ALLEN & OVERY

DRAMATIC DECEMBER ELECTION - CONSEQUENCES FOR FINANCIAL SERVICES REGULATION

As people process the result of Thursday's general election in the UK and the political drama that entailed, we reflect on what it means for financial institutions' Brexit plans.

What now?

The clear message of the UK's new government is that the UK will leave the EU on the 31 January 2020. It is expected that the EU (Withdrawal Agreement) Bill (the **WAB**), the legislation to effect the agreement negotiated with the EU by Boris Johnson in October 2019 (the **Withdrawal Agreement**), will be tabled for its first reading in the UK's parliament this week. Assuming that both the UK and the EU 27 ratify the agreement, there will be a transitional period through to 31 December 2020. This will mean that, notwithstanding the UK's exit from the EU on 31 January, the majority of EU rules and legislation will continue to apply in the UK as they do today until the end of 2020. As such, firms should be planning to implement the new UK post Brexit financial services regime from 31 December 2020 rather than 31 January 2020.

Article 132 of the Article 50 Withdrawal Agreement provides that the Joint Committee (to be established under the Withdrawal Agreement) may, before 1 July 2020, adopt a single decision extending the transitional period for up to 1 or 2 years. Boris Johnson has insisted that this transitional period will not be extended.

If the Withdrawal Agreement is not ratified before 31 January 2020, the UK would still face a "hard" Brexit on 31 January 2020, unless a further extension of the Article 50 date is agreed. In this case, all existing preparations for a hard Brexit to date would remain pertinent. Ratification is of course now considered to be highly likely on both sides.

Future market access?

Assuming that the Withdrawal Agreement is ratified, the new UK government will have until the end of the transitional period to negotiate with the EU and put in place a trade agreement. It seems unlikely that the UK will emerge with EU financial services access rights similar to those that apply today in that agreement. Valdis Dombrovskis, an Executive Vice-President of the European Commission also in charge of financial stability, financial services and capital markets union, has been quoted as saying that the EU would be willing to grant the UK access based on a series of equivalence decisions but that "the more systemically important the market is for the EU,… the closer the regulatory alignment that is expected."

Assuming that no free market access for financial services will be agreed, firms should continue to consider their regulatory position.

© Allen & Overy LLP 2019

UK authorisation of EEA passported firms

Assuming the UK enters into a transitional period, it is possible that the PRA will consider that a temporary permission regime (**TPR**) at the end of the transitional period is no longer necessary given how advanced most EEA banks are in terms of their licensing applications. We understand that the PRA was intending to authorise many EU banks that had notified them of their intention to rely upon the TPR in Q2 of 2020. On this basis, it seems feasible that any firm intending to carry out PRA regulated activities in the UK from the end of 2020 might expect to have its UK authorisation application processed in time.
However, the story for FCA-only regulated entities may be different. Given the vast number of applications from EU firms which the FCA will need to process, it may well need more than 11 months. So a TPR for solo regulated entities may well remain part of the Brexit regulatory process. The regime will undoubtedly require amendment to reflect any future agreed new relationship and its duration may be shortened.

It is also likely that the regime for continuity of pre-existing financial services contracts will still be required, subject to amendment to reflect any future relationship agreement.

Firms should reach out to their primary regulator without delay to discuss their expectations.

Preparing for the new UK legislative rule set

Much work has been done to prepare for a "hard" Brexit, an exit from the EU without an agreement. Over 60 statutory instruments and numerous "exit instruments" have been published relating to the on-shoring of EU legislation in the financial services sector. Even if the Withdrawal Agreement is ratified, that work is not redundant. Although such pieces of legislation were drafted on the assumption of a hard Brexit, many of the "deficiencies" corrected by the SIs and exit instruments may still need to be made at the end of the agreed transitional period depending on what, if any, agreement is reached in the future relationship. Changes to the on-shoring legislation may also need to be made to reflect the nature of any future relationship agreed between the UK and the EU. Additionally, further legislation will be required to "on-shore" any EU legislation which becomes applicable between now and the end of the transitional period. Notable examples of this include CRD5, BRRD2, the buy in and other settlement discipline requirements of the CSDR, SFTR and EMIR Refit reporting requirements and MLD5. But for the most part, we anticipate that firms' preparations to implement the numerous SIs and exit instruments to date will not be redundant but will need to flex to adapt to pre-Brexit legislative change during the transitional period.

