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CMS Brexit webinar - **Helping financial institutions deal with Brexit - perspectives from London and Frankfurt**

Brexit webinar | 5 July 2016

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Legal Implications

Your hosts for today's webinar



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Agenda

1. Observations from Germany and the UK reaction
2. The legislative position & political options
3. The importance of passporting and market access
4. Requirements for a future passporting regime: Continental EU position
5. Capital Markets
6. General Documentation Issues
7. The Way Ahead

- The German people and government were in shock over the outcome of the referendum.
- German / EU politicians are taking rather clear positions:
 - No negotiations or pre-talks with the UK before article 50 is triggered.
 - It “shouldn’t take forever” to begin exit negotiations, but there is “no need to be particularly nasty” to Britain in Brexit talks.
 - Negotiations should take place in an “objective, good” climate.
 - However, there shall be no cherry picking. There must be a clear difference between treatment as a member state of the EU and a third country.
 - “Fair negotiations”; Germany and the EU still need the UK as a partner in defense, trade and economic affairs in the future. However, no room for “special treatment”.
- Germany and the other member states see Brexit as a challenge but also as a chance to reform and improve the EU.

Observations from Germany – How did the financial industry react? (I)

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The general response of German market participants has been rather reluctant:

- "We stay where our clients are."
- "We have a long history of adapting to change and we will work with the relevant authorities as the terms of the exit become clear. We [...] will work diligently to ensure the best possible outcome."

Observations from Germany – How did the financial industry react? (II)

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Some players indicate imminent changes to their corporate structure

- "We will maintain a large presence in London [...] serving local clients as we have [...] In the months ahead, however, we may need to make changes to our European legal entity structure and the location of some roles [...] these changes are not certain [...]"
- "... our American competitors are using their London subsidiaries as passporting hubs into Europe. In the case of a full Brexit, they will need to change their corporate setup and work through newly licensed subsidiaries before they are in the position to render financial services to EU customers."
- "In the medium-term a lot will depend on the question which impacts the withdrawal of United Kingdom from the EU has on the use of the EU passport."

Several restructurings and transactions / mergers are on hold:

- Credit institutions which intend to withdraw from the mainland market and planned to operate via passport and/or branch are now reconsidering their restructuring intentions.
- Cross-border mergers of certain financial institutions have been put on hold for the time being.
- LSE and Deutsche Börse boards have insisted their proposed merger will still go ahead. However, shareholders of both entities are currently voting with respect to the merger plans. Regulatory bodies have expressed their concern about a potential non-EU seat of the new holding company.

- "In light of the importance and dimensions of the British economy we expect that London will remain a world financial center [...] It will take years to build a new financial center that is comparable to London."
- However, an unofficial competition between the remaining European member states and even between cities of the same member state has begun:
 - In Germany, Frankfurt is generally considered the new financial center of the EU mainland.

- The Bank of England
- The FCA
- The politicians
- The markets

- The Bank will continue to consult and cooperate with all relevant domestic and international authorities to ensure that the UK financial system can absorb any stresses and can concentrate on serving the real economy.
- That economy will adjust to new trading relationships that will be put in place over time.
- The best contribution of the Bank of England to this process is to continue to pursue relentlessly our responsibilities for monetary and financial stability.
- And it will take some time for the United Kingdom to establish new relationships with Europe and the rest of the world.
- Some market and economic volatility can be expected as this process unfolds.

- Much financial regulation currently applicable in the UK derives from EU legislation. This regulation will remain applicable until any changes are made, which will be a matter for Government and Parliament.
- Firms must continue to abide by their obligations under UK law, including those derived from EU law and continue with implementation plans for legislation that is still to come into effect.
- The longer term impacts of the decision to leave the EU on the overall regulatory framework for the UK will depend, in part, on the relationship that the UK seeks with the EU in the future.

Continue business-as-usual planning for all regulatory change projects.

1. The people of the United Kingdom took the decision to vote to leave the European Union. It is not the decision I, or the government, wanted. It was a clear democratic decision on a higher turnout than in a general election. Because that decision has been taken, we must look forward.
2. The government is now focused on preparing for the negotiations with the EU. For my part, I want us to agree an economic relationship with the rest of Europe that provides for the best possible terms of trade in financial services.
3. Only the UK can trigger Article 50, and as the Chancellor made clear on Monday, we should only do that when our new Prime Minister has spelled out a definite view about the new arrangement we are seeking with our European neighbours.

