

# Brexit uncertainty

Getting ready for 2021

September 2020



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# Introduction

The UK is over half-way through the status-quo transition period that began when it left the European Union (EU) on 31 January 2020, with only months to go before it leaves the structures of the single market on 31 December 2020.

The end of June was an important milestone in the transition period. Under the Withdrawal Agreement, it was the last chance for both sides to agree an extension. Under the Political Declaration, it was also the date targeted for equivalence assessments in financial services to be undertaken and future fishing quotas to be agreed for the new relationship.

With no extension requested, the UK will be outside the EU single market on 1 January 2021. The negotiations are believed to be stalled on four big issues: fair competition in trade, governance, fisheries and security.

While both sides are now in intensive in person negotiations, it is difficult to see there being time for a deal to be struck before October. There are even hints from the UK Government that it might walk away from the talks if no progress is made in order to dedicate resources to preparing for life outside the single market.

For the financial services industry, there is at least some certainty. Passporting will end on 31 December, to be replaced with third-country rules, or at best, equivalence. Free movement of people and guaranteed data transfers will end. What is unclear is whether there will be any UK/EU agreements providing access over and above those prescribed by the WTO and the EU's standard third-country treatments.

Regardless, 1 January will mean significant changes. Structure and strategy, access to customers and customer migration, data, mobility, access to market infrastructure, governance, and relationships with supervisors will be some of the big issues firms need to grapple with.

This short board paper looks at the possibility and importance of equivalence determinations, and the big questions boards should be considering regardless of whether they are granted. As ever, we are grateful to all those who have taken the time to contribute to our thinking.



# Preparing for the end of the transition period

With passporting ending on 31 December 2020, regulators in the UK and EU have stressed the importance of all firms being adequately prepared for the end of the transition period and all possible contingencies.

In the UK, the Financial Conduct Authority (FCA) has called on all firms to consider how the end of the transition period may impact their business and their customers. It expects "firms to continue to consider the implications of a range of scenarios, including the possibility that the UK and the EU do not conclude a free trade agreement or make any equivalence determinations before the end of the transition period".



In the EU, the European Banking Authority (EBA) has called on all banks "to finalise the full execution of their contingency plans in accordance with the conditions agreed with the relevant competent authorities and ensure adequate communication to concerned EU customers<sup>1</sup>". Where UK banks are establishing operations in the European Economic Area (EEA), the European Central Bank (ECB) expects them to "reach their end-state target operating models" soon. The ECB warns that "banks that have failed to hire staff with sufficient seniority and skills, neglected to make necessary transfers of material assets, or unduly split trading desks across multiple legal entities, will not be considered as complying with the ECB's requirements. Not addressing this qualitative dimension means operating as (half-) empty shells – something that the ECB will not accept. The ECB's expectation is very clear: all activities related to European products or European customers should, as a general principle, be managed and controlled from entities located in the EU".

The European Securities and Markets Authority (ESMA) has also urged financial market participants to finalise preparations and implement suitable contingency plans before the end of the transition period. By 1 January 2021, it expects financial market participants whose activity might be impacted to have fully implemented their preparatory measures to mitigate any risks stemming from the end of the transition period and also have provided appropriate information to their clients on any resulting consequences.

## Is equivalence a panacea?

The message from both EU and UK regulators remains firmly that equivalence determinations cannot be counted upon on 1 January. The one exception is a temporary equivalence determination that the EU will make over UK central clearing counterparties in order to maintain short-term financial stability<sup>1</sup>. The ECB has also warned banks that "while equivalence can offer limited additional possibilities to banks in the short-term, it does not constitute a sustainable basis for