Despite the additional time that firms may now have to prepare for the new regime, the market may still need certain transitional arrangements. We would urge firms to start identifying where such transitional arrangements would still be needed even post December 2020 and recommend that they start discussions with regulators and legislators concerning this now. By way of example, the market may consider that it remains not feasible to build the systems required to deliver the on-shored UK EMIR margin requirements or various transparency requirements by 31 December 2020.

Additionally, industry should continue to press legislators and regulators on both sides of the Channel on the importance of resolving the problems associated with potentially conflicting share trading obligations (**STO**), derivatives trading obligations (**DTO**) and central counterparty (**CCP**) recognition.

Preparing for the new UK regulatory rule set

With uncertainty around whether and if so, how any temporary permission regime may still apply, it is difficult to predict how the regulatory rule set will apply to firms immediately after the end of the transitional period. It

© Allen & Overy LLP 2019

is possible that the regulators may no longer consider it necessary to provide any form of transitional relief for firms in TPR, given that they will have had extra time to implement the required changes. Again, we would urge firms to start identifying where such transitional arrangements may still be needed and recommend that they discuss this with the regulators without delay.

What should firms do?

Firms still face two possible cliff edge scenarios. If the new UK government is unable to pass the WAB to ratify Mr Johnson's October agreement before 31 January 2020 or the EU 27 is unable to complete the ratification process, we still face a hard Brexit on 31 January 2020 (although that scenario is considered unlikely). Alternatively, if the UK and the EU are unable to agree on their future relationship before 31 December 2020 then the resultant loss of cross-Channel access will give rise to a similar outcome. Firms should also consider that by that date, there may be less transitional relief available. Firms should:

- Discuss with regulators their authorisation expectations
- Continue to plan to implement on-shored legislation
- Consider what transitional arrangements may still be needed at the end of the implementation period
- Track future legislative developments in on-shoring EU legislation
- Continue to lobby on issues of concern such as the STO, DTO and CCP recognition

© Allen & Overy LLP 2019

Your Allen & Overy contacts

Bob Penn
Partner
Banking
Tel +44 20 3088 2582
bob.penn@allenovery.com

Damian Carolan
Partner
Banking
Tel +44 20 3088 2495
damian.carolan@allenovery.com

Nick Bradbury
Partner
Banking
Tel +44 20 3088 3279
nick.bradbury@allenovery.com

Kate Sumpter
Partner
Banking
Tel +44 203 088 2054
kate.sumpter@allenovery.com

Etay Katz
Partner
Banking
Tel +44 20 3088 3823
etay.katz@allenovery.com

Knox Mcilwain
Partner
Banking
Tel +44 20 3088 2087
knox.mcilwain@allenovery.com

Jodi Norman
Partner
Banking
Tel+44 20 3088 4259
jodi.norman@allenovery.com

Ben Regnard-Weinrabe
Partner
Banking
Tel +44 20 3088 3207
ben.regnard-weinrabe@allenovery.com

Oonagh Harrison
PSL
Banking
Tel +44 20 3088 3255
oonagh.harrsion@allenovery.com

Kirsty Taylor
PSL
Banking
Tel +44 203 088 3246
kirsty.taylor@allenovery.com

If you would like to discuss the issues raised in this paper in more detail, please contact any of the experts above or your usual Allen & Overy contact.

© Allen & Overy LLP 2019

Allen & Overy means Allen & Overy LLP and/or its affiliated undertakings. Allen & Overy LLP is a limited liability partnership registered in England and Wales with registered number OC306763. Allen & Overy (Holdings) Limited is a limited company registered in England and Wales with registered number 07462870. Allen & Overy LLP and Allen & Overy (Holdings) Limited are authorised and regulated by the Solicitors Regulation Authority of England and Wales.

The term partner is used to refer to a member of Allen & Overy LLP or a director of Allen & Overy (Holdings) Limited or, in either case, an employee or consultant with equivalent standing and qualifications or an individual with equivalent status in one of Allen & Overy LLP's affiliated undertakings. A list of the members of Allen & Overy LLP and of the non-members who are designated as partners, and a list of the directors of Allen & Overy (Holdings) Limited, is open to inspection at our registered office at One Bishops Square, London E1 6AD.

© Allen & Overy LLP 2019. This document is for general guidance only and does not constitute definitive advice.