Harriett Baldwin MP Economic Secretary to the Treasury

What we can see happening

- Uncertainty
 - Trading relationship unclear before 2018 – 20
- S&P downgrades UK from AAA to AA
 - Increases cost of borrowing
- 2020 fiscal surplus target abandoned
- FTSE 100 down 3% on day 1 but rebounds to highest for 2016
 - Domestic FTSE 250m greatest fall for 2016 but recovering
- Sterling v \$/€ down
 - Weaker £ raises import costs – energy; food
 - Drives inflation
 - Exacerbates grievances

“You were only supposed to blow the bloody doors off”

Michael Caine *The Italian Job*
1969

- Establishment leaders of Brexit did not want or expect to win
- Expression of discontent against globalisation
- Many voters shocked at outcome

An unexpected result

- No government plan
 - No Cabinet position
 - No long-term Prime Minister
- No effective opposition
- Two leadership battles in train

But corporates will have contingency plans

- may not await the political certainty before triggering

The result in the referendum on the UK's membership of the EU will be final. The government would have a democratic duty to give effect to the electorate's decision.

The procedure for withdrawing from the EU 2.16

The British people would rightly expect [the process of withdrawal] to start right away.

The Prime Minister 22.2.16

First of all, we have to respect the outcome of the referendum. I think it is right not to trigger article 50 because that will start a process that will have to result in an exit within two years. That could be an unmanaged exit if the process is started too soon.

The Prime Minister replying to a PMQ 28th June 2016

- 1975 EU Referendum
- 2011 AV Referendum
- 2014 Scottish Referendum

A referendum is to be held on whether the United Kingdom should remain a member of the European Union.

Section 1(1) European Union Referendum Act 2015

The Minister must make an order bringing into force the alternative vote provisions if more votes are cast in the referendum in favour of the answer “Yes” than in favour of the answer “No” ...

Section 8(1)(a) Parliamentary Voting System & Constituencies Act 2011

There is no binding commitment to implement.

An Act to make provision in connection with the enlargement of the European Communities to include the United Kingdom, together with (for certain purposes) the Channel Islands, the Isle of Man and Gibraltar. [17th October 1972]

BE IT ENACTED by the Queen's most Excellent Majesty, by and with the advice and consent of the Lords Spiritual and Temporal, and Commons, in this present Parliament assembled, and by the authority of the same, as follows:—

1. Any Member State may decide to withdraw from the Union in accordance with its own constitutional requirements.
2. A Member State which decides to withdraw shall notify the European Council of its intention. In the light of the guidelines provided by the European Council, the Union shall negotiate and conclude an agreement with that State, setting out the arrangements for its withdrawal, taking account of the framework for its future relationship with the Union ...
3. The Treaties shall cease to apply to the State in question from the date of entry into force of the withdrawal agreement or, failing that, two years after the notification ...
4. ... the member of the European Council or of the Council representing the withdrawing Member State shall not participate in the discussions ...
5. If a State which has withdrawn from the Union asks to rejoin, its request shall be subject to the procedure referred to in Article 49.

Four possible outcomes

1. New Tory Prime Minister gives Art 50 notice late 2016
 - Or 2017
 - After negotiation with EU
2. Or secures some token concessions
 - Parliament approves
 - No Art 50 notice
 - French & Irish precedents
3. Or calls a general election (needs 2/3 majority to call before 2020)
 - Europhile Labour/Tory government
 - Secures token concessions
 - Either accepted
 - Approved by further referendum
4. Or plan collapses and Art 50 notice given

The importance of passporting (I)

- Four freedoms
 1. Goods
 2. Workers
 3. Services
 4. Capital

- Home state authorises & supervises prudential; host supervises conduct
 - Requires harmonisation of rules & convergence of supervisory practices

The importance of passporting (II)

The issue of passporting will loom large in the negotiations because ...

- the passport does help British firms, and
- it helps other countries' firms come to Britain. One of the reasons why the Swiss banks are here in such large measure is that they do not get passporting rights through Switzerland.

This should be a very important feature; it is one of the aspects of what access to the single market actually means.

The Prime Minister replying to a PMQ 29th June 2016

The single market directives

An EEA national established in one EEA state has freedom to provide cross-border services to other EEA states under Article 56 of the Treaty on the Functioning of the EU, and this freedom can be exercised by the establishment of a branch, or the provision of services, in that other state. An inwardly passported firm is an authorised person under FSMA 2000.

- Solvency II
- Markets in Financial Instruments Directive
- Insurance Mediation Directive
- UCITS Directive,
- Alternative Investment Fund Managers Directive
- Payment Services Directive
- Second Electronic Money Directive.

How important is the passport?

The UK is attractive because ...

