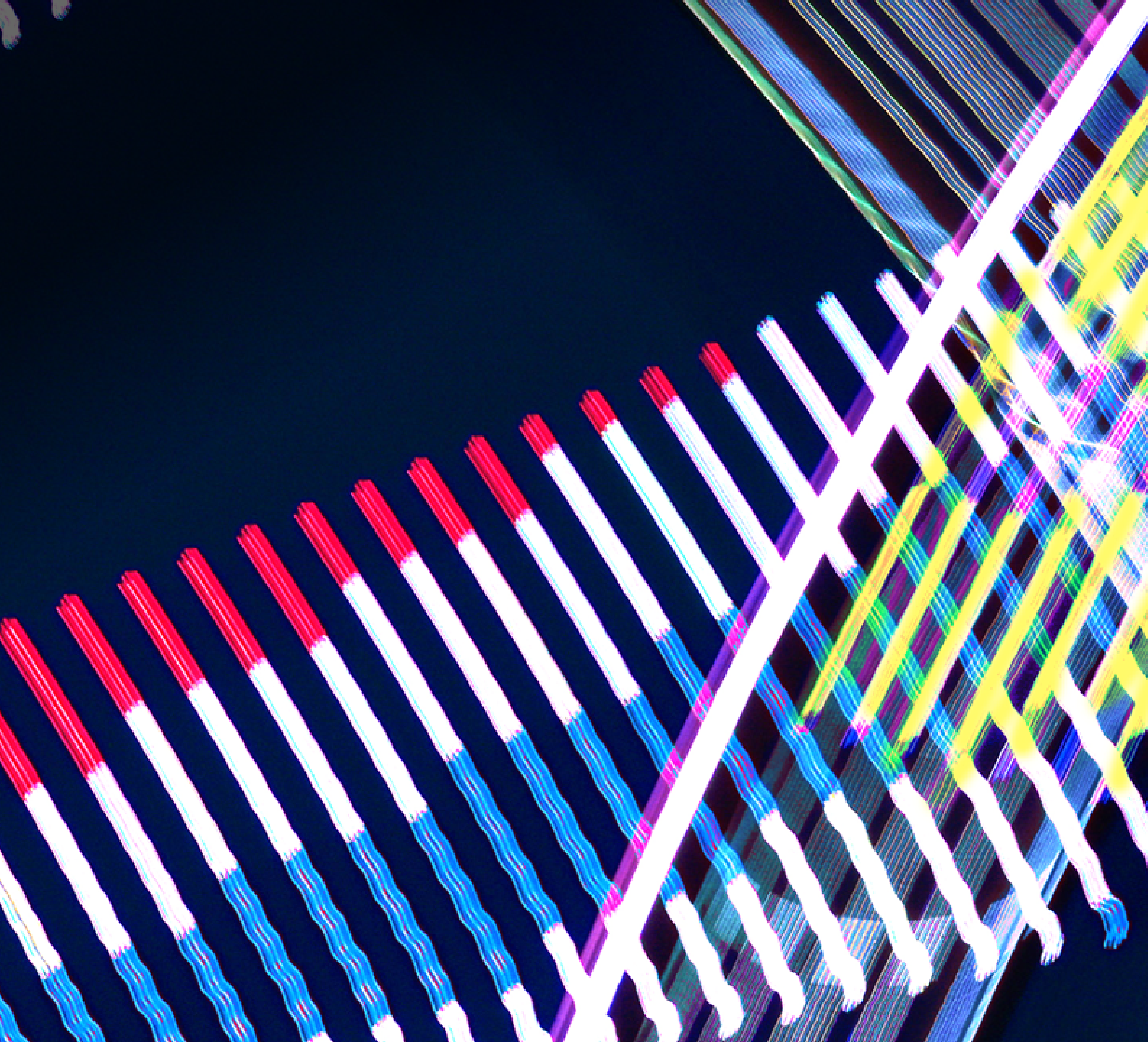
