Feature

KEY POINTS

- The three-year assessment of the impact of Brexit on financial markets has informed much of the contingency planning but uncovered some problems which have proved intractable.
- Whilst the UK might argue that the Hague Convention of Choice of Court Agreements would have been in force in the UK at all relevant times (assuming the choice-of-court agreement was concluded on or after 1 October 2015), others could argue that the Convention was in force in the UK on a different basis before Brexit and therefore it would not apply continuously.
- The EU's review of its approach to equivalence determinations and new tougher rules for the regulation of credit rating agencies in the EU mean that it is likely that the UK will have to maintain regulatory alignment with the EU if it wishes UK market participants to rely on equivalence for market access.
- As each type of contract should be assessed separately, the degree of difficulty which might arise with regards to legacy contracts is uncertain.

Authors Joanna Perkins and Venessa Parekh

The impact of a No-Deal Brexit on financial markets: are we better prepared?

The Financial Markets Law Committee (FMLC) has focused since the 2016 Referendum on identifying concerns with respect to the financial services and making recommendations to resolve them. This analysis focused on four areas: (i) the loss of recognition across the EU 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.[1]

Two narratives emerged during the campaign for the 2016 Referendum – in which the British electorate voted to leave the EU – about the future of the UK and its financial services industry. The first offered a vision of the UK unfettered by EU bureaucracy, an enticing prospect for service providers who are either focused on the domestic, Asian or US markets. On the other hand was the idea of Brexit-as-degeneration an idea born perhaps of the markets' conventional antipathy to uncertainty and protectionism. Neither narrative has prevailed. An undercurrent to both visions, however, has been the legal and regulatory priorities to be adopted upon withdrawal.

To recap briefly the events since the 2016 Referendum: On 29 March 2017, HM Government took the first step in the withdrawal process and officially served notice to the EU of the UK's withdrawal under s 50 of the Treaty on European Union (TEU), beginning a two-year "notice" and negotiation period and setting the date on which the UK was to withdraw from the EU (Exit Day) as 29 March 2019. Over that period, although negotiations for a Withdrawal Agreement progressed between the UK and EU, both market participants and HM Government continued to prepare for the possibility that the UK might withdraw from the EU without ratifying an Agreement (known in government documents as a "No Deal" Brexit). In March 2019, HM Government requested two extensions to the Article 50 notice period, subsequently setting Exit Day as 31 October 2019.

The three years since the Referendum have provided market participants, authorities and research organisations with an opportunity for a thorough-going analysis of the impact of Brexit on the financial markets – analysis which, perhaps, had not been completed before the Referendum. The assessment that resulted has informed much of the contingency planning in which market participants have engaged in the past three years but it has also uncovered some problems which have proved intractable.

THE JURISDICTION OF ENGLISH LAW AND THE RECOGNITION OF ENGLISH COURT JUDGMENTS

Commercial contracts frequently contain a choice-of-court clause favouring the High Court in London, often accompanied by a choice-of-law clause designating English law. In many cases, the parties will have no connection with the UK: they choose English courts and English law because they want a neutral forum and a system of law that is known to them as satisfactory from a business point of view. Until recently, in large part owing to the UK's membership of the EU, there has been a high degree of certainty that the provisions on choice of law and choice-of-court would be valid and effective both in the UK and in other EU and EFTA member states.

The chief EU instrument on choice of law for contracts – the Rome I Regulation (EC 593/2008) – is based on the principle of universal application: the rules it lays down operate in the same way irrespective of whether the country whose law is to be applied is a member state of the EU or a non-member state. Therefore, the application of English law under this instrument – for example, by virtue of an English choice-of-law clause – will not be affected by Brexit. The position with regard to jurisdiction and the recognition of English court judgments, however, is quite different. The object of the Recast Brussels Regulation (EU 1215/2012), which regulates jurisdiction and the recognition and enforcement of judgments between EU member states, is to ensure the mutual recognition and enforcement of judgments in the courts of EU member states. No courts outside the EU are favoured by its provisions. After Brexit, absent any agreement between the UK and EU, the Recast Brussels Regulation will cease to apply to the judgments of UK courts in civil matters and these will not be automatically recognised across the EU.

The FMLC had recommended, in December 2016, that some of these concerns be ameliorated by accession, on the part of the UK, to the Hague Convention of Choice of Court Agreements (the UK is currently party by virtue of its membership of the EU). The Hague Convention requires the court or courts favoured by an exclusive choice-of-court agreement to hear the case; it precludes courts of other contracting states from hearing parallel proceedings and it requires any judgment granted by the favoured court to be recognised and enforced in other contracting states.

