Brexit: 2017-22

Political and regulatory considerations for financial services firms

November 2017

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Introduction

It has been almost 18 months since the United Kingdom (UK) voted to leave the European Union (EU). Having submitted the Article 50 notification of withdrawal in March 2017, the UK and EU have a two-year period to agree exit terms and establish a new, or transitional, arrangement.

This document provides an overview of the key political milestones to occur over the next five years, including: key dates for the negotiation, European Council meetings, and upcoming European and global elections. Alongside this, the document highlights important regulatory considerations for financial institutions, which could impact firms' Brexit programme planning. It is not an exhaustive list, but provides an outline of the intricacies that lie beyond Brexit and any transitional arrangement. Finally, Brexit is just one indication of wider uncertainty in Europe: conflicting priorities and visions for the future in key countries will determine its direction, and businesses will need to be prepared to react to these.

If you would like to speak with us about any of the topics discussed, please do not hesitate in contacting a member of our Brexit team, outlined at the back of this document.

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2017 2018 2019 2020 2021 2022

2017

Sep

Labour Party Conference: 24

The UK Prime Minister has indicated that an implementation period of around two years will be necessary post-Brexit. Nevertheless, the EU and the UK have around a year to finalise an exit deal in order to ratify this at European and national parliaments.

Furthermore, the UK Government (HMG) has summarised its position on a number of areas of the negotiation process in a series of papers. Whilst details on services are yet to be published, the UK's starting position on some relevant areas are:

Bespoke customs arrangement

- Encourage growth via free and frictionless trade in goods with the EU, whilst allowing UK to strike new independent trade deals with non-EU countries.
- Alternative proposals of a highly streamlined version of the current EU-UK customs union, or an entirely new customs partnership. The new arrangement would seek to avoid administrative burdens or delays.

Exchange and protection of data

- Maintain alignment to much of the EU's regulatory structure; mutual recognition of data protection rules to ensure free flow of data.
- Data flows with third countries with EU adequacy should be retained; this impacts London's status as an FS hub.

Enforcement and dispute resolution

- Does not rule out continued jurisdiction of the European Court of Justice during a transition period.
- Suggests joint committees, underpinned by technical groups, for dispute resolution, supervision, and monitoring.

Trade in goods

- Goods placed on the single market before exit should continue to circulate freely, without additional requirements or restrictions.
- No restriction to provision of services packaged with goods should undermine an agreement on goods.

Cross-border judicial cooperation

- Contracts signed pre-Brexit will be subject to European rules on courts and choice of law.
- It is not clear how insolvencies and other contract continuity issues will be addressed.

Repapering contracts

- If the regulatory framework and passporting that allows EU27 customers to access UK financial services (and vice versa) falls away, firms may no longer be authorised to deliver existing cross EU27-UK contracts. There may also be concerns that cross-border enforceability has become more complicated.
- Firms may need to repaper/rewrite affected client, distributor and vendor contracts and/or agreements to transfer them to new entities or restructure how they operate, and make them compliant with post-Brexit regulatory standards.
- Repapering can be a lengthy process and FS firms should prepare sufficient resources to complete the task before March 2019. Firms should also ensure that any new contracts entered into that go beyond 29 March 2019 remain operative post-Brexit.

Insurance Distribution Directive (IDD)

- The IDD is a new EU directive that impacts insurance brokers (or insurers that go directly to market) coming into effect in 2018.
- It requires all brokers at EU firms to be appropriately registered; however, there is less clarity on any activity outside of the EU.
- This creates some uncertainty about what happens when the flow of trade crosses the EU border, and firms will need to monitor any announcements in this space as it could impact post-Brexit insurance brokerage.

▶ Political considerations ▶ Business considerations

This document provides an overview of the key political and regulatory events taking place between 2017 and 2022

2017 2018 2019 2020 2021 2022

2017

Northern Ireland

- The Belfast (Good Friday) Agreement between the UK and Ireland during the peace process should be fully upheld; Common Travel Area to be maintained.
- Hard border to be avoided, with cross-border cooperation preserved, including on energy.

