Brexit: potential impact on the UK's banking industry

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Foreword

The debate around Brexit is multi-faceted. We should not, for a moment, pretend that it is dominated by the impact on the UK's banking industry. However, a "Leave" vote on 23 June will undoubtedly have a significant impact.

In this document, we take a close look at the impact of Brexit in a technical sense. Although the outcome of Brexit is not clear, it is clear that only countries that pay into the EU budget, and permit free movement of people from within the EU, currently benefit to any degree from flexible entry into the EU's financial services single market. Brexit would therefore challenge London's role as the venue of choice for global firms to conduct their European business. Whether it survives such a challenge depends in part upon the deal that the UK manages to negotiate on exit, and in part upon London's legendary ability to reinvent itself where necessary.

No matter where you stand on the Brexit debate, the devil is in the detail – and this document attempts to make that detail comprehensible. One thing is for sure – if there is a Brexit, the UK's banking industry will never be the same.

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Headlines

- To discuss Brexit at this stage is to balance a position which is broadly known – the EU as it is currently and post the implementation of the agreed reform package – against a post-Brexit future which is largely unknown, depending as it does on multiple variables.

- The potential downsides of Brexit can be assessed to some degree by considering the impact it might have on the legal environment in which the UK banking industry currently operates. The potential upsides are harder to assess, and arguably are more speculative.

- As a starting point, much cross-border banking business within the EU is made possible by EU-level legislation, including, for example, investment services, deposit taking and payment services.

- Much of the relevant EU legislation incorporates an equivalence process intended to permit access to the EU by "third country" (i.e. non-EU) institutions. This document looks at some of the key pieces of legislation in that context.

- It is at best uncertain whether the necessary equivalence decisions will have been issued in respect of the UK pre-Brexit. The likelihood of this will depend on the processes involved and the motivations of key protagonists at a macro level and in relation to particular pieces of legislation.

- A primary risk for institutions which access EU markets from the UK is therefore the post-Brexit loss of that access on a short or longer term basis because no equivalence decision has been issued in time. Whether this risk is material depends on the business mix of the institution in question and its current structure. A key challenge in mitigating this risk is that implementation of a solution may be a lengthy process, and the final landscape will only become clear at a relatively late stage in the Brexit process.

- Brexit could, absent agreements as to equivalence, also affect elements of financial services infrastructure, such as access to clearing houses or payment services, or the provision of custody services to certain clients.

- Brexit would have impacts on transaction documentation, although these are likely to be controllable. More generally, Brexit will affect the legal environment in which banks deal with each other, their clients and their counterparties, for example in terms of the recognition of judgments and complex cross-border insolvency matters.

- Other issues are harder to assess at this stage, for example the effect of Brexit on a highly-skilled and multinational workforce and – longer term – any effect on London's esteemed status as a financial and legal centre.

- Boards, senior management and regulators are asking and will be asking institutions to assess their risks and to demonstrate adequate planning. This document aims to help you examine your institution's position in this regard and identify the priority areas for consideration and, if necessary, action.

Withdrawal from the EU – practicalities

- A UK withdrawal from the EU would need to follow the process set out in Article 50 of the Treaty on European Union and would take effect on the earlier of:

    - entry into force of a withdrawal agreement establishing the framework of the UK's future relationship with the EU; and

    - two years after notification of withdrawal to the European Council by the UK Government (absent unanimous agreement to extend).

- The European Communities Act 1972, the English statute which brought the UK into the EU as a matter of domestic law, would need to be repealed. This would result in the effective repeal in the UK of all directly and indirectly applicable EU legislation.

- "Saving legislation" would likely be enacted by the UK in many areas (including financial services) to maintain the status quo and avoid legal voids, at least initially.

- Much EU-derived legislation would need to be retained or replicated to allow key industries, including the banking industry, to continue to function in a meaningful way. A conservative timeframe estimate for this process would be ten years.

- Any upside of a reduction in regulation would be countered by the downside of inevitable restriction of access to the EU's single market.

- Unless it retained membership of the EEA (which seems unlikely), the UK would become a "third party" for the purposes of much EU legislation. This would mean that, in order to continue to do business with EU entities, the UK would need to maintain a regulatory environment at least "equivalent" to that of the EU despite not benefitting from the advantages of being a member. Obtaining an equivalence decision could be time-consuming and may become political. In certain cases (e.g. UCITS), there is no equivalence regime and in others (e.g. MiFID II) the regime is uncertain, or has never been used.

