ‘with recourse’, the lender or pledgee may include the time that the affiliate or pledger held the securities prior to the pledge in calculating the holding period. The meaning of the phrase ‘without recourse’ is subject to much debate and interpretation. Particularly where the pledgor is a special purpose entity, market participants generally consider that a guarantee by a parent entity would be required for the pledge to be considered ‘with recourse’.

Because the pledged securities often were not issued in a public offering and are not initially freely tradeable, they are typically held either in physical, certificated form, or in dematerialised form as restricted book entries on the books of the transfer agent, in each case with legends describing the transfer restrictions. In addition to the securities laws restrictions, these securities are often subject to various ‘lock-up’ provisions in the related investment agreements that must be drafted to carve out the pledge and foreclosure sale by the lender. Lenders will seek to pre-establish procedures with the issuer and its transfer agent to ensure that, in the event of a foreclosure, the shares can be quickly de-legended (if permissible at the time of foreclosure) and transferred to a potential purchaser or purchasers, preferably through the facilities of the Depository Trust Company.

Lenders may also sell under an effective registration statement and may require borrowers to pledge their rights under any registration rights agreement with the issuer, although this is not typically a favoured method. The availability of the registration statement can never be assured; there is a risk of underwriting liability and potential unavailability of due diligence defences, and lenders may learn about material non-public information not disclosed in a prospectus from affiliate borrowers. Registration rights agreements may also impose lock-up restrictions on parties to the agreement in certain circumstances.

If no ‘public exit’ is available, lenders may have to dispose of the collateral via private placement, although it will be subject to a liquidity discount and the purchaser will acquire restricted stock.

Lenders often contractually limit the number of shares they can hold on foreclosure (blocker provisions) and the manner in which they can sell those shares (bust-up provisions) to ensure that they do not themselves become an affiliate of the issuer.

Law stated - 15 May 2025

Borrower bankruptcy

19 If a borrower in a margin loan files for bankruptcy protection, can the lender seize and sell the pledged shares without interference from the bankruptcy court or any other creditors of the borrower? If not, what techniques are used to reduce the lender's risk that the borrower will file for bankruptcy or to prevent the bankruptcy court from staying enforcement of the lender's remedies?

Under section 362 of the US Bankruptcy Code, an automatic stay takes effect immediately on a debtor's bankruptcy filing and prevents creditors from foreclosing on collateral for pre-bankruptcy claims. However, section 362 enumerates certain classes of protected contracts in respect of which the automatic stay does not apply. 'Securities contracts', which are defined to include 'any margin loan', are one such class. The term 'margin loan' is not defined in the US Bankruptcy Code, however. Market participants often worry that only those transactions that have been historically characterised as margin loans (ie, buying stock on margin through a broker) qualify as margin loans for the purposes of the definition of securities contracts, and that the more structured and complicated transactions known to equity derivatives participants as margin loans may not be eligible for protection. Careful structuring of a margin loan to make it more like a 'classic' margin loan (eg, ensuring compliance with margin regulations applicable to banks or brokers, ensuring that each lender in a multi-lender facility has individual rights with regard to its portion of the collateral) may afford market participants some comfort that their remedies against a borrower would not be subject to the automatic stay. Judicial interpretation of the phrase 'margin loan' in the context of the US Bankruptcy Code is lacking, so there is uncertainty as to the outcome of any litigation of this issue.

In the light of this uncertainty, market participants are careful to structure margin loans to minimise the risk of a borrower bankruptcy in the first instance. Lenders typically require a would-be borrower to create a new 'bankruptcy-remote' special purpose vehicle (SPV) to serve as the pledgor and borrower. This technique has the benefit of assuring the lender that the borrower has no legacy indebtedness or obligations that could be the impetus for a bankruptcy filing. Lenders also often demand certain separateness and limited purpose provisions in the loan documents and SPV's organisational documents. These provisions generally require the SPV to maintain a separate and distinct existence from any other entity (decreasing the likelihood that the SPV's bankruptcy will be consolidated with that of its parent or affiliates) and prevent the SPV from incurring other indebtedness or obligations and from engaging in any other activities (other than the borrowing and related pledge) that could result in the SPV having any other creditors that could file the SPV for bankruptcy. It has also become standard for a lender to require that the SPV appoint an independent director to be an objective evaluator of fiduciary duties without any biases in favour of the parent, whose affirmative vote is required to, among other things, permit the SPV to file for bankruptcy.