Election: Germany — 24

- Angela Merkel's Christian Democratic Union (CDU) won the German election on 24 September with 33% of the vote. She is expected to form a coalition with the pro-business Free Democrats (11.3%) and Greens (9.4%) in order to govern. The Social Democratic Party, the CDU's former junior coalition partners, announced that they will go into opposition after slipping to 20.5%, whilst the right-wing Eurosceptic party Alternative for Germany (AfD) rose to gain 13.3% of the vote.
- The Labour and Conservative Party conferences took place on 24–26 September and 1–3 October respectively, and provided evidence of the parties' priorities.
- Following the publication of relevant White Papers, HMG will put forward its proposed Trade and Customs Bills to be debated in Parliament in the autumn. These will provide further detail on the UK's intended approach for EU trade and post-Brexit VAT, customs and excise systems.

Oct

Conservative Party Conference: 1

Election: Austria — 15

European Council Summit: 19

Election: Czech Republic — 20

Nov

Financial Services licences: setting up a new entity

- Passporting rights mean that once an FS firm has been established and authorised in one EU country, it can provide services in other countries across the EU with relatively few authorisation requirements. Passports are not available to firms based outside of the EU and the European Economic Area (EEA).
- UK-headquartered FS firms should be looking at their EU client base and deciding whether, and where, to apply to establish a legal entity in the EU27. EEA-headquartered FS firms should perform a similar analysis for UK business continuity.
- Applying for an EU licence can be a lengthy process – it can take between six months and a year from the applicant providing a complete application to a licensing decision being taken by the relevant authorities. Transferring existing business to the new entity can also be complex and lengthy.
- UK and EU firms alike will therefore need to have finalised their application for local regulatory authorities to review and approve prior to the UK's withdrawal.

European Council Summit

- The European Council of 19–20 October is the first opportunity to sign off on key areas, such as the Irish border, the financial settlement and citizens' rights. In the event that sufficient progress has been made on these, the UK and EU could begin shaping an agreement on any transitional arrangements to come into place post-Brexit.
- Government ministers and diplomats from the EU27 will decide where to base the European Medicines Agency and the European Banking Authority after Brexit.

Maintaining delegation rights

- Many UK and EU funds and investors delegate the management of their portfolios to UK-based experts. Brexit may impact these rights. Firms should be reviewing which entities, and in what jurisdictions, their portfolio management duties are authorised and performed.
- It will be possible to assess whether the establishment of an EU-based portfolio management entity with substance is required.

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2017

Dec

- If sufficient progress has been made on the Irish border, citizens' rights, and the financial settlement at the October summit, the EU and UK could use the European Council summit of 14–15 December 2017 to discuss future arrangements.
- From this point, FS firms will have more clarity on the actual impacts of Brexit, irrespective of whether the UK enters into a transitional deal, as questions impacting staffing, travel, and market access in the eventual EU-UK relationship will have been addressed.
- FS licence applications for EU jurisdictions can take between 6 and 12 months; firms will therefore need to have finalised their application for local regulatory authorities to review and approve prior to the UK's withdrawal.

14 European Council summit:

2018

Jan

- EU-wide stress testing by the European Banking Authority will begin in January, assessing EU banks' ability to meet supervisory capital ratios during an adverse economic shock. The UK will still be in the EU in 2018, so the stress tests, set to cover 70% of the EU banking sector, will apply.

EU Presidency: Bulgaria

03 MiFID II and MiFIR I and II come into effect

Feb

Election: Cyprus

Election: Italy

Election: China

- Italian elections are required to take place before 20 May 2018. As of August 2017, the governing Democratic Party (locally known as Partito Democratico (PD)) had 27.5% support, whereas Eurosceptic Beppe Grillo's Five Star Movement (M5S) had 27.1%.

  Whilst commentators feel it is unlikely for M5S to win outright, the governing PD may find themselves in search of another coalition.

Markets in Financial Instruments Directive (MiFID II)

- On 3 January 2018, MiFID II and the accompanying regulation (MiFIR) will come into effect, impacting a range of authorised persons, exchanges, and businesses that currently do not have to be authorised to conduct certain investment activities.
- Regardless of any transitional deal that is agreed, firms must ensure they have the correct permissions in place to carry out the relevant regulated activities.
- Firms should be considering the implications of Brexit for their MiFID II planning programmes, ensuring that MiFiD authorisations are approved in EU entities by March 2019.

Open banking

- The revised Payment Services Directive, PSD2, is required to be passed into local law by 13 January 2018. Whilst aiming to better protect consumers and their payments, PSD2 looks at the development of safe online, mobile and cross-border European payment services.
- In the UK, the Competition and Markets Authority has passed the Open Banking order, which is aligned to PSD timelines and requires nine of the largest UK banks to offer a standardised application programming interface (API) for customer data. This may prove to be an incentive for FinTechs to enter the UK market, supporting an emerging wave of new third-party products and services, such as tailored price comparison websites.