<sup>1</sup> [https://eba.europa.eu/eba-calls-financial-institutions-finalise-preparations-end-transitional-arrangements-between-eu-and?utm\\_source=POLITICO.EU&utm\\_campaign=bfa99b57df-EMAIL\\_CAMPAIGN\\_2020\\_07\\_29\\_01\\_08&utm\\_medium=email&utm\\_term=0\\_10959edeb5-bfa99b57df-190042265](https://eba.europa.eu/eba-calls-financial-institutions-finalise-preparations-end-transitional-arrangements-between-eu-and?utm_source=POLITICO.EU&utm_campaign=bfa99b57df-EMAIL_CAMPAIGN_2020_07_29_01_08&utm_medium=email&utm_term=0_10959edeb5-bfa99b57df-190042265)

their business models" (for example, because decisions can be withdrawn unilaterally). However, in addition to third-country access regimes, equivalence provisions will also be important for prudential regulatory purposes – for example, for the calculation of risk weightings applied to EEA banks' exposures to UK firms from 1 January 2021 – and to remove areas of regulatory duplication – for example, the overlapping UK and EU share and derivatives trading obligations.

Michel Barnier has stressed that equivalence determinations, even if granted, do not cover all areas of financial services, saying, "in some areas – such as insurance, commercial bank lending or deposit-taking – EU law does not provide for the possibility to award equivalences that would grant market access to third-country firms. In these areas, if British firms want to provide services in the EU, they must ask for an authorisation in the EU. Or comply with all the relevant national regimes of those EU Member States where they want to continue to be active". The EU has also expressed concerns over the UK's stated intention to diverge from some areas of EU regulation after the end of the transition period and while the UK Chancellor's Statement of 23 June <sup>2</sup> was designed to provide clarity on the UK's future approach to EU regulation, it does illustrate a future in which the EU and UK will not be fully aligned on financial services regulation (for example, if the UK's review of certain aspects of Solvency II results in changes).

Furthermore, the commission's "readiness" communication of 9 July 2020 explained that the commission will not adopt an equivalence decision in the short or medium-term, in a number of areas where for instance, the EU legal framework is not yet fully in place. These areas, detailed in footnote 21, include Article 47(1) of the Markets in Financial Instruments Regulation and third-country firms providing investment services to EU professional clients and eligible counterparties.

As the FCA has highlighted, there are also a number of Brexit-related risks facing firms that require multilateral action,

i.e., agreement at a member state, as opposed to a commission level, rather than reciprocal action (e.g., the equivalence determinations). These include contract continuity issues and the ability of UK firms to continue to services contracts with EU consumers, which will depend on the regulatory regimes of individual EEA member states and, as we discuss later, whether extant temporary transition regimes are available.

The European Court of Justice (ECJ), in a judgement<sup>3</sup> dated 16 July 2020, has invalidated the Commission's EU-US Data Protection Shield Decision. The ECJ took the view that "the limitations on the protection of personal data arising from the domestic law of the United States on the access and use by US public authorities of such data transferred from the European Union...are not circumscribed in a way that satisfies requirements that are essentially equivalent to those required under EU law, by the principle of proportionality, in so far as the surveillance programmes based on those provisions are not limited to what is strictly necessary". However, the Commission's Decision on standard contractual clauses for the transfer of personal data to processors established in third-countries remains valid.

As the UK Information Commissioner's Office flagged in a statement on the judgement<sup>4</sup>, the ECJ has "confirmed how EU standards of data protection must travel with the data when it goes overseas, which means this judgment has wider implications than just the invalidation of the EU-US Privacy Shield". Although the EU has committed, most recently in its readiness communication, to "use its best endeavours" to conclude an assessment of the UK data protection regime by the end of 2020 with a view to possibly adopting an adequacy decision if the UK meets the applicable conditions, the ECJ judgement will have implications for data transferred to the UK from the end of the transition period. The EU For UK firms, though, the UK Data Protection Act has conferred adequacy on EU Member States until the end of 2024.

