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GODDARD

# TOP 10 BREXIT MYTHS FOR FINANCIAL SERVICES FIRMS

This is a fraught time for in-house legal and compliance teams who are being expected to be conversant in all things Brexit-related. We have compiled this list of 10 of the most common Brexit Myths that are circulating in financial services businesses.

We are here to help with contingency planning and implementation; and understanding what the various Brexit scenarios would mean for your business. We also have a strong network of EU firms with whom we work closely and who can help you to explore different options.

## 1. We don't need to comply with any EU legislation now

No. All legislation currently in force, whether it implements an EU Directive, is a directly applicable EU Regulation, including Regulatory Technical Standards, or is based on case law of the European Court of Justice will continue to be applicable to UK firms until we formally leave the EU (the likely earliest date being September 2018). The UK regulatory authorities have made it clear that EU law is still in force and must be complied with.

Even after a Brexit, if we stayed in the EEA, we would need to continue to comply with EU law governing the single market, although there may be some scope to look at disapplying some unattractive legislation where there is less cross border sensitivity (for example, banker bonus caps; customer disclosures that make little sense; and EU case law on unfair contract terms that gives rise to significant business risk). In any event, much EU law implements requirements set at a global level (e.g. By Basel or the G20), or reflects requirements that the UK would choose to put in place domestically. Therefore, unravelling or rewriting EU law and regulation is a long way off.

## 2. We can stop implementation projects relating to new EU legislation

This would be unwise. While it might be understandable to temporarily pause projects until there is more certainty in coming weeks as to the future path, in all likelihood, the earliest date that the UK might exit the EU would be September or October 2018 (and even this soon would be unlikely). Until then, the UK will be required to implement all EU legislation in the same way that it does today.

In addition, it is possible (and some believe very probable) that any Brexit scenario would leave the UK with access to the single market in financial services, and hence require firms to comply with associated EU law and regulation, at least in so far as they are seeking to provide those services into the EU.

Even if we were outside the single market, it is likely to be in the UK's interests to implement certain EU requirements in order to maintain "equivalence" so as to be able to take advantage of third country access provisions available in some EU legislation, for instance, MiFID2 and the AIFMD but *not* banking under the Capital Requirement Directive IV/Capital Requirements Regulation.

Given this, whilst a temporary pause in implementation might be understandable right now, the likelihood is that you will need to continue to implement further down the line. If your business has lots to do to get compliant, you need to ensure that your project timelines can realistically cope if it is put back slightly.

## 3. A solution would be to relocate businesses there to be able to continue to offer services into the EU

No. Until the UK formally leaves the EU, financial services businesses using EU passporting rights will continue to be able to do that. Further, at this stage, it is premature to conclude that UK based businesses will not be able to continue to operate via a passport upon exit under an EEA type arrangement.

Even in the event of an exit that removed all passporting rights, setting up a business solely in another EU state outside the UK would not give access to the UK market (unless the UK Government chose to legislate to allow it - although the UK does have a generous overseas persons exclusions for some activities). This would mean that firms would potentially need to be authorised in both the UK as well as in the EU. They are also likely to need some form of permanent establishment in both countries to meet regulatory requirements for "mind and management" and sufficient substance. Hence, migrating a business outside of the UK does not necessarily solve the problem if the business wants to continue to access the UK market.

Not all financial services business will need to rely on a passport. It may be conducted on a wholly unsolicited basis in the EU (although in many EU states merely being a counterparty to a derivative trade is regarded as doing regulated business there). Alternatively, it may be that the UK negotiate transitional provisions when we leave the EU that enable businesses to continue to operate without a passport, or that they can operate pursuant to third country access provisions in EU law.

Further, not all firms have to rely on passporting, or are, in fact, able to rely on passporting. For instance, most consumer finance activities are domestic in nature; while those firms currently engaged in cross-border consumer lending are unlikely to be operating under a passporting regime and will rather hold local authorisations.

Businesses should explore the possibility of offering services on a purely cross border basis into the EU from the UK and without any EU physical presence. For certain types of services, these may not be subject to local regulatory obligations. For example, legislation implementing the Payment Services Directive may only be applicable to payment services providers based within the EU. There is a separate regime applicable to "one leg out" transactions.

