P.R.I.M.E. Finance

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Hard Brexit: What are firms in the UK and EU doing to prepare?

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What happens on March 29?

- The UK becomes a “third country” to the EU.
- Each member of the EU becomes a “third country” to the UK – “Reverse Brexit”.

Two major challenges of a Hard Brexit include:

- Loss of passporting
- Access to financial market infrastructures
  - e.g., central counterparties (“CCPs”), trading venues, central securities depositories, trade repositories

Passporting – the issue

- Brexit
  - UK firms must generally look into the domestic implementation of MiFID II licensing obligations in each EU Member State in which it intends to do provide investment services or activities.
  - Many EU Member States have relatively underdeveloped third-country licensing frameworks or exemptions for third-country firms active in the wholesale markets.
- Reverse Brexit
  - EU firms need to determine a legal basis on which to continue to provide investment services or perform investment activities into the UK.
- Is the only solution: UK firms setting up presence in the EU and EU firms setting up a presence in the UK?

Reverse Brexit - Passporting: EU possible solutions (1)

- Question whether existing UK passport was necessary and if reliance on Overseas Person Exclusion under the Financial Services and Markets Act (Regulated Activities) Order 2001 Regulated Activities Order ("OPE") is possible.
- Article 23(1) of MiFIR (share trading obligation):
  - London Stock Exchange ("LSE") 11 December 2019 notice to members:
    - Members to assume LSE not MIFID II authorised or granted an equivalence decision on "Brexit Day"
    - Article 23(1) of MiFIR requires EU investment firms for the trades they undertake in shares admitted to a MiFID II authorised trading venue take place on a MiFID II authorised trading venue or third country equivalent trading venue
    - Firms shifting LSE membership from UK to generally an Asian affiliate

Reverse Brexit - Passporting: EU possible solutions (2)

- Establish an FCA authorised branch or subsidiary in the UK
- FCA Temporary Permissions Regime (“TPR”)
  - Up to 3 years temporary permission
  - Requires notice –
    - Opened on 7 January 2018, closes on end of day 28 March 2019;
    - notifying firm given a landing slot, first to be from October to December 2019, with a further five closing at the end of March 2021

Reverse Brexit - Passporting: EU possible solutions (3)

- TPR applies to certain EU firms and funds:
  - EU Firms
    - Firms which have passports under Schedule 3 to FSMA; including firms with top-up permission.
    - Treaty firms under Schedule 4 to FSMA; including firms with top-up permission.
    - Electronic money, payment institutions and registered account information service providers who are exercising their passporting rights under the Electronic Money Directive or the Payment Services Directive before exit day.
  - EU Funds
    - UCITS schemes
    - Alternative Investment Funds (including EuVECAs, EuSEFs, ELTIFs and AIFs authorised as MMFs)
- EU credit institutions and insurers
  - Should contact the Prudential Regulation Authority at the Bank of England now.

Reverse Brexit - Passporting: EU possible solutions (4)

- EU firms that cannot rely on the OPE or file within time for the TPR could continue to fulfil existing contractual obligations in the UK under the FCA's proposed Financial Services Contracts Regime
  - Would apply automatically
  - Would apply for a maximum or five years for financial contracts
  - Although would apply for 15 years for insurance contracts

Brexit - Passporting: UK possible solutions(1)

- Article 46 of MiFIR
  - Enables a “third country passport” for firms in jurisdictions that benefit from a determination by the European Commission that their local statutory and regulatory regime applicable to investment services is equivalent to MiFID II and MiFIR.
  - Equivalence decisions cannot be formally requested and are solely within the purview of the European Commission to grant.
  - No equivalence decisions under the Article 46 regime have been issued.

Brexit - Passporting: UK possible solutions(2)

- Business restructuring/relocation of activities from the UK into the EU
  - Establish a presence in an EU Member State that can be authorised under EMIR
    - Proprietary Trading Firms
      - Amsterdam, Dublin, Frankfurt, Paris
- Look to regulatory relief from each EU jurisdiction as appropriate
  - Currently limited and generally proposed rather than adopted

Access to Infrastructures

- CCPs
  - Brexit – European Commission’s issuance of temporary equivalence for existing UK CCPs for a 12 month period
  - Reverse Brexit – Temporary Recognition Regime
- Trading Venues
  - Reverse Brexit - reliance on the OPE or become recognised as a recognised overseas investment exchange
  - Brexit - no proposal
    - UK trading venues become third country trading venues
    - Exchange-traded contracts become OTC