<sup>2</sup> <https://www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Commons/2020-06-23/HCWS309/>

<sup>3</sup> <https://curia.europa.eu/jcms/upload/docs/application/pdf/2020-07/cp200091en.pdf>

<sup>4</sup> <https://ico.org.uk/about-the-ico/news-and-events/news-and-blogs/2020/07/updated-ico-statement-on-the-judgment-of-the-european-court-of-justice-in-the-schrems-ii-case/>

## Might a Free Trade Agreement help?

In late May, the UK released its draft legal text for an EU – UK Free Trade Agreement (FTA), based on a “standard” trade deal, as opposed to a Norwegian or even Swiss style model closely linked to the single market. In Financial Services, the UK confirms its expectation that equivalence will be the basis for any future relationship in chapter 17, albeit with some new mechanisms proposed for regulatory cooperation on how the two sides might consult on the process of adoption, suspension and withdrawal of equivalence decisions to reduce the possibility of determinations being revoked at short notice.

Michel Barnier's response to this suggestion has been robust: “The UK is seeking to create a legally enforceable regulatory cooperation framework on financial services in our agreement. It is attempting to frame the EU's process for withdrawing equivalence decisions; trying to turn our unilateral decisions into co-managed ones. It wants to limit the scope of the so-called prudential carve-out. There is no way Member States or the European Parliament would accept this!”

There is still a long way to go in the negotiations but, if agreed, an FTA may only include limited provisions on financial services.

The FCA has confirmed that it will use its Temporary Transitional Power (TTP) to waive or modify new rules so that up to 31 March 2022 “firms will generally not need to prepare now to meet the changes to their UK regulatory obligations resulting from onshoring ... although it is important firms realise that there are necessarily some exceptions”.

## Are EU firms better placed?

For incoming EEA firms though, there is more certainty as in addition to the UK regulators' TTP power discussed above, Temporary Permission Regime (TPR) for incoming EEA firms and funds is still available for use:

The Temporary Permission Regime (TPR) – For incoming EEA firms and funds, the Government has legislated so that the UK

TPR will now take effect at the end of the transition period. The FCA will be re-opening their notification window on 30 September 2020 to allow firms and fund managers to submit notifications to the FCA, if they did not do so previously, and to enable fund managers to update previous notifications where necessary. There has been no confirmation that the Prudential Regulation Authority (PRA) will open their notification window although their TPR will still now take effect from the end of the transition period.

## Will regulatory co-operation provide some mitigation?

Given the challenges of agreeing financial services provisions in a free trade agreement and, as discussed above, the EU making equivalence decisions, the foundations for UK/EU financial services from 1 January 2021 may well rest on cooperation and coordination between regulatory authorities. In preparation for the UK leaving the EU and the possibility of a “no deal”, Memoranda of Understanding (MoUs) were agreed between the PRA and FCA and the European Supervisory Authorities (ESA) and in July 2020, the FCA, ESMA, and EU national securities regulators have confirmed that their MoUs remain relevant and appropriate to ensure continued good cooperation and exchange of information and come into effect at the end of the transition period. The UK regulators are also continuing to engage with counterparts on a practical level, particularly through the COVID-19 pandemic. Interestingly, Michel Barnier has indicated that in the EU's view is future cooperation on financial services should be voluntary and based on trust and the EU “would like to set up a voluntary framework for dialogue among regulators and supervisors that would allow for intensive exchanges on regulatory and prudential issues”.

These arrangements will be vital in some areas, for example fund manager outsourcing and delegation to UK entities.



## Will temporary transition regimes be available from 1 January 2021?

For UK firms, while many EU Member States had temporary regimes ready for a "no deal" exit during the Article 50 period, these can no longer all be relied on. The FCA warns "some of these laws have now lapsed and there is no guarantee that new laws will be issued. So, if you intend to continue servicing customers in the EEA from 1 January 2021, you will need to have adapted your business according to the local laws and local regulators' expectations by that date, speaking to local regulators as appropriate, and obtaining permissions and repapering contracts where necessary, whilst treating customers fairly throughout ...".

In the UK, the Government has retained TTP designed for a "no deal" Brexit. Both the PRA and FCA are able to grant flexibility where regulatory requirements would change as a result of Brexit and the on-shoring of EU rules.