Law stated - 15 May 2025

Market structure

20 What is the structure of the market for listed equity options?

The largest US exchange by volume is the Chicago Board Options Exchange (CBOE), which normally accounts for around one-quarter of the total market share. In recent years, approximately 88 per cent of the total options contracts traded have been equity options, and approximately 12 per cent have been index options. Most of the main options exchanges trade all (or nearly all) equity options, with only the CBOE trading a significant number of index options (approximately 43 per cent in 2017). Securities underlying listed options must be 'optionable' under the rules of the applicable options exchange, meaning that they must meet certain criteria relating to share price, liquidity and other factors.

Although listed options have standardised features, such as the number of underlying shares, strike prices and maturities, certain listed options incorporate various characteristics of OTC equity options. 'FLEX options' allow investors to customise certain terms, such as the exercise prices, exercise styles and expiration dates, while maintaining the benefits of listing and clearing. 'LEAPS options' have longer maturities than typical shorter-dated options, with exercise dates of up to three years in the future.

All listed equity options are issued, guaranteed and cleared by a single clearing agency – the Options Clearing Corporation (OCC) – which is a registered clearing agency with the SEC. The OCC is the largest equity derivatives clearing organisation in the world.

Law stated - 15 May 2025

Governing rules

21 | Describe the rules governing the trading of listed equity options.

The trading of listed equity options is largely governed by the laws applicable to broker-dealers under the Exchange Act and FINRA rules, as well as the rules and bylaws of the OCC and options exchanges.

Broker-dealers are subject to a number of rules when trading listed equity options for their own account or the account of others, including position and exercise limits for listed equity options imposed by FINRA and exchange rules with respect to proprietary and customer positions. FINRA rules also require FINRA members to enter into agreements with listed options customers containing certain minimum terms, send confirmations and obtain explicit authorisation from a customer before exercising discretionary power to trade in options contracts for the customer.

Exchange rules and systems regulate the manner of trading on the exchange, including the manner in which orders may be submitted to the exchange, market maker quoting, display of orders and the priority of order interaction. Exchanges also establish a range of requirements and prohibitions on members' proprietary and agency activities on the exchange. For example, exchange (and FINRA) rules prohibit trading ahead of customer orders.

Unlike OTC equity options, in which the parties may elect how to determine what adjustments should be made to account for certain corporate events involving the underlying security – such as stock splits or combinations, mergers and acquisition activity or dividend payments – all adjustments for listed options are made by the OCC.

Law stated - 15 May 2025

TYPES OF TRANSACTION

Clearing transactions

22 What categories of equity derivatives transactions must be centrally cleared and what rules govern clearing?

All listed equity options must be centrally cleared, and the Options Clearing Corporation (OCC) is the only clearinghouse for listed equity options traded on all US exchanges.

Equity derivatives that are Commodity Futures Trading Commission (CFTC)-regulated swaps (such as swaps referencing broad-based securities indices or US government securities) must be centrally cleared if the CFTC has issued an order requiring clearing of that category of swap. Certain index credit default swaps (CDS) are currently required to be cleared.

Equity derivatives that are security-based swaps are subject to analogous rules under the Exchange Act. The Securities and Exchange Commission (SEC) has recently implemented its security-based swap regulatory regime under the Dodd-Frank Wall Street Reform and Consumer Protection Act. As a result, while no equity derivatives that are security-based swaps are currently required to be cleared, the SEC could begin issuing mandatory clearing orders on a going-forward basis.

Law stated - 15 May 2025

Exchange-trading

23 What categories of equity derivatives must be exchange-traded and what rules govern trading?

Listed equity options must be traded on an options exchange.

Any equity derivative that is a CFTC-regulated swap that is the subject of both (i) a mandatory clearing determination and (ii) a ‘made available to trade’ determination, must generally be executed on a designated contract market (ie, a futures exchange registered with the CFTC) or on a CFTC-regulated swap execution facility. Currently, certain equity derivatives that constitute CFTC-regulated swaps are subject to these mandatory clearing and trade execution requirements, principally certain index CDS.