## 4. We should relocate operations to Scotland

The Scottish Parliament is threatening a new referendum on Scottish independence in order for Scotland to stay in the EU. However, there are various economic and political reasons that would make this outcome improbable. Scotland would need to negotiate accession to the EU as a separate Member State, which is unlikely to be a smooth road. Until it is clear that Scotland is going to be able to operate as a separate EU Member State, a decision to relocate business there is premature. In addition, were Scotland to become a separate EU Member State, it would then be in a similar position to Ireland so a business based in Scotland would need to apply for Scottish authorisation to trade. Scotland does not currently have its own financial services regulatory body so there would be uncertainty as to what that would look like and the timeframe within which this was possible to establish.

## 5. Brexit will be agreed within 2 years

The only legal way to leave the EU is by triggering the Article 50 process. The earliest that this is likely to happen is September 2016 on the election of a new Conservative Party leader - it may take longer if the new Prime Minister feels that further time is needed before that process begins. It has also been suggested that Parliament must act to invoke Article 50. Some EU members have sought to put pressure on the UK to start the process earlier, but this is not something that the EU can force as it remains within the control of the UK. Until notice to leave is given, the UK remains a full member of the EU.

Once the Article 50 notice is given, the Treaty gives a period of 2 years in which to agree the exit plan. Those negotiations could be extended at the end of 2 years by unanimous consent of the 27 EU Member States. The exit plan merely needs agreement by qualified majority voting and consent of the European Parliament. However, it is important to note that the exit plan does not necessarily include the basis of any new trading arrangements and these may well take longer (unless we can agree an existing model such as EEA) and would require the unanimous consent of all 27 EU member states.

## 6. People working for our business from other EU countries will have to leave the UK

No. The future impact on UK immigration remains to be seen but, for now and for as long as the UK remains a member of the EU, EEA nationals will be able to continue to exercise their right of free movement and so there is no immediate change to their immigration status in the UK. It would be open to those who have already been continuously in the UK for a period of five years or more to apply for permanent residency (and thereafter citizenship), if they wish to do so, to consolidate their immigration status.

Whatever the nature of the UK's relationship with the EU going forward it is difficult to imagine a scenario at this stage whereby there will not be at least some kind of arrangement (perhaps short of full free movement) in respect of EEA migrants, but precisely what that will be is likely to remain unclear for some time. Taking the three most likely models of our future relationship with the EU:

<u>Option 1</u> - the "EEA Model": If the UK were to decide to maintain its relationship with the EU as a member of the European Free Trade Association (EFTA), as well as a member of the European Economic Area (EEA), like the 3 other EFTA/EEA members (one of which is Norway), it is likely that the UK would be required to agree to the free movement of persons for all existing EU member states and all EEA members (unless, that is, the UK can agree a unique arrangement which has not been achieved by any other EFTA/EEA member which allows the UK to limit full free movement). So, and rather significantly, if the UK is willing to adopt the EEA Model in the same form as Norway and the other EFTA/EEA members, there would be no change to the rights of EU nationals to live and work in the UK (save that the UK would have the ability to apply temporary "safeguarding measures" such as an emergency break if the level of migration is considered too high). At this early stage, this is the model favoured by most commentators and therefore a strong possibility, however, it may not deliver politically on the Leave campaign's promises.

<u>Option 2</u> - the "Swiss Model": If, like Switzerland, the UK decided not to be a member of the EEA, but instead became a member of EFTA only, there is more scope for the UK to control the number of migrants coming to live and work in the UK, as it would no longer be bound by the principle of free movement of persons. But, the UK would need to reach bi-lateral agreements with the EU member states with regard to its ongoing relationship with them and, as part of that negotiation, the UK (like Switzerland) may be required to agree to the free movement of persons anyway. Unless the UK can negotiate a more restrictive immigration arrangement than Switzerland, free movement will continue and so, again, this is unlikely to satisfy Leave voters who may regard it as a continuation of the status quo from an immigration perspective.