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2017	2018	2019	2020	2021	2022

2018

Mar

Negotiations midway point

Election: Russia — 18

European Council summit: — 20

29 March 2018

- With a year left of the Brexit negotiations, FS firms will need to be considering any cross-border UK-EU contracts that will last over a year. Clauses may need to be added to ensure contract validity post March 2019.
- Financial institutions will have made their structural decisions and be in the process of implementing them. Firms should seek clarity on points, such as run-off and group supervision, with a view to mitigating adverse impacts where possible.

Apr

Election: Hungary

- The Hungarian election could change the interests or balance of power at the European Council and Council of Ministers. Right-wing conservative Prime Minister Viktor Orbán looks likely to win re-election.

May

GDPR enters into force: — 25

- By 25 May, the EU's General Data Protection Regulation will have entered into force; firms will need to be compliant regardless of Brexit. It is not yet clear whether the UK will be seen as a third country with an adequate level of data protection. If so, British businesses and public authorities will be able to transfer data securely in and out of the EU.

  If either an adequacy decision, or a new UK-EU model (as suggested by the UK's position paper on 24 August 2017) is agreed, cross-border transfers of data will be possible without the need to employ further adequate safeguards.

  In the event the UK does not receive an Adequacy Decision or no new arrangement is agreed, EU companies will not be able to transfer data to the UK without the benefit of adequate safeguards. Firms with their EU headquarters in the UK will find that another EU location will be their 'main establishment' and another data protection authority will be their lead authority. Adjusting to this could complicate cross-border business operations from UK and EU-based firms.

Undertakings for Collective Investments in Transferable Securities (UCITS): are you on track?

- UCITS funds must be managed in the EU. UK-based management companies will need to transfer management of UCITS into the EU post-Brexit.
- Firms should assess whether they have an existing entity that can be used or repurposed. If not, a clear location strategy is required to establish the new entity, in order to avoid losing international investors.
- Firms should also consider the MiFID II, GDPR, conduct and regulator implications in their operating model planning.
- It is necessary to review the expectations of your international client base. Are they being met by your current product, and will this continue to be the case post-Brexit?

Central Counterparty (CCP) Clearing: Is your CCP being relocated?

- The European Commission has proposed to enhance the EU's supervisory framework for both EU and third-country CCPs.
- EU clearing services are heavily concentrated in the UK, with some 75% of Euro-denominated derivatives transactions cleared in the UK. As of 30 March 2019, CCPs located in the UK will be classified as third-country CCPs.
- Users of third-country CCPs will need to consider whether any potential relocation of CCPs as a result of this proposal might impact their business model.

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2018

Jun

European Council summit: 28

- The European Council summit of 28-29 June could be used as an opportunity to finalise agreements on key areas of the negotiations. This is the last scheduled opportunity to do so before the October summit and EU negotiations chief Michel Barnier's indicated deadline for agreement, in order to provide sufficient time for ratification.

Election: Malta

Jul

Aug

Sep

Party conferences

- Once again, the UK political party conference season will focus on Brexit, providing insight into the party stances before the final rounds of negotiations with the EU and the intended ratification process at the UK Parliament.

Oct

Election: Latvia

19 October 2018 — **Proposed end to negotiations**

Election: Luxembourg

European Council summit: 18

- Michel Barnier has indicated that a final deal should be agreed by the European Council of 18-19 October 2018. This is so that there will be enough time for its ratification at the national and European Parliamentary levels, ready for March 2019.

Nov

Dec

Election: Sweden

European Council summit: 13

- If the EU and UK have not reached a deal by October, it is likely the EU and UK will work towards an agreement by the Council summit of 13-14 December.

  This is effectively the last window for all parties to reach agreement in order to have it ratified at national and European Parliamentary levels.

Checkpoint: UK politics

- Throughout the negotiations, it is worth keeping track of the UK political scene and the key players at the Brexit negotiating table. The 2017 UK General Election gave the Conservatives a working majority of 13 votes, essentially leaving Theresa May needing the support of all her party, and the Democratic Unionist Party, to govern.
- Boards should monitor by-elections, reshuffles and potential changes in party leadership, all of which could impact the balance of power and therefore the Government's ability to pass key Brexit-related legislation.
- Firms should also closely follow Jeremy Corbyn's leadership of the Labour Party. The leader of the opposition did better than expected in the 2017 General Election, and has been able to mount more opposition towards the Government.
- The role of the House of Lords will also be important in scrutinising and passing Brexit-related legislation.