Equity derivatives that are security-based swaps are subject to analogous rules under the Exchange Act and the SEC’s Regulation SE. This regime came into effect in February 2024 and the SEC approved the registration of eight security-based swap execution facilities (SBSEFs) in February 2025. However, similar to the CFTC’s swap execution facility regime, mandatory execution on an SBSEF will not apply until a relevant category of security-based swap transactions is the subject of both (i) mandatory clearing and (ii) a ‘made available to trade’ determination by a relevant SBSEF. No such determinations are currently in effect but may be adopted in the future. Moreover, even once such determinations are adopted, certain transactions may be out of scope of mandatory execution on an SBSEF under the cross-border provisions of Regulation SE.

If one or both of the parties to an equity derivatives transaction that is a swap or security-based swap is not an 'eligible contract participant' (as defined in the Commodity Exchange Act), then the transaction must be exchange-traded.

Law stated - 15 May 2025

Collateral arrangements

24 Describe common collateral arrangements for listed, cleared and uncleared equity derivatives transactions.

Swaps and security-based swaps

Counterparties to uncleared equity derivatives that are swaps or security-based swaps typically document their collateral arrangements using a Credit Support Annex published by the International Swaps and Derivatives Association (ISDA) that supplements the ISDA Master Agreement. Under rules issued by US banking regulators and the CFTC, swap dealers (and security-based swap dealers, in the case of the US banking regulators' rules) are (in some cases) and will be (in others) required to collect and post initial and variation margin with certain counterparties in specified amounts, and subject to requirements concerning collateral types, segregation and documentation. The SEC recently implemented similar rules for security-based swap dealers that are not subject to the US banking regulators' rules, compliance with which rules became required beginning in October 2021.

Equity options

For listed equity options, an investor must deposit cash or securities or both as collateral in its brokerage account when writing an option. Options buyers generally do not post margin, but they are required to pay a premium. Initial and maintenance margin requirements for options writers are established by the options exchanges and Financial Industry Regulatory Authority, Inc (FINRA) rules and vary by option and position type. Broker-dealers carrying customer options accounts may impose higher margin standards than those required by FINRA and the exchanges. The OCC imposes margin requirements on its clearing members with respect to each account maintained at the OCC.

There are no margin requirements imposed by US regulators, exchanges or clearinghouses for OTC equity options, and therefore any collateral arrangements are established bilaterally between the counterparties.

Law stated - 15 May 2025

Exchanging collateral

25 Must counterparties exchange collateral for some categories of equity derivatives transactions?

Swaps and security-based swaps

Uncleared swaps and security-based swaps

Swap dealers and security-based swap dealers are, in certain cases, required to collect and post margin pursuant to rules that have been issued by the US banking regulators (which apply to swaps and security-based swaps entered into by bank dealers and certain other 'prudentially regulated' dealers) and the CFTC (which apply to swaps entered into by non-bank swap dealers). The SEC's uncleared security-based swap margin rules apply to security-based swap dealers that are not prudentially regulated by a US banking regulator.

The uncleared swap and uncleared security-based swap margin rules of the CFTC and US banking regulators are in effect for variation margin, and are subject to a phased-in compliance schedule for initial margin, which lasted until September 2022 for the final implementation phase, with the precise date for a given counterparty pair depending on the size of their respective derivative portfolios.

Under the CFTC's and US banking regulators' rules, certain counterparties of swap dealers and security-based swap dealers to uncleared swap and uncleared security-based swap transactions may be required to collect or post initial and variation margin. Specifically, all transactions where one counterparty is a swap dealer (or a security-based swap dealer, in the case of the US banking regulators' rules) and the other counterparty is either a swap dealer (or security-based swap dealer, as applicable) or financial end user require variation margin to be exchanged bilaterally. Additionally, if the counterparty facing a swap dealer (or a security-based swap dealer, in the case of the US banking regulators' rules) is a swap dealer (or security-based swap dealer, as applicable) or a financial end user with 'material swaps exposure', the parties will be required to exchange initial margin bilaterally (subject to regulatory minimums). If the counterparty facing a swap dealer (or a security-based swap dealer, as applicable) is not a financial end user, the US banking regulators' rules require that the swap dealer or security-based swap dealer collect initial and variation margin, as appropriate; the CFTC's rules, on the other hand, do not affirmatively require the collection of initial and variation margin from non-financial end users. Certain swap transactions that are subject to an exemption from the CFTC's mandatory clearing requirement are exempt from the initial and variation margin requirements. Finally, if neither counterparty is a swap dealer (or security-based swap dealer, in the case of the US banking regulators' rules), the margin rules do not apply.