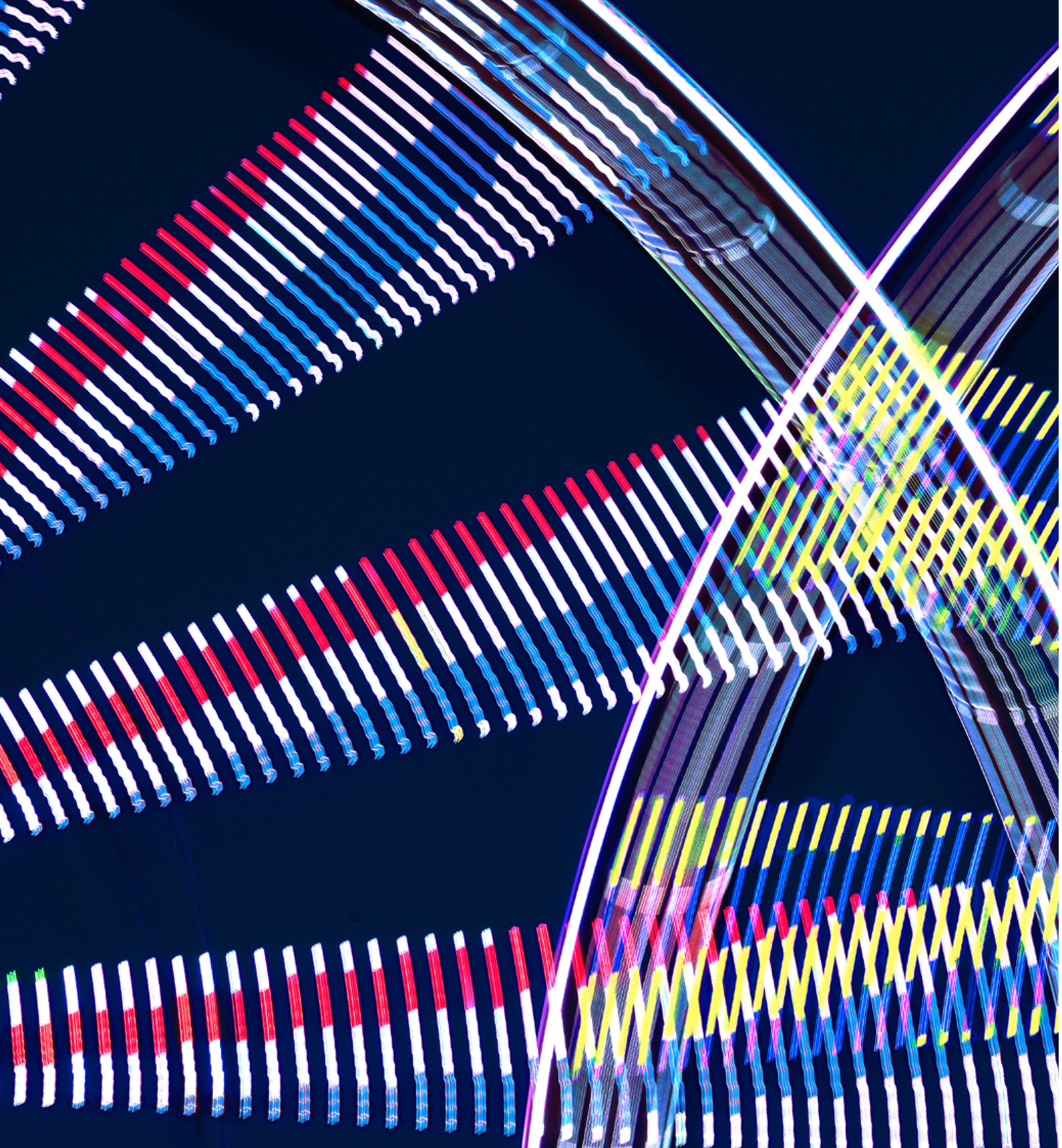
Baker McKenzie.