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2019

Jan

End of CRD IV and CRR phase in period

- 1 January marks the end of the phase-in period for the Capital Requirements Directive IV (CRD IV) and its accompanying Regulation (CRR). Firms should be aligned with CRD IV and CRR by this point, regardless of whether a post-Brexit transitional deal is put into place.
- The UK's Customs Declaration Service will come into place, replacing HMG's existing Customs System. This will remain compatible with the EU's Union Customs code, which should ensure continuity for businesses post-Brexit.
- By 1 January, banks in the UK are legally required to have completed their ring-fencing programmes.

EU Presidency: Romania

Feb

Mar

29 March 2019: Brexit

UK to leave the EU

UK to leave the EU

- By 30 March, a transition period could enter into force, which could allow for most businesses and people to continue engaging with the European market, broadly continuing the status quo.

  It seems that any transitional period would not exceed two years. Therefore, once the transition period is over, firms will need to be ready to operate under the new EU-UK relationship.
- EU citizens who have been in the UK for over five years will be granted settled status in the UK; EU citizens not resident in the UK for five years by March 2019 may not be granted settled status.
- Firms should have European banking licences and contracts repapered in the event of no transitional deal.
- EU Commission President Jean-Claude Juncker has proposed holding a European Council summit the day after Brexit in March 2019, to map out the future of the EU.

What happens now?

- Under Article 50, approval of the exit deal is reached via the Qualified Majority Voting (QMV) system.
- If the final trading arrangement between the UK and EU has not been agreed under Article 50, then negotiations on the UK's final relationship with the EU could continue beyond the UK's formal exit.
- As the UK's withdrawal is not being proposed by the European Commission, a reinforced, or 'super', qualified majority will be required for the exit agreement.
- This requires 72% of Council members (excluding the departing country, this is 20 out of 27 states), representing 65% of the EU population (without the departing state, this equals 288mn out of 444mn) to vote in favour of the exit deal.

Election: Estonia

Election: Slovakia

Apr

Election: Finland

May

European Council summit:

Election: Belgium

Election: European Parliament

- With the UK out of the EU, the approach of the post-Brexit European Parliament and other bodies such as the European Supervisory Agencies could change significantly. This could have an impact on the way the EU interacts with the UK during and after any transition period, and how FS is regulated in the future.

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2019

Jun

G7 summit: France

▶ The G7, set to take place in France in the summer of 2019, will be a useful barometer to assess EU-UK relations during the transition period and negotiation of the future relationship.

Jul

EU Presidency: Finland

Selection of President of EU Commission

▶ A new EU Commission President should be appointed in July 2019. This may represent a new direction of travel for the EU27, and could also have an impact on the EU's relationship with the UK during and after any transition period.

Aug

Sep

Oct

Election: Greece

Election: Portugal

Election: Poland

Nov

Appointment of College of Commissioners

Selection of President of the European Council

▶ The selection of the President of the European Council, and the appointment of the College of Commissioners will take place in November 2019. From this, we could potentially see a new approach for both institutions.

Dec

Transitional period

- ▶ If a transitional period is agreed, corporates should consider the impact on their post-Brexit operating model implementation plans. Whilst there are likely to be elements of cross-border corporate restructuring requiring immediate implementation, it may be possible to treat other elements on a more 'transitional' basis.
- ▶ Areas that fall under the 'transitional' banner will likely be more operational by nature (rather than strategic) and will likely be prone to implementation leadtimes (such as those requiring IT investment/restructuring).
- ▶ A transitional approach would ease the impact of, and risks associated with, Brexit. Clear documentation of transitional requirements, governance, and exit plans could meaningfully support regulatory conversations and applications.