The FCA has confirmed that it will use its TTP to waive or modify new rules so that up to 31 March 2022 "firms will generally not need to prepare now to meet the changes to their UK regulatory obligations resulting from onshoring ... although it is important firms realise that there are necessarily some exceptions".

The PRA and Bank of England have put out a similar statement.

For incoming EEA firms though, there is also more certainty as in addition to the UK regulators' TTP, the Temporary Permission Regime (TPR) for incoming EEA firms and funds will still be available to use. The TPR will now take effect at the end of the transition period.

The FCA will be re-opening their notification window on 30 September 2020 to allow firms and fund managers to submit notifications to the FCA, if they did not do so previously, and to enable fund managers to update previous notifications where necessary. There has been no confirmation that the PRA will reopen their notification window although their TPR will still now take effect from the end of the transition period.

## What should firms be doing?

The availability of third-country regimes to access EEA markets and the resolution of the risks discussed above remain outside of firms' control but should be monitored closely over the rest of the year.

However, regulators in the UK and EU regulators have flagged a number of areas where action needs to be taken and their expectations are that all firms should be considering these areas, ensuring they fully understand the impacts on their firm and taking appropriate action. While there has been an understandable focus on the implications for firms currently providing financial services on a cross-border basis, purely domestic firms will also need to check whether they are impacted by the changes, for example, implications for any outsourcing arrangements. The EBA has also warned that "there is no room for complacency even for banks that have already obtained all necessary authorizations and permissions".

Specific issues that regulators expect firms to be addressing include:

Issues	Expectations include
Finalising preparations and effective establishment in the EU	<p>The EBA has warned UK-based banks to ensure they have appropriate authorisations from the EU competent authorities in place, including for their existing branches already operating in the EU, and fully establish those operations.</p> <p>This includes, in particular, ensuring that associated management capacity, including appropriate technical risk management capabilities, is effectively in place ahead of time, and is commensurate to the magnitude, scope and complexity of their activities, to allow for effective and efficient management of risks they generate.</p> <p>Amongst other things, UK banks establishing operations in the EU should:</p> <ul style="list-style-type: none"><li>▶ not outsource activities to such an extent that they operate as 'empty shell' companies.</li><li>▶ increase their EU footprint, including their local resources, proportionally to the amount of business carried out in and from the EU.</li><li>▶ have clearly articulated and appropriate booking arrangements</li><li>▶ pay attention to a number of areas where further action stills needs to be taken: in particular these include "changing and moving contracts and clients, systemic exposures to UK-based financial market infrastructures and access to funding markets, including possible related capital impacts.</li><li>▶ assess and take necessary actions to address any impacts on rights and obligations of their existing contracts, in particular derivative contracts.</li><li>▶ comply with all applicable EU legislation, paying particular attention to prudential, consumer protection and Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) requirements.</li></ul>

