



Transitional measures for financial institutions under a no-deal Brexit scenario

24 April 2019

CHIOMENTI

CUATRECASAS

GIDE
GIDE LOYRETTE NOUËL

Gleiss Lutz

The European Council met on 10 April 2019 to discuss the letter of Prime Minister Theresa May of 5 April asking for a further extension of the deadline for the withdrawal of the United Kingdom ("**UK**") from the European Union ("**EU**").

In response, the European Council agreed to an extension to allow for a possible ratification of the withdrawal agreement negotiated so far until 31 October 2019 at the latest. Progress on this matter will be reviewed at the meeting of the Council of June 2019 (communication of the European Council of 10 April 2019).

On the same date, the European Commission issued a communication reminding that the likelihood of a no deal Brexit ("**Hard Brexit**") remains significant, and that although an orderly Brexit remains the preferred solution, the EU Member States are now prepared for a no deal Brexit in particular in the financial sector, stressing that keeping a coordinated and consistent approach is crucial.

Please find below is a summary of the transitional measures adopted for financial institutions in the main jurisdictions of the EU: Germany, France, Italy, Spain and Portugal.

Germany

Regulation approved

The German Federal Parliament (*Deutscher Bundestag*) has recently adopted a new law according to which the German financial supervisor (BaFin) will be empowered to decide the applicable regime on the pre-Hard Brexit agreements (possibly by way of a general ruling regarding certain types of regulated firms).

The new law is relevant for banks, investment firms, payment services providers and insurance companies from the UK.

Treatment of existing business relationships

The BaFin is likely to determine that supervised UK firms and their German branches may continue the existing agreements with German clients, which were entered into on the basis of the European passport in the past, for a transitional period. They may even conclude new agreements of the same type with such German existing clients. The transitional regime may last **up to 21 months**.

This would enable supervised UK firms to continue the regulated business activities in Germany for the time being, in a legally secure manner, while applying for a regulatory license

for an EU/EEA subsidiary to which the existing agreements could be transferred at the end of the transitional period.

Treatment of existing licenses

The regulatory licensing requirements relate to regulated activities "in Germany" (section 32 para. 1 of the German Banking Act).

The German nexus criterion is generally fulfilled if a company:

- operates from its registered office in the Federal Republic of Germany or from a German branch; or
- carries out substantial parts of the regulated business activities in Germany; or
- targets the German market (e.g. by way of calling German customers, advertising in Germany, German websites, German hotlines, etc.).

Since the cross-border continuation of existing agreements by UK firms does not meet any of these criteria, we are of the view that a regulatory license is not required. However, others consider the continuation of agreements with German clients to trigger a German licensing requirement after the transitional period in the event of a Hard Brexit and, therefore, there is no comprehensive legal certainty. It is advisable to make plans for the worst case. In some cases, it is possible to apply for an exemption from the regulatory licensing requirements.

Additional questions

It is not yet clear which transitional regime will be implemented by BaFin in case of a Hard Brexit. In particular, it cannot be ruled out that the BaFin will provide for a transitional period that is shorter than 21 months as a first step.

France

Regulation approved

The French ordinance no. 2019-75 regarding the preparatory measures in connection with the withdrawal of the UK from the EU in respect of financial services (the "**Ordinance**") was

published on February 7, 2019 in the *Journal Officiel* and has been amended by ordinance no. 2019-236 published on March 28, 2019. It has been completed by a decree and two orders (*arrêtés*) published on March 24, 2019.

Treatment of existing business relationships

As a general rule, most ongoing banking and financial contracts will continue post Brexit, to the extent that no material amendments are brought to the contractual terms of the agreements amounting to the provision of a new regulated services.

The Ordinance however addresses specific issues in order to ensure stability and prevent systemic risks in the financial sector in the event of a Hard Brexit.

The Ordinance guarantees French entities' access to UK interbank settlement and delivery-versus-payment systems (CLS, CHAPS, CREST and the clearing houses) by applying the French rules implementing "Settlement Finality" Directive (98/26/EC) to them, ensuring that settlements made through these systems are final.

The Ordinance provides for a transitional regime with respect to master agreements concluded between UK and French entities relating to transactions on financial instruments, including notably derivative transactions. In case of a Hard Brexit, the offer for a new master agreement governed by French law made by an EU subsidiary of a UK-regulated entity shall be deemed accepted by the French client provided notably that it is strictly identical to the existing master agreement with the UK entity. Such mechanism, only available for a transitional period of 12 months from the effective date of Brexit, intends to ensure smooth substitution of the existing master agreements.

In the event of the UK leaving with no deal, UK securities would lose their eligibility to the assets of collective investment undertakings in terms of the exposure ratios to European entities. The Ordinance and its implementation text thus ensures, for limited transitional periods (from 15 to 21 months), the eligibility of UK securities to collective investment undertakings distributed via equity savings plans and equity savings plans dedicated to small and medium-sized firms and mid-caps securities, and in private equity funds subject to exposure ratios to European entities.