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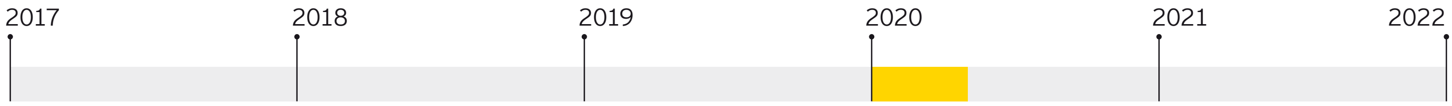

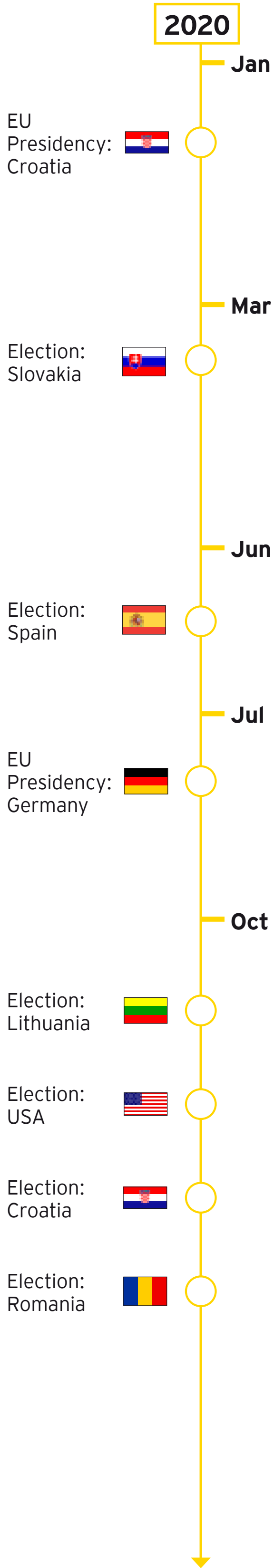

Boards can be considering some of the following operational and financial questions:

- Have you achieved the objectives of your Brexit plan?
- Have you been able to retain operational success and revenue in both the UK and EU?
- How is your new entity adapting to operating under a new supervisor?
- Has your staff adapted to cultural and organisational changes?

Furthermore, it is worth bearing in mind these policy and regulatory considerations:

- Three years after the Brexit vote, are you prepared for possible regulatory divergence?
- How has the UK and European political and regulatory landscape developed?
- A new Europe in a changing world: how has the EU's approach to supervision, clearing and trade developed?

- The deadline for reporting on the implementation of the Single Resolution Mechanism/Bank Recovery and Resolution Directive is 31 December.

Considerations for insurance firms

- Underwriting: Brexit challenges the status of UK entities writing business in the EEA, and European entities operating in the UK, as well as intermediation services across what will be an external EU border. Firms providing cross-border insurance under the freedom to provide services face other challenges, as the establishment of a UK presence could make their business model ineffective.
- Third-country branches: EU rules currently allow the establishment of 'third-country branches'. These provisions are rarely used, and UK operators cannot assume that existing branches in the EU27 can be converted. A third-country branch cannot passport across borders. This may be less of an issue for EU operators with UK branches, for whom the third-country branch is an attractive proposition as it allows continuity of operations. UK authorities are expected to require firms to apply for authorisation as a new third-country branch or subsidiary.
- Equivalence: Solvency II provides scope for the UK to be determined as equivalent, but this is limited to reinsurance and group supervision. Equivalence would not allow UK insurers to underwrite in Europe without local authorisation; the status of UK reinsurers could vary from country to country.
- Contractual terms: Insurance contracts are often long-term, and many operators have to reserve for historic contracts. This 'back book' cannot be left behind post-Brexit and may require local authorisation. However, it could be transferred to an authorised entity under an agreed European process, which can take up to 18 months to complete. Insurers have to consider where they are going to locate their operations and obtain new authorisation, and whether to transfer the back book to their new entity, increasing the restructuring time needed.

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2021

Jan

EU Presidency: Portugal

29/3 — 29 March 2021: UCITS

30/3 — Potential end to transition period

- If the UK and EU have agreed a transition period by 2019, it could come to an end as early as 2021.
- HMG has proposed introducing a smart, hi-tech 'invisible' border in Ireland, with cameras, facial recognition and other technology, in order to retain the Common Travel Area whilst restricting EU free movement.

Mar

Election: Netherlands

Apr

Election: Ireland

31/5 — Selection of President of the European Council

- 31 May 2021 will see the selection or reselection of the President of the European Council, which could mark a change in direction for European leadership.

Jun

Election: UK

Jul

G7 summit: UK

EU Election: Slovenia

- The G7, set to take place in the UK in the summer of 2021, will offer insight into EU-UK relations after the transition period and the total withdrawal of UK membership of the EU.

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Notes

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EYG no. 05993-174GBL

EY-000039735.indd (UK) 10/17.
Artwork by Creative Services Group London.

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