Issues	Expectations include
Providing continuity for customer	<p>Firms that provide financial services, on a business cross-border, to UK or EEA customers should have plans in place to address any risk from the end of passporting and maintain continuity for customers.</p> <p>The FCA is “clear that firms’ decisions need to be guided by what is the right outcome for your customers. You must treat customers fairly, irrespective of where they are based. In many cases, it would be a poor outcome for customers if you simply stop servicing them suddenly”.</p> <p>Firms should, therefore, consider how the end of the transition period and the loss of single market passporting rights could affect them and their customers, and determine what action could be taken to continue to service UK and EEA customers from 1 January 2021.</p> <p>UK firms also need to monitor and understand whether temporary transition regimes will be available in the EEA Member States in which their branches or customers are based and the expectations of the competent authorities.</p>
Changes to legislative and regulatory requirements	<p>All firms will need to understand the changes to legislation and regulatory requirements that impact them in the UK and each EEA Member State in which they operate.</p> <p>All firms in the UK will need to consider how they are impacted by the changes resulting from the onshoring of EU regulation, how the regulators will use their TTP to waive or modify new rules and, importantly, where there are exceptions and new rules will apply from 1 January 2021.</p>
Outsourcing	<p>All firms should assess how their outsourced services providers, or other key third-party relationships, could be impacted by the end of the transition period (for example, could there be any disruptions to services provided) and consider any operational risk or consumer harm arising as a result and how it could be mitigated. The FCA also warns firms to consider the demand for change management requests if more than one client of the service provider.</p> <p>UK firms establishing operations in the EU should also ensure that they have not outsourced activities to such an extent that they could be regarded as operating ‘empty shell’ companies and their local resources are proportional to the amount of business carried out in and from the EU.</p>
Use of credit ratings	<p>UK firms should, amongst other things, ensure they are operationally ready to use credit ratings issued or endorsed by FCA-registered credit rating agencies.</p>
Preparedness of payment and electronic money institutions	<p>The EBA has warned UK-authorised payment and electronic money institutions wishing to continue to offer services to EU-based customers that it is illegal for them to provide payment or electronic money services in the EU after 31 December 2020, unless they have been adequately authorised beforehand by an EU competent authority.</p> <p>UK-based payment and electronic money institutions should ensure they have submitted application documents that are compliant with the EBA Guidelines on authorisation and registration under the revised Payment Services Directive (PSD2) in time to be granted authorisation prior to 1 January 2021.</p> <p>Note that account information service providers and payment initiation service providers registered/authorised in the UK will no longer be entitled to access customers’ payment accounts held at the EU payment service providers.</p>

Issues	Expectations include
Data sharing	All firms should, amongst other things, identify the risks and possible mitigations if the EU does not confirm the adequacy of the UK to allow the transfer of personal data between the EEA and the UK after 31 December 2020.
Communication with customers	<p>FCA expects firms to contact, in good time, each group of customers impacted by the end of the transition period, to explain clearly how they are or will be affected.</p> <p>The EBA has called on all banks affected by the UK withdrawal from the EU, and in particular, those providing financial services to the EU-based customers on a cross-border basis “to adequately inform their EU customers on any relevant actions undertaken as part of their contingency planning affecting the availability and continuity of such services, or whether institutions plan to cease offering services to the EU-based customers after the end of the transition period”. ESMA also expects financial market participants to provide appropriate information to their clients on any resulting consequences.</p> <p>If a firm is ceasing to provide services, they should inform their customers in due time before the cessation about the effect of cessation on the provision of services and the way to exercise their rights, in order to avoid any detrimental effects for clients. The EBA also expects banks to “ensure adequate support and communication channels for the EU-based customers requesting information or assistance”.</p>
Wider communication	Firms should consider what information is made available more widely, such as on websites.
Revisiting outstanding issues	For example, the Share Trading Obligation (STO), Derivatives Trading Obligation (DTO), clearing, uncleared derivatives, data exchange, progress on contract repapering and retail financial services.

# Managing Talent

Irrespective of the nature of any FTA agreed between the UK and EU, business will face people challenges, with 17% EU talent in the London Financial Services workforce, rising to 28% in FinTech. These challenges are exacerbated by the exponential rise in remote working brought on by the Covid-19 pandemic. This increased demand for cross-border remote work adds an extra layer of complexity to talent challenges. A flexibility around cross-border work models may impact attracting and retaining talent. Cross-border remote work should be Brexit proofed, and remote workers and business stakeholders made aware of the vastly different immigration landscape from 1/1/21. Businesses with EU/EEA nationals located in the UK, UK nationals located in the EU/EEA, and those with significant UK/EU/EEA cross-border travel must proactively engage with HR and business leaders to address key areas of concern:

- **Retaining talent:** EU/ EEA citizens resident in the UK before 31 December 2020 have the right to settlement but need to apply to EU Settlement Scheme before 30 June 2021. UK nationals resident in the EU should ensure they have complied with any registration requirements.
- **Attracting talent:** The UK is introducing a points-based immigration system for all nationals entering the UK from January 2021. There will be many improvements on the current model, but very significant cost implications as EU arrivals from 1/1/21 will require sponsored visas in most cases (taking the immigration cost from £0 to £9,500 for a 5 year work visa).
- **Travelling and working in Europe:** Unless a UK/EU trading relationship establishes a favourable mobility framework, there will be restrictions on the employment and movement of EU citizens in the UK, and vice-versa. Businesses should prepare and educate their travellers to avoid risk and to ensure operational resiliency. Only business visitor activities will be permitted for those who do not hold a right to work in their location, impacting travellers and those requesting cross border remote working arrangements.
- **Social security:** If the UK is unable to agree new coordination rules on social security contributions with the EU, it is possible some Member States will agree on new rules with the UK while others will not. This could lead to increased cost and add complexity to compliance.

# 1 January 2021: Preparatory checklist

a

**Business  
viability**

- I. Have you assessed the potential impacts of market volatility and economic uncertainty to business sectors, your clients, financial products and services and thus your business model and strategies?
- II. Given the political uncertainty, do you have appropriate liquidity plans in place, in all relevant currencies, and have you built appropriate stress scenarios into your Internal Capital Adequacy Assessment Process and Internal Liquidity Adequacy Assessment Process?

b

**Conduct**

- I. Have you ensured continuity of client services in the event of a no trade deal, including speed and level of access to their investments?
- II. In the event of a cliff-edge how will you ensure that all clients are treated equally and fairly?
- III. Have your Sales force been adequately trained as to licencing restrictions across the Continent post a no trade deal?
- IV. Have you ensured that your controls around Reverse Solicitation and Mis-bookings are adequate?
- V. Have you met all KYC obligations if your European entity is based in a location with differing standards to the UK?
- VI. Will clients be provided the same level of client asset protection that they previously had?
- VII. What controls have been put in place to counteract the increased risk of financial crime and market abuse during the transfer of business to the new entity?

c

**Legal  
contract  
continuity**

- I. Do you have assurance that all service provider (outsource and intra-group) contracts are robust enough for a no trade deal scenario?
- II. Are all your contracts valid and enforceable in the event of a no trade deal scenario?
- III. Do you have the processes in place to transfer customer and service provider contracts to your new branch or subsidiary?
- IV. Will your service providers be appropriately licensed to continue providing regulated services to/for you in the UK?

d

**Data  
Adequacy**

- I. Have you identified contracts that require model clauses, and lined up business pre-approval?
- II. Have you assessed the impact of revised data architecture and processing on EU data subjects?

**e**  
**People**

- I. Are you aware of the restrictions that will apply to your short-term business travellers to, and those working remotely in, each relevant country in the EU from the UK, and how these interact with fast changing COVID-19 pandemic travel restrictions?
  - II. Are your systems, policies and processes robust enough to identify and manage a commuter or remote worker population to ensure tax, social security, regulatory, compliance and health and safety risks are adequately managed/mitigated?
  - III. Are you confident your workforce planning strategy provides current/future regional staff the support and skills required to successfully execute on a regional office build out and have the knowledge to operate under a new regulatory environment?
- 

**f**  
**Financial  
Market  
Infrastructure**

- I. Have you secured all the relevant FMI and central counterparties (CCP) memberships in the UK and EU27, considering the cross-jurisdiction market access issues?
  - II. Have you tested your front-to-back connectivity to the relevant FMIs, CCPs, and central securities depositories (CSDs)?
- 

**g**  
**Operational  
resilience**

- I. Have you established and documented a global strategy framework around operational resilience including identifying and mapping global business services and dependencies?
  - II. Are you confident that your crisis and continuity plans are adequate to cater for potential no-deal disruption, and have you tested them with senior leader participation simulating across scenarios to determine impact tolerances?
  - III. Do you have assurance that all service provider (outsource and intra-group) contracts are robust enough for a no trade deal scenario?
- 