Brexit: Key Implications for the Financial Institutions Sector





Key Implications for Business

With the post-Brexit transition period ending on 31 December 2020 and the prospects of a no-deal Brexit having increased, financial institutions need to continue to prepare for the key challenges ahead as the UK continues to negotiate a trade deal with the EU.

What should financial institutions think about to prepare for the post-transition period? To help you get started, we have identified a number of key areas that will be affected by the end of the transition period, and some practical considerations so that you can plan ahead and minimise the impact to your business.

The global nature of our Firm and the clients we represent means that we have a number of experts who can provide advice that is tailored to your organisation and the challenges that you face. If you would like help navigating the complicated, evolving landscape, please contact a member of our dedicated team of specialists (contact details below) or your usual Baker McKenzie contact. Additionally, for further analysis of more general key legal and regulatory issues resulting from Brexit, please see our **'No deal' Brexit Checklist: Key Implications for Business**.

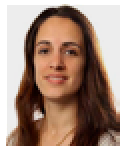
KEY CONTACTS

London

Sue McLean
Partner, IP Tech
+ 44 20 7919 1998
sue.mclean@bakermckenzie.com

London

Mark Simpson
Partner, Banking
+ 44 20 7919 1403
mark.simpson@bakermckenzie.com



London

Jennifer Revis
Partner, EU Competition and Trade
+ 44 20 7919 1381
jennifer.revis@bakermckenzie.com

Market access & Licensing

- One of the main consequences of Brexit on financial institutions will be significantly diminished market access. The precise effects will vary depending on the type of business conducted and whether it is subject to licensing requirements. There will be adverse impacts even if agreement is reached over an EU/UK Free Trade Agreement (FTA). Authorisations that allow institutions to provide services from the UK across the EU will cease to apply on 31 December 2020. The position for EU FIs accessing the UK will be ameliorated initially because of the availability of UK temporary permissions (and marketing) regimes (TPRs).

- In a no-deal scenario, UK-based organisations will be dependent on the WTO's General Agreement on Trade in Services as detailed in each bloc's Schedule of Commitments in Financial Services, which only provides limited rights of market access and protections. The UK's proposed FTA follows the precedents of the EU-Canadian and the EU-Japan FTAs, modestly augmenting the WTO terms and, therefore, it is not expected to remove post-Brexit licensing barriers in any significant way. The UK is instead prioritising regulatory autonomy over alignment in negotiations with the EU, while seeking regulatory and supervisory cooperation arrangements.

- The UK will instead rely on assessments of equivalence, where available, under EU directives such as MiFID 2 and EMIR. The UK and EU aim to conclude their equivalence decisions by the end of the transition period, but this is not certain — not least in relation to all of approximately 40 outstanding assessments. It is likely that the commission will leave these critical decisions to the final months or weeks of 2020, with equivalence only granted where it is in EU interests, for example, on a time-limited basis for derivatives clearing where EU firms are dependent on the UK. Moreover, equivalence regimes do not cover the entirety of the financial services sector. For example, there is no equivalence regime for retail banking, while for wholesale investment it is yet to come into force and, in other cases, only extends to prudential or reporting reliefs. In any event, equivalence decisions may be withdrawn unilaterally, as happened recently to Switzerland.

- For EU businesses that currently rely on "passports" to access the UK, passporting rights will cease at the end of the transition period (as they will for UK-based entities accessing the EU). The UK authorities have announced TPRs to allow financial institutions to continue operating for up to three years. Entities supervised by the PRA may enter its TPR by submitting an application for permission under Part 4A of FSMA; the FCA has confirmed that the TPR for inbound passporting EEA firms and investment funds will reopen on 30 September 2020 to allow organisations, which have not yet done so, to notify it before the transition period ends. Alternatively, a financial services contracts regime (FSCR) will enable EU passporting entities to continue to service UK contracts entered into before the end of the transition period for a limited period, in order to wind down their UK business in an orderly fashion.

- For UK-based businesses accessing the EU, to date, the EU has announced limited transitional measures concerning equivalence of central clearing. While the EU has taken a different approach to the UK in terms of the impact of a "hard Brexit," its position is made more complex by the split of competences between the EU and Member States. We must wait to see whether individual jurisdictions will put in place limited temporary measures (e.g., on contractual continuity), as many did when it looked as if the UK might leave the EU without a transition period.

Data Protection

- The free flow of data is crucial for financial institutions. During the transition period, i.e., until the end of 2020, personal data can flow freely between the EU, including the European Economic Area (EEA), and the UK. However, it remains to be seen how data transfers will be addressed afterwards. The Political Declaration contemplates that adequacy status will be granted to the UK and the adequacy assessment is currently underway, but a UK adequacy finding may not be available immediately and is by no means a given (as the Political Declaration is not legally binding). On the other hand, the UK has indicated its intention to treat the EEA as adequate for the purposes of data transfers from the UK to the EEA, at least initially.