- Banks currently relying on the EU "passporting" regime will probably need to set up a separately authorised subsidiary in Europe, and transfer some staff there, in order to continue to do business with EU customers.

Ongoing relationship with the EU – potential models

There are five broad models for the UK's ongoing relationship with the EU. The impact of Brexit on business will depend on the model chosen. The UK Government has given no indication of which model it might aim for should Brexit occur.

Brexit would not only affect the UK's ongoing relationship with the EU but also a number of relationships with third countries which have been negotiated between the relevant third country and the EU as a whole. These agreements may need to be renegotiated on a bilateral basis.

Free trade agreement

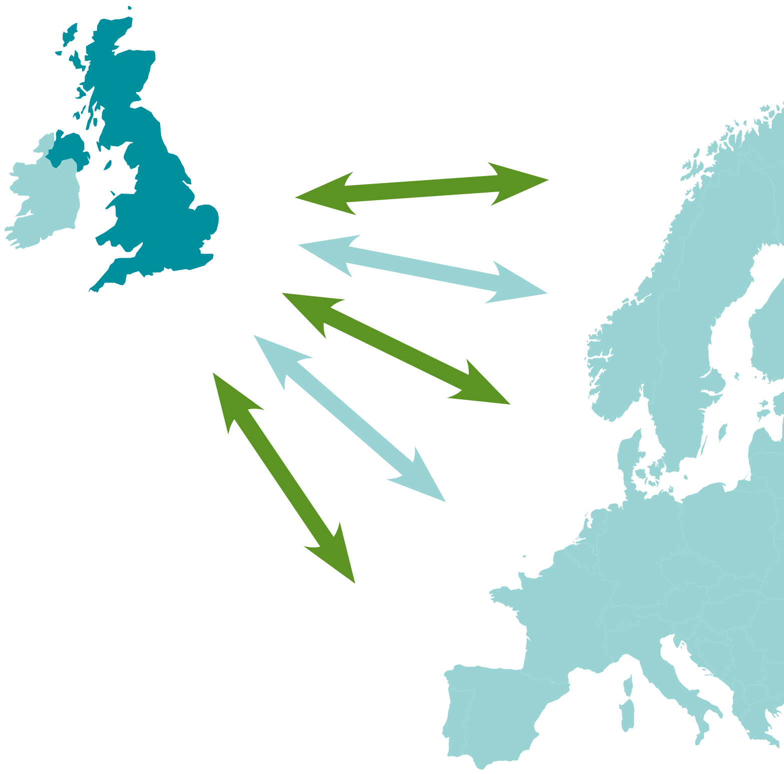
Negotiation of a comprehensive bilateral free trade agreement (FTA) with the EU would allow reasonable access to the internal market in some areas but would not afford the UK any influence over EU regulation of those areas.

World Trade Organization approach

Adoption of the "most-favoured nation" model used by the WTO would require the EU to grant the UK trade advantages at least equal to those granted to the nation to which it gives the "best" treatment. The UK would not be required to contribute to the EU budget but neither would it have automatic access to the internal market of the EU. All UK exports to the EU would need to comply with applicable regulations but the UK would have no influence over the development or application of these.

Customs union

Creation of a free trade area (for goods but not services) and establishment of a common external tariff. The UK would not need to contribute to the EU budget but it would be required to comply with EU regulation on product standards while having no influence over its development.



EFTA membership

This would require negotiation of a set of bilateral accords governing UK access to the EU in certain sectors and would potentially involve negotiating and adopting a huge number of individual accords. FTAs would also need to be agreed in relation to other sectors. Switzerland has a similar relationship with the EU but its ongoing viability is in question.

EEA membership

Continued membership of the European Economic Area would allow unfettered access to the internal market of the EU but would not address many of the UK's political concerns; for example, it would require a large contribution to the EU budget and would not allow the UK to impose restrictions on immigration.

Background

The UK is currently Europe's major international financial centre and leads in most financial services areas. For example, in cross-border bank lending, the UK holds a 17 per cent international market share, compared to 9 per cent for France and 9 per cent for Germany. Hedge fund assets amount to an 18 per cent market share by the UK compared to 1 per cent in France. The UK dominates wholesale financial services and has done so for decades. It also dominates the world's foreign currency trading market, a trend that accelerated initially with the creation of the EU single market and again with the arrival of the euro in 1999. Today, it is by far the biggest centre in the world for trading the euro.

