A reflection on the current state of play regarding how EEA firms can provide financial services into the UK post-Brexit

On 11 April 2019, politicians kicked the possibility of a cliff edge Brexit into the (relatively) long grass but with UK politics still deeply divided, a leadership contest for the next prime minister underway and the Irish backstop still unresolved, it is unlikely that clarity on the Brexit saga will be forthcoming any time before 31 October 2019.

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A hard Brexit would result in UK financial services providers losing their rights to provide products and services into the EU. This gives rise to a 'cliff-edge' risk of market disruption as it may become unlawful for UK providers to undertake new business, and potentially even to service existing business, in the EEA. The EU authorities are apparently relaxed about this risk. Contingency planning at the Europe-wide level has been limited to measures permitting continued access by EU market participants to CCPs and CSDs. This has left individual member states to deal with 'cliff edge' concerns through national measures. Our 'hard Brexit law' tracker for each Member State can be found on our Brexit Law website which can be accessed here. On 12 June 2019, the Commission published a communication on the "state of play" of hard Brexit contingency preparations and confirmed that there was no need to amend the substance of any of their existing legislative and non-legislative measures. Whilst the Commission acknowledged that some "residual issues remain" in the context of financial services, there are no plans for any new measures ahead of 31 October 2019.

By contrast, in the UK both the legislator and the regulators have taken extensive action to ensure that EEA firms and other market participants accessing the UK market are provided with a high level of comfort that their access rights will be maintained (for a time limited period), whatever the outcome of the political negotiations.

THE PROPOSED UK REGIME IN THE EVENT OF A HARD BREXIT

Once the EU (Withdrawal) Act 2018 (EUWA) received Royal Assent last June, HM Treasury (HMT) began laying secondary legislation. This not only ensures the UK has a functioning financial services regime (both legislative and regulatory) in the event of a hard Brexit, but also:

- creates a temporary permissions regime (TPR) enabling passported EU banks, investment firms, payment service providers and investment funds to continue their activities in the UK for a limited period of time if the UK leaves the EU with no deal and related transitional arrangements;
- provides regulators with the power to grant some flexibility in applying the new requirements under the EUWA (the temporary transitional powers (TTP)). The TTP will allow the regulators to delay, or phase in, regulatory requirements where they change as a result of Brexit or where they apply to firms for the first time; and
- creates a legislative framework to allow those EEA firms that do not enter the TPR, or which exit the TPR without authorisation, to continue servicing existing contracts for a limited period to enable an orderly wind down of their existing business, thereby providing transitional relief in respect of the so-called 'contractual continuity' issues associated with the loss of passporting rights.

An overview of all options available to EEA firms accessing the UK market can be found here. This summary includes a review of the mechanics for gaining entry to the TPR, the regulators' proposed approach to transitional relief – bar certain prescribed areas, both the FCA and PRA are looking to postpone the application of onshoring (that is, amendments to rules and legislation made using powers under the EUWA) changes to firms' obligations for a period of 15 months until 30 June 2020 (this date may be subject to change given the article 50 extension to 30 October 2019) and an overview of the approach each regulator will take in applying the rule-set to TP firms, subject to the application of the TTP.

In terms of what rules apply to firms in the TPR, each regulator has taken a different approach, which will make implementation particularly challenging in those areas where common requirements are currently applied by both regulators. The FCA has proposed a highly detailed set of rules determining the application of its regulatory ruleset to TPR firms, whereas the PRA proposes a more straightforward approach, based on the the application of its rules for third country firms from the point firms enter into the TPR. In summary:

- the FCA generally proposes only to preserve those requirements which implement EU directives; the PRA has chosen to apply its rules generally;
- the FCA is offering substituted compliance for those rules which implement EU directives; the PRA is not; and
- the FCA has sought to preserve the application of existing rules which are deleted at the point of Brexit; the PRA has not.

This difference in approach is considered further in the article linked above. We have produced a toolkit enabling firms which conduct wholesale business into the UK to identify how the PRA and FCA rules would apply to them on entry into the TPR on a hard Brexit, and on exit from the TPRs. Further information about the toolkit is available here.

WHAT HAS CHANGED OR IS LIKELY TO CHANGE DURING THIS EXTENDED ARTICLE 50 TIME PERIOD?

TPR notifications

On 24 May 2019, the FCA confirmed the deadline for notifications for the TPR would be extended to the end of 30 October 2019. For EEA payment services and e-money firms, the notification window is closed but it will open again on 31 July and end on 30 October. As regards incoming EEA credit institutions and insurers, the PRA confirmed, on the 11 April, that it would not be extending the window further to take account of the revised timeline.

Inflight legislation

The UK government is intending to legislate to clarify the status of "in-flight" EU financial services legislation. For these purposes, "in-flight" legislation refers to:

- EU legislative measures that have been adopted by the EU, but do not yet apply and so do not fall within the scope of the EUWA; and
- Legislative proposals that are currently in negotiation and may be adopted up to two years post Brexit.

The Financial Services (Implementation of Legislation) Bill has currently stalled and the next date for its Parliamentary process has not been confirmed; however, a number of key pieces of EU regulation will now be onshored under the EUWA rather than relying on the mechanics of the Bill. The further extension to the article 50 time line means that EMIR REFIT, the Shareholders Rights Directive II, the EU risk reduction package (including CRRII, CRDV and BRRD II) and the cross border distribution of funds regulations (amongst others) will now be onshored under the EUWA and as a result, Government departments such as HMT will be required to produce additional statutory instruments to correct "deficiencies". HMT has indicated that these should be expected during July.

WHAT AREAS REMAIN OUTSTANDING?

A key outstanding issue that has garnered a lot of attention during the extension to the article 50 timeline regards trading venues and the lack of equivalence determinations by either the UK or the EU. On a hard Brexit, UK venues will no longer be considered European venues for the purposes of MiFID II and will instead be third country trading venues. Likewise, in the UK onshoring of the MiFID II legislation, European venues will be third country trading venues. This has significant ramifications in the context of both the share and derivatives trading obligations under MiFID II.

Whilst the FCA has stated (in the context of the share trading obligation) that in the absence of reciprocal equivalence, it stands ready to "engage constructively" with ESMA and other European authorities to find a time limited solution to mitigate disruption (until longer term solutions are found), it is clear that recognition of trading venues on either side of the channel is a political pawn in the Brexit game &

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