



# Brexit and finance

Private Equity Forum 2017 Conference

21 November 2017

**Joanna Perkins**, Chief Executive, FMLC

## Slide 1—Title slide

Hello and thank you to PEF and Simon Hooper for inviting me to speak here today.

## Slide 2—The two faces of Brexit

Two alternative visions for a post-Brexit future were set out during the Referendum campaigns and, as a community of financial services professionals, we have not yet been able to choose decisively between them.

On the one hand, there is the idea of Brexit-as-regeneration. This is an enticing prospect, I think, principally for service providers who are either focused on the domestic, Asian or U.S. markets. On the other hand, there is the idea of Brexit-as-degeneration, an idea born perhaps of the markets' conventional antipathy to uncertainty and protectionism.

While these are two equally valid and equally unknowable visions of the future, it is the question of Brexit-as-uncertainty on which the FMLC has focused. And that is because we are a small charitable think-tank established for the very purpose of addressing the risks of legal uncertainty.

## Slide 3—Brexit and financial services

When it comes to market participants, they find themselves facing a tripartite division of Brexit-related issues at the moment. Many of these are operational and strategic but very often decisions in the operational sphere will depend upon legal and regulatory issues.

The core issue for any financial business currently doing cross-border business in Europe is at once operational, legal and regulatory and it is the question of whether it can continue to do cross-border business in the E.U. after Brexit. Each firm is currently wondering whether it will need new authorisations to do so and whether, ultimately, the business will be required to restructure and establish a larger presence on the Continent. Ancillary to this question are several others about the U.K. legal and

**Registered Charity Number: 1164902**

“FMLC” and “The Financial Markets Law Committee” are terms used to describe a committee appointed by **Financial Markets Law Committee**, a limited company. Registered office: 8 Lothbury, London, EC2R 7HH. Registered in England and Wales. Company Registration Number: 8733443.

regulatory framework and the changes that Brexit will bring about. This talk is my attempt to provide the briefest overview of those questions and to offer clarification where I can.

#### **Slide 4—the U.K. legal system after Brexit**

In the wake of the Referendum result businesses, foreign and domestic, began to ask what would be the impact of Brexit on commercial law. Some even began to ask whether withdrawal from the E.U. would mean sacrificing chunks of our existing legal and regulatory framework. This became known as the “Swiss cheese” theory.

On closer inspection, however, it is clear that the Swiss cheese theory was itself incomplete because it failed adequately to specify the type of law which was supposed to disappear. Today, those who still propose the Swiss cheese theory may put forward any one of three different ideas:

- First, there is the idea that courts in E.U. Member States will no longer be required to recognise the jurisdiction and judgments of English courts
- Second, some point out that, even with so-called “standstill legislation” in place, there will be provisions of European law which we cannot logically or sensibly retain and so must lose from our domestic law. One example is those provisions referring to the authority and discretion of E.U. institutions. Another is any provision requiring one member state to confer benefits on another.
- Third there is the idea that some legacy contracts which were premised on a united Europe will not be capable of interpretation or enforcement in a post-Brexit world.

The first of these ideas certainly has some legal merit. It will not be possible for the U.K. government unilaterally to guarantee the recognition of English jurisdiction and judgments in the rest of the E.U. once Brexit has removed us from the protective umbrella of E.U. civil justice measures. In practice, however, some provision for mutual recognition may be possible if the political will is present and the British government has indicated that it is keen to pursue this possibility. For the time being, then, it is a case of “wait-and-see”.

The second and third ideas also have some merit and they have been espoused by some very prominent thinkers and commentators. It is, however, important not to overstate the challenges posed by these concerns and not to conflate them with others so as to run away with the idea that English law will be riddled with holes following Brexit. The next two slides examine these concerns in greater depth.

## Slide 5—Reception

The much-touted Great Repeal Bill has now entered Parliament in the guise of the European Union (Withdrawal) Bill. It is a Bill to repeal the European Communities Act and bring existing E.U. legislation, which will no longer have direct effect in the United Kingdom, into domestic law. This process of incorporating law after constitutional change is often referred to as “reception”. (It is also sometimes colloquially referred to as “standstill”.) It is an essential plank of any orderly constitutional transition but the Withdrawal Bill has come in, nevertheless for a great deal of criticism. The boxes on the slide indicate the main areas which are regarded as problematic:

- **Syntax and sense:** it is sometimes said that the project to incorporate E.U. legislation into U.K. law will be much more complicated than the Withdrawal Bill suggests. The Bill makes basic provision for the law that is in force on “Exit Day” to remain as part of the law of the United Kingdom but much of that law is addressed to multiple jurisdictions with shared organs of government and makes no sense at all in the context of a single country legal system. The Bill attempts to deal with this by conferring powers on Ministers to adapt the law after it is incorporated but many lawyers think that the size of the challenge has been significantly underestimated.
- **Role of E.U. institutions:** as I mentioned earlier, one category of rules which it will be difficult to interpret and apply post-Brexit is the category of rules which confer power and authority on the political and regulatory organs of the E.U. There has been no definitive account given yet of how powers currently exercised by the European Commission or the European Securities and Markets Authority will be exercised by domestic agencies post-Brexit.
- **The European Court of Justice (“ECJ”):** one of those key institutions is the ECJ. Its role and jurisdiction in the U.K. after Brexit remains a hotly contested point in political negotiations, particularly in regard to the rights of E.U. citizens and the enforcement of any trade deal. From a commercial lawyers’ perspective, however, the most pressing question is likely to be whether regulation which derives from E.U. legislation still means what the ECJ once said it means, even when it is incorporated into domestic U.K law.
- **Exit Day:** as you probably know, the Government wants to stipulate 29 March 2019 as Exit Day for the purposes of the Withdrawal Bill. This is the designated date on which European law that is already effective will be incorporated into our own legal framework. Laws which are made in the E.U. after that date will have no domestic effect. Whenever Exit Day occurs, lawyers will have to grapple with the question of how to interpret E.U. legislation which comes into effect in stages, with some provisions effective before Exit Day and some provisions only coming into effect afterwards.

- **Ministerial powers (so-called “Henry VIII” powers):** the powers conferred on ministers to amend or replace E.U. law after Brexit have been drafted very broadly. Many commentators have criticised this aspect of the Withdrawal Bill, suggesting that there is no mandate to repatriate power and discretion from Brussels only to confer it on executive ministers in the U.K., acting without the political and constitutional constraints that would normally accompany the exercise of law-making powers by Parliament.

## Slide 6—Legal risk?

The idea that British businesses face a cliff edge on Exit Day has grasped the popular imagination even more firmly than the idea of English law as a Swiss cheese, but is it accurate?

Once again we find that those who pose the question are, on closer scrutiny, divided between those with two different concerns. On the one hand, many financial firms worry about regulatory permissions and the loss of pass-porting. If there is no political agreement over transitional arrangements for U.K. firms seeking access to E.U. markets to pursue new business opportunities in wholesale investment services, securities issuance, and capital-raising, then those firms will find themselves relying on a series of divergent and complicated regulatory Third Country access regimes embedded in individual E.U. legislative measures. In these circumstances, the U.K.’s equivalence may be part of the story but so, too, will be the discretion of E.U. agencies and the often lengthy timetable for decision-making by those agencies. The FMLC has looked at this patchwork of Third Country Regimes closely in a paper published over the summer.<sup>1</sup>

On the other hand, some who talk about a cliff edge are worried about so-called legacy business and disruption to existing financial instruments. Here the concern is that aspects of Brexit may trigger contractual terms and doctrines—some of which are listed on the slide—that bring an abrupt and, in some cases, disorderly end to financial contracts across the market.

On the whole, this should be less of a concern than the loss of pass-porting. Broadly, the issue under all these doctrines and terms is whether Brexit makes performance of the contract illegal, impracticable or impossible in some way. It is sometimes said that performance of an obligation which one has no regulatory permission to perform in a foreign jurisdiction is either impracticable or illegal and, in those circumstances, the parties must unwind, terminate or walk away from their contract. This is certainly true in principle but the size of the problem depends on the number of obligations in legacy contracts subject to regulatory permission. Thankfully the number is not huge because, in general, it is the activity of entering into contracts which requires permission, not the performing of them. For example, a market participant

---

<sup>1</sup> FMLC, *Issues of Legal Uncertainty Arising in the Context of the Withdrawal of the U.K. from the E.U.—the Provision and Application of Third Country Regimes in E.U. Legislation*, (13 July 2017), available at: <http://www.fmlc.org/fmlc-paper-on-brexite-and-third-country-regimes.html>. Updates about the FMLC’s Brexit publications and events programme can be found on our website at: <http://www.fmlc.org/brexit.html>.

will normally need regulatory permission to deal in swaps but not to perform a payment obligation under an existing swap contract. There are, however, exceptions to the general rule and this is where it is right to be cautious. Some contracts, such as certain insurance contracts, need regular servicing. Other contracts require *ad hoc* or ancillary servicing—an example is where the swap dealer acts as compression agent or calculates a benchmark under a derivative, for example. Performance of these servicing obligations in circumstances where regulatory permission is unavailable may possibly trigger one of the terms or doctrines listed on the slide.

### **Slide 7—Conclusion**

Legal and regulatory concerns since the Referendum have focused on around four major areas: i) the loss of recognition across the E.U. of English court judgments; ii) provisions of European law which it would be problematic to incorporate into domestic law; iii) regulatory controls over access to markets; and iv) contractual continuity. The Government's efforts to resolve some of these issues, by way of the Withdrawal Bill, may have raised nearly as many questions as it addressed. Despite this and despite continuing concerns over market access for U.K. firms, I find it reassuring that when we drill into the continuity and robustness of the U.K. legal framework we will find, I believe, that it is well-placed to withstand the upheaval of Brexit.