Special rules also apply to certain cross-border transactions, in which certain exemptions are provided for foreign banks (but not their US branches), though these exemptions are subject to many conditions and limitations.

For uncleared security-based swaps with a security-based swap dealer that is regulated by the SEC and not by a US banking regulator, compliance with the SEC's uncleared security-based swap margin rules began in October 2021.

Cleared swaps and security-based swaps

For cleared swaps and security-based swaps, the counterparty must comply with the collateral exchange requirements of the particular clearing organisation and the clearing member through which the counterparty obtains access to that clearing organisation, which has requirements that are themselves subject to CFTC and SEC requirements.

Equity options

For listed equity options, there is no requirement for the counterparties to exchange collateral, although a listed equity options writer is required to post collateral to its broker-dealer.

Any collateral arrangements for OTC equity options are established bilaterally between the counterparties.

Law stated - 15 May 2025

LIABILITY AND ENFORCEMENT

Territorial scope of regulations

26 What is the territorial scope of the laws and regulations governing listed, cleared and uncleared equity derivatives transactions?

In general, US securities laws have a broad extraterritorial reach, and any trades with US-listed underlying equities will have to consider the implications of US securities laws even where the counterparties and governing law of the derivative contract are otherwise non-US. US-listed underlying equity in a derivative contract may also create a sufficient nexus to give rise to US bankruptcy considerations. Absent other activities in the United States, however, listing equity on a US exchange generally would not subject the issuer to US net income taxation. In addition, certain specific rules may apply to swaps and security-based swaps under the Commodity Exchange Act and Exchange Act, and investors in listed equity options generally must comply with requirements imposed by broker-dealers to comply with Securities and Exchange Commission (SEC) and Financial Industry Regulatory Authority, Inc (FINRA) requirements, regardless of their location.

Law stated - 15 May 2025

Registration and authorisation requirements

27 What registration or authorisation requirements apply to market participants that deal or invest in equity derivatives, and what are the implications of registration?

A dealer entering into equity derivatives that are Commodity Futures Trading Commission (CFTC)-regulated swaps (such as swaps referencing broad-based securities indices or US government securities) must register as a swap dealer if certain of their activities in a dealing capacity exceed stated thresholds (ie, US$8 billion over a rolling 12-month period, or US$100 million with ‘special entity’ counterparties, as defined in the rules). A counterparty that is not required to register as a swap dealer may nonetheless be required to register as a major swap participant and to become subject to rules similar to those applicable to swap dealers if its swap activity exceeds thresholds of current exposure and potential future exposure that are set out in rules; there are currently no registered major swap participants.

Similar registration requirements apply to counterparties to equity derivatives that are SEC-regulated security-based swaps, which registration requirements became effective on 6 October 2021.

A person who acts as a broker or dealer (as defined in the Exchange Act) with respect to options that are securities must register with the SEC as a broker-dealer and must generally become a member of FINRA. Broker-dealers that facilitate transactions in listed equity options may also be required to become members of the Options Clearing Corporation (OCC) and an options exchange.

Law stated - 15 May 2025

Reporting requirements

28 What reporting requirements apply to market participants that deal or invest in equity derivatives?

Equity derivatives that are CFTC-regulated swaps are required to be reported to a swap data repository (SDR). In most cases, the SDR is required to publicly disseminate certain anonymous information about the swap. Swap dealers are also subject to various financial and other reporting requirements. Where one of the parties to the transaction is a registered swap dealer, reporting responsibility will generally lie with such dealer counterparty.

Similar reporting and public dissemination requirements apply to equity derivatives that are SEC-regulated security-based swaps under the SEC's Regulation SBSR. In most cases, reporting responsibility will lie with the dealer counterparty if registered as a security-based swap dealer.