- Critical mass
- Labour & skills
- Law
- Openness
- Language
- Stability
- EU

House of Commons Treasury Committee
***Economic & Financial Costs & Benefits of UK's
EU membership.*** Final report 2015/16

Market access matters – 3691/7220 MiFID passports used by UK firms

EBA Report on Investment Firms 12.15

UK withdrawal may enhance attractiveness of other member states

Six models

- **Norway** – access in return for recognising four freedoms & contribution.
 - Pay but no say
 - Copy out EU laws
- **Switzerland** – 120+ agreements, only 1 on FS. EU not favour this approach.
- **Canada** – free trade – mainly goods and slow to achieve
- **Turkey** – customs union for goods only
- **Liechtenstein** – largely agricultural
- **WTO** – goods tariffs alone

Increasing loss of influence ... but the agenda remains

Already

- No Commissioner
- No Presidency
- Exclusion from all discussions
- For the City, probably
 - Loss of EBA
 - Loss of € clearers

In the longer term

- The need to maintain equivalence to secure market access

But unchanged

- G20 agenda
- UK regulators will be influenced by ESFS
 - Though query if bound
- Need to maintain market access
 - And replicate EU legislation

MiFID II

3rd country firm must be authorised before providing branch services

- Mandatory for retail business
- Commission to certify 3rd country equivalent & reciprocal
- Plus cooperation & OECD agreements
- Subjected to initial capital, COBS and SYSC

AIFMD

Non-EU AIFM may manage EU AIF and/or market EU/non-EU AIF if:

- Full compliance with AIFMD
- Disclosure of marketing strategy to “MS of reference”
- Legal representative in MSOR
- Cooperation arrangements between MSOR, AIFM home state, and MS where managed/marketed
- FATF/OECD compliant
- AIFM home state laws must not prevent effective supervision of AIFM

Jersey – must fulfil requirements bilaterally; subject to periodical inspection – Moneyval.

Third Country Regimes – perspectives from the EU mainland (I)

- European fundamental freedoms aim to create a single market within the EU. Only member states shall enjoy these freedoms.
- EFTA members indirectly benefit from these freedoms.
- Third countries may benefit from the freedom of capital and payment transfers. However, member states may limit this freedom for third country market participants on a large scale.

Third Country Regimes – perspectives from the EU mainland (II)

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- Member states allow market admission and refrain from applying any trade restrictions (customs), so long as this does not lead to unwarranted economic disadvantages for any member state.
- Third country market access in many areas requires reciprocity (MiFID II, EMIR)
 - Reciprocity for third country access became one of the cornerstones of the EU legal system in negotiating and agreeing third country relations.
 - Reciprocity interferes with independency

Third Country Regimes – perspectives from the EU mainland (III)

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- EU law provides that member states are not permitted to allow more favourable treatment to third country firms than to EU firms.
 - discrimination of EU-nationals vs. third country nationals?
- Hence, bilateral negotiations cannot lead to "better" conditions for third country firms than the existing intra-EU rules.
- "Traditional" third country market access must always happen through an entity in an EU member state.

- Most recent (modern ?) regulations on AIFMD Market product and management access allow "state of reference approach" for products to be passported all over Europe
 - Limited to AIFMD, not for banks and FSPs
 - Unlikely that UK can negotiate an AIFMD-style EU-wide "passporting via state member of reference from the outside" for banks and FSPs soon.
 - Consequently, third countries operating through London will have to look at their market access paths and look for alternatives within post-Brexit-EU.

- Prospectus Directive
- PD allows entities to use one prospectus to offer securities in multiple jurisdictions across the EEA
- Equivalence issues if outside the EU
- Any prospectus required for a public offer in another Member State or for admission to trading on a Regulated Market in another Member State will require approval outside of the UK in relevant jurisdictions (Art 20 PD)

- Wholesale/non-listed issues essentially unaffected
- Assuming non-EEA option, legislation would be needed to deal with PD Regulation, related regulatory technical standards, FCA Handbook and Financial Services and Markets
- Different prospectus and listing requirements in the UK from those in the EU could make it difficult and costly for issuers to make public offers of securities in both the UK and Europe

- Applies to undertakings established in the EEA that qualify as financial counterparties or non-financial counterparties
- If post Brexit, UK no longer EEA, then UK undertakings would become third country entities (TCEs)
- Non-EU CCPs and Trade Repositories can be recognised if the legal and supervisory arrangements are equivalent
- Number of provisions have extra-territorial effect including margin for uncleared trades and mandatory clearing
- Compliance with the regimes of countries outside the EU such the US?
- Full impact will not be known until there is clarity on the post-Brexit regime

- At the moment no immediate requirements pending confirmation the negotiated political outcome
- Due diligence
- Construction Clauses
- Governing law
- Jurisdiction
- Material Adverse Change Clauses
- Events of Default and Termination Events
- Tax Implications
- Financial Collateral Arrangements
- Article 55 BRRD

- A fast letter of notice - or more time to think?
 - The dangerous "Exit from Brexit" discussion
- Making the EU better
 - ...and more flexible in terms of third country access regimes?
- Frankfurt, Paris, Amsterdam or Dublin?
 - In search for "the new banking location" in Europe
- Towards a new regulatory authority regime within the EU?

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