Ability to Work

- Brexit gives rise to the question of the immigration status of UK and EU citizens working for financial institutions in each other's territory. Under the Withdrawal Agreement, the rights of UK and EU citizens who are legally resident will be preserved. From 1 January 2021, new UK arrivals will be subject to the local requirements in the EU and EEA should no agreement be reached. Similarly, EEA nationals and their family members arriving in the UK who wish to work will need to apply under a new immigration rules system (primarily the points-based system).

VAT & Tax

- UK businesses that supply financial and insurance services (specified supplies) to EU customers may be able to recover VAT incurred on costs where previously the VAT was restricted from recovery. This will bring the rules for supplies made by financial and insurance businesses to EU customers in line with the current rules as they apply to non-EU business.

- VAT may apply differently to cross-border supplies of advertising and broadcasting service, transfers and assignments of copyright, patents, licences, trademarks and similar rights, legal advice, banking services, supplies of staff and hire goods amongst other things, where one counterparty is in the EU and one in the UK, particularly where the services are supplied to non-taxable persons. This is because the place of supply rules may be impacted for such services. Financial institutions are recommended to review contracting arrangements to ensure they are optimal from a VAT perspective and mitigate VAT cost for them and their clients.

- Financial and insurance institutions should monitor changes to the existing VAT rules, and in particular the scope of VAT exemption for the services they supply and the purchase of outsourced services; once the UK is no longer bound by decisions of the CJEU, the approach of the UK government and tax authorities may begin to diverge.

- As for direct taxes, much of tax law falls outside EU competence. There will nonetheless be an impact, for example, the UK's status as a holding company location may be affected by the UK losing the benefit of the EU Parent-Subsidiary and Interest and Royalties Directives.

Sanctions

- The enforcement of financial and economic sanctions is increasing. At the end of the transition period, EU sanctions regimes will cease to automatically apply in the UK. The UK has implemented legislation providing for an autonomous sanctions regime, and has already drafted statutory instruments to continue the existing EU sanctions regimes, due to be implemented at the beginning of 2021. While the new UK legislation follows the principles of the EU regime, it is lengthier and there are some nuanced differences in interpretation and definitions of particular concepts and restrictions. The UK has also unilaterally introduced a "Global Human Rights" sanctions regime, a "Magnitsky"-style regime that designates various individuals and entities from Russia, Saudi Arabia, Myanmar and North Korea accused of involvement in severe human rights violations. In future, the UK may diverge further from the EU, for example, in its approach to licensing or to pursue specific foreign policy objectives (e.g., in respect of Russia and China).

However, no firm proposals have been made on the future UK sanctions landscape (other than the new Global Human Rights Regime), and there is no indication that the UK intends to adopt a more aggressive, US-style approach to sanctions. To date the UK has remained broadly aligned with the EU on many areas of sanctions policy, for example, by continuing to support the Joint Comprehensive Plan of Action (also known as the Iran deal) through upholding the EU "Blocking Regulation," which the UK is retaining in amended form after the end of the transition period. Further background on the UK's post-Brexit sanctions framework can be found in OFSI's financial sanctions guidance, an updated version of which has been made available in advance of the new framework becoming fully operational.

Competition Law

- The substantive application of competition law will remain essentially the same for now. At present, UK regulators and English courts have an obligation to interpret UK competition law consistently with EU law. However, after the transition period expires, the UK Competition & Markets Authority (CMA), sectoral regulators (including the FCA) and English courts will likely have some flexibility to depart from pre-Brexit EU case law. The CMA and the sectoral regulators will be responsible for competition law investigations and merger control reviews that affect the UK market, where previously many cross border investigations or mergers would have fallen under the one-stop-shop jurisdiction of the European Commission. The CMA in particular intends to significantly scale up its operations to take on these new responsibilities.

Recommendations

- UK-based organisations must be prepared for a loss of ready market access at the end of the transition period even if an FTA is negotiated between the UK and EU, and notwithstanding the EU making a limited number of equivalence decisions. They should consider how this may affect their operations and take all necessary steps to prepare for all possible scenarios. Strategies need to be adopted to address issues around contractual continuity if the organisation is carrying on regulated activities in the EU and, specifically, where appropriate, to review and re-paper stationery and contractual documentation. Aside from the licensing issue, for the governing law of contracts, although the position is complex, in general terms little should change, assuming the UK fulfils its intention to transpose EU regulations on the rules determining applicable law into domestic law. English law remains a valid choice of law and its appropriateness for a given contract should be considered in the usual way. For legal proceedings begun in 2021, the enforceability of an English judgment in the EU will depend on whether the UK has acceded to the Hague or Lugano Conventions and if not, the national law of the individual state. In the case of enforcement of an EU judgment in the UK, absent the conventions, this would turn on common law rules.