FINRA member broker-dealers are required to report large options positions held by the broker-dealer or any of its customers to the Large Options Positions Reporting System, which is hosted by the OCC. Broker-dealers are also subject to various financial and other reporting requirements.

Law stated - 15 May 2025

Legal issues

29 What legal issues arise in the design and issuance of structured products linked to an unaffiliated third party's shares or to a basket or index of third-party shares? What additional disclosure and other legal issues arise if the structured product is linked to a proprietary index?

Structured products linked to an unaffiliated third party's shares or to a basket or index of third-party shares raise issues about the appropriate level of and responsibility for disclosure about the issuers of those shares, baskets or index components. With respect to individual shares or baskets of shares, the SEC staff issued a no-action letter that permits third-party unaffiliated issuers to link to other issuers' shares with minimal incremental disclosure, provided that such issuer satisfies what is referred to as the 'reading room analysis'. If there is adequate publicly available information about the issuer of the linked shares and sufficient market interest in the shares, the prospectus for the structured product may provide a brief description of the nature of the issuer of the underlying stock, and its performance, and may refer investors to that issuer's filings with the SEC for additional information. This 'reading room' principle also extends to baskets. Typically, each basket component is analysed to determine whether it complies with the requirements of the no-action letter, but some issuers may determine that components that comprise only a small part of the basket need not strictly satisfy the requirements. For structured products linked to a broad-based index of third-party stocks, most issuers conclude that disclosure about each component would not be meaningful to investors and do not apply the reading room analysis.

Broad-based indices, whether third party or of a proprietary nature, raise additional disclosure issues in light of regulatory concerns surrounding the complexity and transparency of such indices and the accountability of their sponsors. Structured product issuers must ensure that the index disclosure adequately describes the index methodology, as well as any embedded costs and fees and any conflicts of interest. Proprietary indices with limited histories have also attracted regulatory scrutiny. FINRA has a long-standing position that back-tested or 'pre-inception performance' data cannot be used in communications with retail investors because it does not comply with FINRA retail communications rules. However, for institutional communications, FINRA permits such data to be provided so long as it is clearly identified as being for institutional use only, the index reflects a rules-based methodology, the back-tested data shows a range of market environments, is distinguished from actual historical performance and discloses any limitations of the back-tested methodology. In addition to complying with FINRA's conditions, disclosure relating to any proprietary index and its performance is subject to the SEC's standards that such disclosure must not misstate or omit material information. All communications must be presented in a way that is fair and balanced to afford institutional investors the opportunity to make an informed investment decision.

Finally, in addition to disclosure considerations, other legal issues may arise. For example, when a structured product is linked to an index, discretion in the calculation of that index must be carefully analysed, in particular to avoid potential issues under the Investment Company Act and the Investment Advisers Act, as well as the Employee Retirement Income Security Act of 1974 and tax issues. Structured products linked to shares of a US third-party corporation (or a basket or index that includes such shares) may give rise to special withholding issues for non-US holders. In addition, if the methodology for rebalancing the underlying shares in a basket or index (regardless of whether shares of a US corporate equity are included) permits a degree of discretion, changes in the composition of the basket or index may be a taxable event to a US holder of the structured product. Separately, the parties to structured products linked to discretionary baskets or indices may be required to report the transaction to the Internal Revenue Service. If a global distribution is contemplated, EU benchmark regulation and the International Organization of Securities Commissions principles for financial benchmarks may also be implicated when linking to third-party or proprietary indexes.

Law stated - 15 May 2025

Liability regime

30 | Describe the liability regime related to the issuance of structured products.

Issuers and other deal participants involved in offerings of structured products face potential liability for material misstatements or omissions, as well as for failing to register the sale of the structured product with the SEC (if required) or complying with one of the exemptions from registration. In addition, potential liability under state securities laws and common law fraud may arise in connection with offers or sales of securities.

In particular, for SEC-registered offerings:

- section 11 of the Securities Act of 1933 (the Securities Act) provides a cause of action if any part of a registration statement contained an untrue statement of a material fact or a material omission at effectiveness. Potential defendants include the issuer, directors, signing officers, named experts and underwriters; and
- section 12 of the Securities Act provides a right of rescission to investors against any person who offers or sells a security by means of a prospectus or oral communication that includes an untrue statement of a material fact or a material omission, or if a security is offered or sold in violation of the Securities Act's registration requirements.