<u>Option 3</u> - the "WTO model": The World Trade Organisation model would mean a complete break from the EU and the European Single Market and instead the application of WTO rules with regard to trade. Significantly, this model would mean that the UK

would not be bound to agree to the free movement of persons and it could implement its own bespoke controls and procedures in order to control the number of EU migrants entering the UK. However, it is not clear that the Government would then want to impose retrospective controls and apply them to those already in the UK. They may implement some form of transitional arrangement.

## 7. We will need to bring home UK employees we have based in other EU states

The situation for the 1.2 million UK nationals living and working in EEA countries (plus Switzerland) will remain unchanged for as long as the UK remains a member of the EU. On an individual basis, if a UK national has lived and worked in another EU member for five years or more, then they may have acquired the right to apply for long term residency status. Depending on the member state's immigration policy, they may eventually be able to apply for citizenship; so there may be scope to consolidate their right to remain in the relevant member state prior to the conclusion of negotiations. Going forward, the status of individual UK nationals will depend on the nature of our relationship with the EU and any future deal that can be struck by the UK government.

If the "EEA Model" or the "Swiss Model" will apply, and the relevant model is adopted in its current form (i.e. full free movement), there will essentially be no change to the status quo in respect of the right of UK workers to live and work on the continent. If some limits on free movement for migrants to the UK are secured, then we may anticipate that similar restrictions could apply to UK migrants based in other EU countries. There is no current model for how that might work in practice.

If there is a complete break from the EU (and the WTO model applies), then in the absence of any specific agreement between the UK and the EU as a whole, the rights of UK nationals to live and work in the EU are likely to be subject to the individual immigration policy of the relevant member state. Such rules will vary significantly and are likely to be subject to the immigration policies of individual member states, but the prospect of an immediate expulsion of British nationals following Brexit would seem unlikely and, even if UK nationals were to lose their right to live and work in the EU, we would expect transitional arrangements to be put in place.

## 8. Existing data protection and privacy laws in the UK are no longer applicable

The UK decision to leave the EU will not affect existing data protection and privacy laws in the UK. Accordingly, the decision should not be seen as an immediate cause for panic. Current laws continue to apply and depending on the exact route chosen for "Brexit", existing and forthcoming directives and regulations such as the GDPR may apply too. These laws (the UK Data Protection Act 1998 (DPA) and the Privacy and Electronic Communications Regulations 2003 (PECR)) protect people’s personal data as well as ensuring that organisations have clear rules and a legal basis when collecting and using such data.

## 9. The payments infrastructures would be challenged by Brexit

Models will need to be looked at. For example, Visa and MasterCard recognise for full membership authorised EU payment entities. That may need to be expanded to capture UK equivalent entities (assuming the UK retains payments regulation). In addition, if the UK is outside the EU or EEA, then it may be considered to be providing cross-border services, permissions for which will also need to be considered within the context of payment system rules.

However, it is unlikely that payment rails will need to change radically. From a UK perspective, they still run on largely domestic rails and platforms. The SEPA arrangements are available for Euro payments, but Sterling payments currently clear on domestic infrastructure. UK Banks will probably want to continue to access SEPA arrangements in order to deal effectively with Euro payments.

## 10. We should incorporate "Brexit clauses" in all our agreements

Whilst many commercial arrangements are likely to be impacted by Brexit, there is no one-size fits all "Brexit clause" that needs to be incorporated into all agreements.

Arrangements relating to regulated sectors, the cross-border provision of goods and services and the transfer of data, are particularly exposed to the impact of Brexit, and parties should consider whether contracts governing such arrangements need to be amended as a result. In relation to long term agreements, parties should consider the extent to which the knock-on effects of Brexit may affect the commercial viability of such agreements, and the extent to which existing mechanisms within such agreements may be triggered by the consequences of Brexit, for example, change control and regulatory change processes, pricing mechanisms and force majeure clauses.

# WHO TO CONTACT

For more information on the implications of Brexit, go to our Brexit hub on [www.addleshawgoddard.com](www.addleshawgoddard.com) or to talk to someone at AG about the issues affecting you. Feel free to contact:


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