- Financial institutions should monitor announcements from relevant regulatory authorities and maintain dialogue with supervisors over planning and contingency measures in preparation for the end of the transition period, and should not assume that any relevant equivalence decisions will be concluded. The European Central Bank has, for example, urged banks to use the remaining time before the end of the transition period to make sure they are fully prepared — in particular, that boards should step up their preparations to complete their target operating models and, where applicable, fulfil their commitments to the ECB to build up local risk-management capabilities and governance structures in the EU-27.

- UK-based organisations wishing to carry on licensed activities in the EU will likely have already sought authorisation for branches or subsidiaries, given the considerable lead time involved. Otherwise, steps should begin immediately to identify what permissions are required for the activities performed and consideration given to adopting contingency measures pending authorisation.

- Given that licensing barriers will exist after the transition period, UK-based firms accessing the EU should consider "workarounds," such as booking business to certain jurisdictions and using back-to-back transactions, although European supervisors are adopting a restrictive approach to such practices. Where organisations are planning to outsource functions to their head office (in the other bloc) careful consideration will be needed to ensure that sufficient decision-making and resources are situated in the jurisdiction where business is transacted.

- EU businesses that wish to maintain UK market access should notify UK regulators of their intention to participate in relevant TPRs (if they have not already) and should prepare to apply for UK licences. They should be ready to disclose their TPR status in communications with retail clients. If they have not already, eligible organisations wishing to notify the FCA of their intention to participate in the TPR should do so from 30 September 2020 when the window reopens. Organisations should also monitor UK-EU negotiations on equivalence that are likely to continue into the future. Workarounds for access may also be available (e.g., the UK's relatively generous Overseas Persons Exclusion). EU financial services providers with operations in the UK should prepare to comply with relevant UK rules.

- As for data flows, absent the UK securing EU adequacy status, businesses will need to use other means to transfer lawfully personal data from the EU to the UK. This will most likely involve inserting model clauses — Standard Contractual Clauses (SCCs) — into contracts involving data transfers between the EEA and UK, or by multi-national companies entering into Binding Corporate Rules that are approved by a supervisory authority. However, the judgment of the CJEU in Schrems II has created uncertainty around reliance on the SCCs, and businesses should factor that uncertainty into the analysis of their cross-border data flows.

- Employers should consider reviewing/amending their HR processes to ensure these are fully compliant, and in the case of the UK, compliant with the obligations arising under a sponsor licence should the business have to fall back upon the points-based system arrangements when hiring EU nationals who do not have settled (or pre-settled) status.

- Organisations should monitor developments around the introduction of the UK's new sanctions framework in order to be aware of any relevant changes, including to the extent that the UK imposes sanctions restrictions diverging from existing EU regimes.

- Organisations should also consider how the transfer of responsibilities for competition law from the European Commission to the CMA is likely to impact UK financial institutions. For example, organisations may be anticipating merger activity that may now require an additional UK merger control filing with the CMA (where the UK jurisdictional thresholds are met), which would have previously only required an EU merger filing under the EU Merger Regulation "one-stop shop" before the end of the transition period. The CMA has encouraged businesses in this situation to make early contact with it to discuss notification if the merger raises material issues in the UK. Likewise, financial institutions that are facing allegations of anti-competitive or cartel conduct should factor the expiry of the transition period into their strategy around leniency applications (it may be necessary to apply for leniency with both the commission and the CMA in these cases). It may also be worth considering opportunities to build relationships with the CMA or the FCA (for example, by contributing to market studies).

Baker McKenzie helps clients overcome the challenges of competing in the global economy.

We solve complex legal problems across borders and practice areas. Our unique culture, developed over 65 years, enables our 13,000 people to understand local markets and navigate multiple jurisdictions, working together as trusted colleagues and friends to instil confidence in our clients.

bakermckenzie.com