For both SEC-registered and unregistered offerings:

- Rule 10b-5 claims of an untrue statement of a material fact or an omission of a material fact necessary to make the statements made, in the light of the circumstances under which they were made, not misleading may also arise; and
- Rule 10b-5 claims require fraudulent intent, or scienter (unlike claims under section 11 or section 12).

Given increasing technology-driven efficiencies, awareness of regulations and potential liability in other jurisdictions where such products may be offered or sold is also important.

Law stated - 15 May 2025

Other issues

31 | What registration, disclosure, tax and other legal issues arise when an issuer sells a security that is convertible for shares of the same issuer?

The majority of convertible security issuances are in the form of convertible notes, which are convertible at the option of the holder under certain circumstances. Typically, conversions may be settled in cash, stock or a combination thereof at the issuer's election, depending on the accounting treatment the issuer desires. Foreign issuers who have listed American depositary shares (ADSs) in the United States may also raise capital through securities convertible into their listed ADSs. In some cases, issuers choose to employ call spread or capped call derivative overlays to synthetically increase the conversion price of the notes and reduce potential dilution. The derivative overlays can be structured such that the premium paid by the issuer (normally not tax-deductible) will be treated as tax-deductible additional interest expense on the convertible debt, and the derivative instruments will receive equity accounting treatment rather than being treated as marked-to-market derivatives.

Most convertible notes are offered on an unregistered basis only to large 'qualified institutional buyers' that are not affiliates of the issuer under Rule 144A of the Securities Act, making them 'restricted securities' that generally cannot be resold to the general public unless one year (or six months if certain of the issuer's filing requirements are met) has elapsed since the original issuance. Issuers typically agree to remove restrictive legends to allow public sales after one year, although the market for convertible notes is dominated by such qualified institutional buyers and may be traded among such entities under Rule 144A prior to de-legending. In certain circumstances, issuers will issue convertible notes in a 144A offering simultaneously with a registered equity offering, in which event issuers must structure the transactions such that the unregistered convertible notes offering is not 'integrated' with the registered equity offering.

In a registered offering, the issuer must simultaneously register the offering of the underlying equity if the convertible securities are convertible within one year (almost always the case). In both a registered and an unregistered offering, an exemption from registration is generally available for the issuance of the underlying securities on conversion under section 3(a)(9) of the Securities Act. In an unregistered offering, the shares received on conversion are restricted securities, but the holding period of those shares may be 'tacked' to the holding period of the convertible securities for the purposes of Rule 144's holding period requirement. On 22 December 2020, the SEC proposed an amendment to Rule 144 that would, in certain circumstances, eliminate tacking of the Rule 144 holding period for securities received upon conversion or exchange of a convertible or exchangeable security. The amendment would only apply to unlisted issuers and 'market-adjustable securities', which the SEC defines as convertible or exchangeable securities that contain conversion rate or price adjustment terms that would offset declines in the market price of the underlying securities (other than adjustments for issuer-initiated changes like stock splits and dividends). The proposed change would not apply to the majority of convertible deals, where the initial conversion rate and price are fixed, subject only to anti-dilution adjustments.

Convertible notes issuances may generate short selling by certain investors in the notes to hedge their position, as well as market activity by dealers under the call spread or capped call transactions, which must be disclosed in connection with the offering. Issuers may have to comply with stock exchange rules requiring shareholder approval where the number of shares into which the convertible security are convertible would exceed 20 per cent of the shares outstanding, unless certain exemptions are met.

Mandatory convertibles are treated as forming the same class as the underlying shares and therefore may not be offered under Rule 144A and are generally offered on a registered basis. In this case, the issuer must simultaneously register the offering of the underlying equity.

For tax purposes, a mandatorily convertible note may be characterised as equity, rather than debt. If so, among other consequences, the issuer would not be allowed to deduct interest expense and coupon payments would be subject to withholding when paid to a non-US holder. Even without re-characterisation, an issuer's deduction of interest payments may be limited for mandatory convertibles and certain optional convertibles, and, in the case of a US issuer, may be limited or disallowed, based on the use of the proceeds. Furthermore, US holders may need to recognise dividend income and non-US holders may have to pay withholding tax, even if no payment has been made, if the conversion ratio is adjusted and certain conditions are met.