In December 2018, the UK deposited its instrument of accession to the Hague Convention, with the intention that it would come into force for the UK on 1 April 2019, ie Exit Day under the European Union (Withdrawal) Act 2018. Following the extension to the Article 50 notice period, however, the UK's accession was suspended and it is now expected that the UK will accede on 1 November after an Exit on 31 October 2019. The European Commission's Notice to Stakeholders (published on 11 April 2019), however, stated that the EU rules on recognition and enforcement of judgments will not apply to UK judgments unless the judgment has been exequatured before Exit Day. Only a judgment where formal exequatur (declaration of enforceability) steps are available and have been taken and completed in the EU country, will be enforced. It will not be enough that the UK judgment was handed down before the withdrawal date, nor that enforcement proceedings were commenced before the withdrawal date.

There is residual legal and practical doubt in respect of choice-of-court agreements concluded before Brexit if enforcement proceedings are commenced in the EU after Brexit. Whilst the UK might argue that the Convention would have been in force in the UK at all relevant times (assuming the choice-of-court agreement was concluded on or after 1 October 2015), others could argue that the Convention was in force in the UK on a different basis before Brexit and therefore it would not apply continuously. The CJEU will then be the final arbiter on the matter.

"ONSHORING" EU LEGISLATION

The European Union (Withdrawal) Act 2018 has three main purposes: (i) to repeal the European Communities Act 1972 as of Exit Day; (ii) to copy into the UK's domestic framework all directly applicable EU law which is in operation on Exit Day; and (iii) to give HM Government the ability to modify and adapt this "retained" law as necessary to resolve any deficiencies. This last stated aim of the Withdrawal Act – which has been referred to as "onshoring/nationalising the *acquis*" by HM Government – would be fulfilled by means of statutory instruments (SIs) published by relevant ministries. This process of incorporating law after constitutional change is an essential plank of any orderly constitutional transition but the "onshoring" programme has nonetheless received some criticism.

The FMLC has reviewed a number of onshoring statutory instruments and drawn attention to some legal and operational uncertainties which will arise in a No Deal context in which it is anticipated that these SIs will be applied. Although the onshoring SIs do a remarkable job of fitting together pieces of the UK's legislative jigsaw, certain aspects remain problematic. For example, each SI amends a piece of legislation which forms but a component of the vast landscape of financial markets regulation. Each SI therefore contains cross-references to definitions, standards and rules from other relevant pieces of directly applicable, domestically implemented (pre-Brexit) or retained (post-Brexit) EU law. A degree of uncertainty is introduced by each SI because it makes reference to other EU legislation as it will stand at two points in the future so as to allow market participants to plan for a No Deal exit. The first point at which the onshoring legislation freezes cross-referenced legislation is as the legislation will have "effect on the day on which" the Regulations are made. A second snapshot is taken on Exit Day itself – Sch 8 of the Withdrawal Act provides that references to EU legislation are to that legislation as it has effect immediately before and on exit day. While there is an undisputed practical need to have a snapshot of EU law as of the date on which the SIs are made, this does give rise to issues of coherence and interpretation.

Given that the onshoring SIs are aimed at implementing HM Government's policy in the event that the UK and the EU are unable to agree upon Withdrawal Agreement, it is perhaps unsurprising that they propose amendments which will have the impact of unilaterally removing the UK from certain benefits which are the subject of mutual obligations between EU member states and, in particular, withdrawing from regional and international collaboration arrangements agreed in the aftermath of the financial crisis. This is, for example, demonstrated most clearly by the position adopted by the SI responsible for onshoring the EU's bank recovery and resolution framework. That SI removes the UK from certain mutual obligations (eg of recognition, notification and consultation) between EU member states and, in particular, withdraws from regional and international collaboration arrangements agreed in the aftermath of the financial crisis. Whilst the prospects for co-ordination in resolution action depend on future political choices and developments, there is likely to be significant operational impact from the loss of the rules on co-ordination given that market participants now rely on the harmonised EU resolution framework and the duties of co-ordination and mutual recognition to which it gives rise as part of their credit planning in relation to counterparties.

MARKET ACCESS

The issue of market access has occupied the popular imagination since the Referendum. There are two different concerns in this regard. First, many market participants worry about regulatory permissions and the loss of passporting: if there is no political agreement between the UK and the EU, UK firms seeking access to EU markets will find themselves relying on, in some areas, a series of complicated regulatory Third Country access regimes embedded in individual EU legislative measures, and, in other areas, the basic access provided by the rules agreed at the World Trade Organization (WTO). The second concern is with respect to so-called legacy business and disruption to existing financial instruments. Here, the worry is that aspects of Brexit may trigger contractual terms and doctrines that bring an abrupt and, in some cases, disorderly end to financial contracts across the market.

Expanding on the concerns around market access, the FMLC has analysed the fragmented, complex and uncertain nature of Third Country regimes. The provisions in EU financial markets legislation for third countries exclude important

Feature

Biog box

Joanna Perkins is Chief Executive of the Financial Markets Law Committee and currently holds a tenancy at South Square, Gray's Inn. Email: chiefexecutive@fmlc.org

Venessa Parekh is Research Manager at the Financial Markets Law Committee where she oversees research on diverse financial law topics. Email: research@fmlc.org

business lines, like deposit taking, lending and retail fund offerings, leaving providers to seek establishment and authorisation in the EU. Moreover, when third country provisions are offered, they may be limited in scope, often only enabling the provision of specific services by third country firms in the EU.