Regarding insurance companies, the Ordinance confirms the validity of the commitments entered into by UK insurers under their European passport and their obligation to fulfil these commitments. However, such insurance contracts, under penalty of nullity, may not give rise to a renewal or the issue of new premiums.

With a new definition in the French *Code des assurances* of insurance operations that cannot be carried out by companies that have lost their European passport, the French Government is trying to encourage the transfer of such activities within the EU.

Treatment of existing licenses

The Ordinance does not provide for any measures with regard to the existing licenses which would notably allow UK firms to enter into new agreements post Hard Brexit with French clients for a transitory period.

After a Hard Brexit, the third-country regime shall be applicable to UK firms intending to operate in France, which will have to:

- either obtain a local license (i.e. through a subsidiary or a branch); or
- with respect specifically to investment firms working with professional clients or eligible counterparties, register with ESMA under the third-country regime, assuming that an equivalence decision concerning the UK is taken by the European Commission.

Additional questions

In addition to the above, the Ordinance provides for the implementation of various measures with respect to a Hard Brexit relating *inter alia* to the French supervisory authorities' jurisdiction over UK firms under certain circumstances or the implementation of an ISDA agreement under French Law.

Italy

Regulation approved

The Italian Government has recently published the Law Decree no. 22 of 25 March 2019, containing the necessary measures for ensuring the continuity of both markets and intermediaries in the event of a Hard Brexit.

Under such a scenario, the UK will become a third country as of the date of Hard Brexit, with the consequent discontinuation of bilateral relations with the EU.

The aforementioned measures are aimed at ensuring the financial stability, the integrity, and the operational continuity of both markets and intermediaries, and at protecting depositors, investors, and customers in general, through the introduction of an appropriate transitional period during which such entities can continue to operate, similarly to the transitional period planned in the event of a Hard Brexit.

Following the entry in force of the Law Decree, the Italian supervisory authorities (CONSOB and the Bank of Italy) have published specific instructions for UK intermediaries wishing either to continue to carry out their activities in Italy during the transitional period or to terminate their relationships with clients based in Italy.

Treatment of existing business relationships

The Law Decree establishes a transitional period that will last **18 months** from the official date of the Hard Brexit. During the transitional period UK intermediaries will be generally able both to continue to manage the existing relationships with the clients and to offer their services to prospects. However, there are certain exceptions.

In particular:

(a) UK intermediaries operating *vis-à-vis* retail clients and professional clients upon request under the freedom to provide services regime are excluded from the scope of the transitional period;

(b) UK banks which carry out the activity of collection of public saving without an establishment in Italy will be only able to continue to manage existing relationship, without entering into new agreements nor renewing the existing ones.

In relation to the point under (a), it should be clarified that entities which, at the date of Hard Brexit, provide investment services and activities in Italy without a branch may continue to carry out the same service and activities solely in respect of eligible counterparties and professional clients for the transitional period, subject to prior notification to the competent authorities.

They shall instead cease operating with retail and professional clients upon request within the date of Hard Brexit. However, in order to avoid any prejudice to the clients and ensure the orderly closure of the existing relationships, these UK intermediaries would be able to continue to manage the relationships already existing for a maximum of **6 months** from the date of Hard Brexit, without the possibility of concluding new contracts, nor tacitly renewing

existing ones. Special provisions are set out for the relationship with clients holding OTC derivatives.

Treatment of existing licenses

The transitional period will be granted only upon the filing by the banking, financial and insurance intermediaries of a specific notification to the competent supervisory authority (and, therefore, not automatically).

This notification shall be submitted no later than 3 working days before the official date of withdrawal, in accordance with the specific procedures which will be laid down by the competent authorities.

Additionally, if applicable, within 15 days from the date of entry into force of the Law Decree (i.e. from March 26, 2019), UK intermediaries which has decided not to continue to provide services in Italy or which cannot continue to provide services under the new framework shall send a communication to clients and to the Italian supervisory authorities.

Spain

Regulation approved

Last March 2, 2019, the Spanish Government approved the transitional measures which would be applicable in a Hard Brexit scenario, through the Royal Decree-Law 5/2019 (the “**Decree**”).

The Decree covers different aspects related to UK citizens residing in Spain, employment agreements, healthcare or customs.

Treatment of existing business relationships

Regarding financial institutions, the transitional regime is mainly focused on keeping the effects of the existing agreements with UK institutions. Those agreements on financial services (banking, investment services, insurance and others) executed before a Hard Brexit with an UK financial institution providing the services (including branches) may be in force after the Hard Brexit, keeping their effects for the parties.