Law stated - 15 May 2025

32 What registration, disclosure, tax and other legal issues arise when an issuer sells a security that is exchangeable for shares of a third party? Does it matter whether the third party is an affiliate of the issuer?

Exchangeable securities are exchangeable into securities of an entity different from the issuer of the exchangeable security and are often issued by a capital-raising entity that is a subsidiary of the issuer of the publicly traded common equity.

Exchangeables may also be offered on a registered basis or an unregistered basis if an exemption from registration is available. For the exemption from registration under section 3(a)(9) of the Securities Act to be available for the issuance of the underlying securities issued upon exchange, the issuer of the exchangeable security must be a wholly owned subsidiary of the underlying shares issuer and its parent must fully and unconditionally guarantee its obligations. Absent such an arrangement, the exchange must be registered at the time of the exchange or qualify for a different exemption. If the underlying shares are 'free stock' (underlying shares that are not restricted and not owned by an affiliate of the issuer), the exchange does not have to be registered, whether the exchangeable securities are offered on a registered basis or pursuant to Rule 144A. Where these conditions are not met, the only practical alternative is to offer the exchangeable security under Rule 144A, effect the exchange on a private placement basis and register resales of the underlying shares, as tacking under Rule 144 is not permitted in this situation.

Mandatory exchangeables may be offered on a registered basis, which requires registration of the underlying shares unless they are free stock. Mandatory exchangeables may be offered under Rule 144A only in certain circumstances where the underlying shares are free stock, the mandatory exchangeable can only be settled in cash and other technical requirements of Rule 144A are met.

For tax purposes, an issuer's deduction of interest may be disallowed for mandatory exchangeables and certain optional exchangeables if the exchange is for shares of a third party (especially if the third party is an affiliate of the issuer). Furthermore, interest payments may be subject to withholding when paid to a non-US holder. Unlike the conversion of a convertible security, an exchange will generally be a taxable event for the holder and the issuer.

Law stated - 15 May 2025

UPDATE AND TRENDS

Recent developments

33 | Are there any current developments or emerging trends that should be noted?

On 14 December 2022, the Securities and Exchange Commission (SEC) adopted amendments to the affirmative defence in Rule 10b5-1(c), which have been effective since 27 February 2023. The amendments updated the requirements for the affirmative defence by imposing a cooling-off period on persons other than issuers, requiring certain certifications from the directors and officers, prohibiting an overlapping Rule 10b5-1 plan, limiting single-trade Rule 10b5-1 plans to one trading plan per 12-month period and extending good faith obligation throughout the duration of the plan. The amended Rule 10b5-1 also requires issuers to disclose Rule 10b5-1 plans on a quarterly basis and insider trading policies on an annual basis. Additionally, Form 4 and Form 5 filers must comply with the amendments to indicate by checkbox that a reported transaction was intended to satisfy the affirmative defence conditions of Rule 10b5-1(c). Although the current Rule 10b5-1 does not require a cooling-off period for an issuer, the SEC indicated that it will continue to consider whether a cooling-off period should be required for issuers.

Additionally, on 15 February 2023, the SEC adopted rule amendments to shorten the standard settlement cycle for most broker-dealer transactions from two business days after the trade date (T+2) to one business day after the date (T+1). The compliance date for the adopted amendments is 28 May 2024. The shortened standard settlement cycle is expected to have follow-on effects on various other rules or market practices that are themselves tied to the standard settlement cycle.

On 22 November 2023, the SEC issued an order postponing the effective date of its previously proposed new share repurchase disclosure rules, which would have required new and expanded disclosures relating to share repurchases. Such rules were subsequently vacated by the Fifth Circuit Court of Appeals on 19 December 2023 for violations of the Administrative Procedure Act. It remains to be seen whether the SEC will appeal the judgment or repropose a rule similar to it.

Finally, since 13 April 2023, Form 144 is required to be filed electronically on EDGAR (the electronic data gathering, analysis and retrieval system), rather than through a paper submission.

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