Contingency measures have been put into place by the European Commission to safeguard financial stability in the EU in the event of a No Deal Brexit, including conditional and temporary equivalence decisions (made in December 2018) to ensure that there will be no disruption in services provided by UK central securities depositories and UK central counterparties. On the other hand, the EU is conducting a review of its approach to equivalence determinations. In its Communication of 29 July 2019, the European Commission emphasised the need for adequate monitoring of equivalence decisions by the Commission and the European Supervisory Authorities to ensure that they continue to fulfil the EU's objectives and preserve financial stability, investor protection and the level playing field in the EU. In this context, in an Annex to that Communication, the European Commission announced that equivalence decisions for credit ratings agencies in Australia, Brazil, Singapore and Argentina had been withdrawn as those jurisdictions had not matched the new tougher rules for the regulation of such agencies in the EU. This means that it is likely that the UK will have to maintain regulatory alignment with the EU if it wishes UK market participants to rely on equivalence for market access. A further complication is introduced through the revised equivalence framework set out in the Proposal (2017/0090 COD) for a Regulation amending Regulation (EU 648/2012) (EMIR 2.2) which would require a new equivalence assessment to be made, leading to the risk of a gap between the current temporary equivalence and the application of the new regime.

Market access for financial services granted within the framework of the WTO rules has always been, and remains, insufficient. The WTO General Agreement on Trade in Services (GATS) requires WTO members to set out the maximum commitments they will accept for granting market access in the absence of a free trade agreement. The GATS does not offer a satisfactory substitute for the high level of integration currently available in the EU single market.

WTO rules are equally unhelpful in the negotiation of new free-trade agreements between the UK and non-EU countries with respect to financial services. The UK, as an EU member state, is currently party to free-trade agreements (FTA) with a number of Third Countries, including Canada, South Korea, Colombia and Peru. These FTA only touch briefly on financial services and follow closely the minimum permissions set out in the GATS. Upon Brexit the UK will cease to be party to such FTA. In order to trade with any of the countries listed above on a preferential basis, the UK will have to negotiate new trade agreements or, for a transitional period and with all parties' consent, adopt the existing free-trade agreements. A similar situation arises in respect of agreements reached by regulators outside of an FTA-framework: UK clearing counterparties may not automatically qualify for the substituted compliance concessions awarded to EU counterparties by the US Commodity Futures Trading Commission. This may leave the UK in the unenviable position of becoming a "Fourth Country".

LEGACY CONTRACTS AND CONTRACTUAL CONTINUITY

As mentioned above, market participants have raised concerns about existing financial contracts and whether their performance would be rendered illegal, impractical or impossible in some way in the event of a No Deal Brexit. The concern with regards to such legacy contracts, which upon Brexit remain wholly or partly unperformed, is that they might require – or the parties to them might expect to be serviced through – further agreements and the provision of further activities. If UK firms lose their "passporting" rights into the EU, equivalence regimes or FTA do not, as demonstrated above, individually and in sum, provide as comprehensive market access as EU membership currently does. In those circumstances, parties to legacy contracts might find themselves unable to fulfil certain requirements to provide further activities or services.

It is sometimes said that the performance of an obligation which one has no regulatory permission to perform in a foreign jurisdiction is either impractical or illegal and, in those circumstances, the parties must revise or terminate the contract. The European Commission observed in a Communication published in July last year that there does not currently appear to be a general concern related to contractual continuity as, in principle, the performance of existing obligations can continue. It advised, however, that each type of contract should be assessed separately. Certain EU member states have adopted national legislation to allow the performance of existing contracts over a fixed period of time immediately after Exit Day.

The degree of difficulty which might arise with regards to legacy contracts is therefore uncertain. There remain some contracts, such as certain insurance contracts, which require regular servicing and, in circumstances where regulatory permission is unavailable, these may possibly trigger legal and operational difficulties.

CONCLUSION

In summary, a No Deal Brexit on 31 October is likely to give rise to a number of significant legal and regulatory uncertainties for financial services in the UK. The impact of these is difficult to assess prospectively but the advantage of the delay which a measure of political stasis has brought about is that financial services firms and regulators have had over three years for detailed contingency planning. It is hoped that these will ensure a fair-to-good degree of stability and continuity over and beyond Exit Day. ■

1 This article is based on several FMLC research papers which are available at http://fmlc.org/fmlcworkonbrexit/

Further Reading:

- The tide goes out: the structure of UK financial services legislation post-Brexit: Part 3 (2019) 4 JIBFL 219.
- Licensing issues post-Brexit: what future for cross-border business? (2017) 2 JIBFL 66.
- LexisPSL: Banking & Finance: Practice note: Brexit – impact on financial transactions.