Treatment of existing licenses

After the Hard Brexit, UK financial institutions will be treated as third country institutions; therefore, they will be required to obtain a new license in order to renew or amend the existing agreements, or to subscribe new agreements in Spain.

The regulatory license of UK financial institutions to operate in Spain before the Hard Brexit will remain valid for a **9-month period, but only in relation to the existing agreements**, with a view to:

- either terminate the existing agreements or assign them to another financial institution duly authorized to operate in Spain; and
- apply for a new license to operate in Spain under any of the relevant regimes for third country institutions, including the incorporation of a Spanish licensed subsidiary. This would rule out the possibility of using the transitional period for operating in the future through an EU licensed institution passported into Spain.

Therefore, UK institutions will not be permitted to commercialize new financial services and investment funds, or to approach prospects, in Spain during the transitional period. Any situation should be treated, however, on a case-by-case basis.

Additional questions

The measures will enter into force on the Hard Brexit. They will be suspended, however, if the UK authorities do not grant a reciprocal treatment to the Spanish institutions.

Portugal

Regulation approved

On 22 February, a specific draft law has been presented by the Government to the Parliament on contingency measures to be applied in the event of Hard Brexit. However, such draft law focuses on rights of natural persons and does not cover the activity in Portugal of financial institutions established in the UK.

The Government has further approved and disclosed a Contingency Plan, which includes a section on financial services, whereby it clearly sticks to the European Commission's statement that only a limited number of contingency measures at EU level (e.g. CCPs, central securities depositories, derivatives settlement, etc.) would be warranted and that no supplementary measures by Member States would be necessary.

The Contingency Plan also includes a reference to coordination efforts at financial supervisors' level (Banco de Portugal, CMVM and ASF). No detailed guidance has so far been disclosed by supervisors.

Treatment of existing business relationships

On the basis of the above and given the lack of an approved transitory period for UK financial institutions acting in Portugal, we expect Banco de Portugal, CMVM and ASF to allow them to continue servicing their clients under existing business relationships, provided that no additional services are provided. There is no clear definition of what "additional services" may mean, but a restrictive approach may be taken.

Treatment of existing licenses

Following a Hard Brexit, UK authorized financial institutions will no longer be authorized to provide financial services in Portugal, unless they:

- incorporate a subsidiary in Portugal authorized by the relevant competent authority;
- establish a registered branch in Portugal as a third-country institution authorized by the relevant competent authority; or
- operate on a reverse solicitation basis only.

Regarding reverse solicitation, we underline that financial institutions shall not, after the Hard Brexit, promote their services or communicate to their prospect or existing clients with a view to providing their services to them. Therefore, financial institutions should ensure adequate communication of their situation prior to the Hard Brexit, while they hold existing licenses.

Additional questions

As there is no transitional period for UK financial institutions to operate in Portugal, we recommend that institutions implement their plans for Brexit immediately, even in case a Hard Brexit scenario is postponed.

Annex - Comparative chart of Hard Brexit transitional measures

	Germany	France	Italy	Spain	Portugal
Existing Agreements before Hard Brexit	<p>Existing agreements will continue in force at least during the transitional period of up to 21 months.</p> <p>New agreements of the same type with such German existing clients may be entered into.</p>	<p>Most existing agreements will continue.</p> <p>Master agreements entered into between EU-members and UK counterparties can be novated subject to a number of conditions.</p>	<p>Existing Agreements will continue in force during the transitional period, keeping their effects for the parties.</p> <p>However, UK intermediaries providing investment services to retail and professional clients upon request under the freedom to provide services regime shall terminate the relationships with those clients within 6 months.</p>	<p>The Existing Agreements may be in force after a Hard Brexit, keeping their effects for the parties.</p>	<p>Not clearly determined yet.</p> <p>We expect financial supervisors to allow financial institutions to continue servicing their existing clients on a no-additional-services basis.</p>
Transitional period	<p>Up to 21 months, however, it may be shorten up by the BaFin.</p>	<p>12 months (for master agreements)</p>	<p>18 months</p>	<p>9 months</p>	<p>No transitional period is foreseen.</p>
Agreements after Hard Brexit	<p>UK financial institutions will need to obtain a license for a local institution or branch in order to enter into agreements with new clients.</p>	<p>Either obtain a local license or apply for an exemption, or register with ESMA under the third-country regime.</p>	<p>UK intermediaries will be able to offer their services to prospects.</p> <p>During the transitional period, except for certain UK financial institutions providing services without an establishment in Italy. The continuation of the activity during the transitional period is subject to the filing of a specific notification to the competent supervisory authority.</p>	<p>UK financial institutions will need to obtain a new license.</p>	<p>UK financial institutions will need to obtain a license for a local institution or branch, or operate under a reverse solicitation basis.</p>