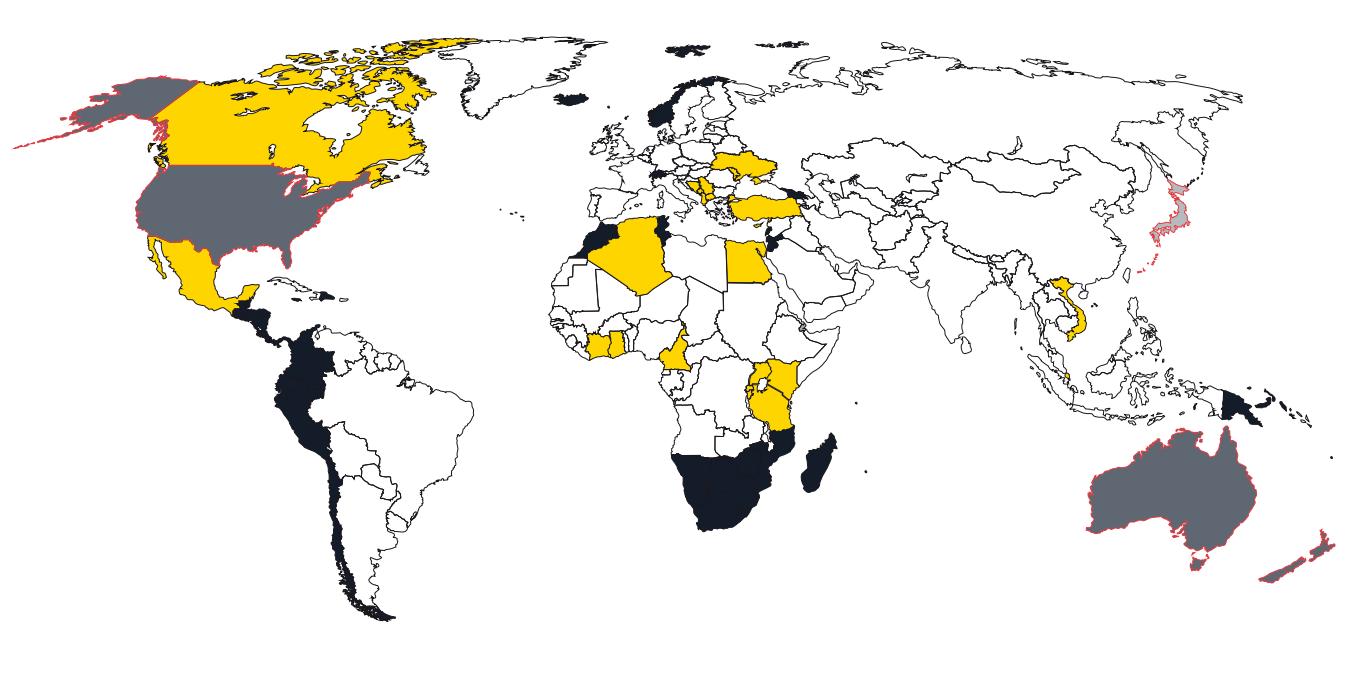
**h**  
**Tax**

- I. Have you assessed your potential UK exit tax exposure by reference to tax, transfer pricing and valuation principles?
- II. Have you got documentation in place to mitigate risk?
- III. Have you socialised identified issues with tax authorities?
- IV. Have you considered whether your post-Brexit operating model is efficient from a tax, transfer pricing and VAT perspective?

# Appendix: UK negotiations with countries outside of the EU

Firms will also be looking at the UK's wider international agreements, which could have a bearing on those it conducts with the EU.

## International negotiations



- — Signed trade agreements ready for 1 January 2021\*
- — Trade agreements still being negotiated
- — MRA signed (an effective replication of previous EU arrangements) and full FTA is in discussion
- — Discussions underway to replicate EU arrangements (MRA)
- UK Government strategic targets for trade deals

\*Including an industrial product conformity agreement signed with Israel

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