Although the UK is not a member of the Eurozone and therefore has no role within the European Central Bank (ECB), the Bank of England is nevertheless a major influence at both a European and a global level. The UK has for many years played an integral role in setting global standards for prudential supervision and regulation of banks and other financial services firms. Indeed, much European legislation and regulation in this area is essentially implementation of recommendations made by global bodies in which the Bank of England, and other UK representative bodies, have influential roles.

The UK's membership of the EU affords it access to the world's largest single market, comprising approximately 500 million people and with a GDP of an estimated €13 trillion. The terms on which UK-based banks can access other markets around the world are generally set by free trade agreements (FTAs) made by the EU with other countries. There are currently FTAs in place between the EU and around 60 other countries and while the UK is a signatory in its own right to these FTAs, the legal commitments in them regarding trade (including financial services) are exclusively between the EU and the relevant country.

Brexit would force many banks in the UK and elsewhere to undertake a fundamental review of their operations and structures. The outcome would likely depend on a number of factors, some of which are considered below.

- The nature and outcome of the negotiations between the UK and the EU over the UK's withdrawal treaty – will the EU present the UK with a package designed to discourage other Member States from leaving? Will the negotiations be short and sweet or long and bitter? Will they produce a treaty at all or will the UK simply drop out and become yet another "third country", as the EU terms non-Member States?

- Consequent policy decisions of the EU – for example, with the assistance of the Court of Justice of the European Union the UK recently successfully resisted an attempt by the ECB to require infrastructure essential to the integrity of the Eurozone, such as clearing of euro-denominated instruments, to be located in the Eurozone. Would the UK be similarly successful following Brexit?

- The impact of Brexit on the stability of the UK – what sort of government would the UK have after the Referendum? Would Scotland demand a second referendum on independence and what might be the impact on Northern Ireland and its relationship with the Republic of Ireland?

- The nature and outcome of the negotiations between the UK and the approximately 60 non-EU countries with which the EU on behalf of its Member States (including the UK) has FTAs, some of which cover financial services and which would cease to be binding as between the UK and those other countries.

It is important to bear in mind that whatever the nature of the ultimate arrangements the UK puts in place following Brexit, the process of getting there may not be a smooth one. In particular, any period of political and/or economic disturbance or uncertainty, especially if it is at all protracted, may influence a bank's decision-making process.

A bank with its headquarters in the UK would need to consider first of all whether the UK was still the most appropriate jurisdiction in which to maintain its headquarters. HSBC has just announced (in the same month that the UK announced the date of the Referendum) that it has completed such a process and decided to remain in the UK. Others may or may not follow suit. Next, such a bank would need to consider its operations in Europe and the extent to which it would be desirable and/or possible for those operations to be carried on from the UK, or whether such operations would require the establishment or restructuring of group companies in one or more Member States. Finally, it would be necessary to consider operations outside the UK in non-EU countries and whether they would be best conducted from the UK, from within the EU or through group companies established in such non-EU countries.

Post-Brexit, a bank with its headquarters in a Member State would need to consider the continuing importance of the UK market and how desirable and/or possible it was for its UK operations to be carried on from the EU or whether such operations would require the establishment or restructuring of a group company in the UK. An extreme possibility would of course be to close down its UK operations. Finally, a bank with its headquarters in a non-EU country would need to consider the nature of its operations (or proposed operations) in the UK and the EU and whether it was now desirable and/or possible for its UK and EU operations to be carried on from a single group company or whether those operations should be divided among group companies or curtailed. Also, in any such case, the bank would need to consider whether it would be best to locate the relevant operations in a company incorporated in the UK, in a Member State or in a non-EU country.

In this context, the chief executive of JPMorgan, Jamie Dimon, was quoted in the *Financial Times* on 23 February 2016 warning that Brexit would constitute a "massive dislocation" to London's financial hub that would reverse decades of growth for international banks in London and scatter them across Europe and the rest of the world. He predicts that Brexit would result in UK-based banks no longer being able to sell services throughout the EU and that his own bank would scale down its London operations and set up elsewhere. Separately, chief executive of Lloyds Bank, António Horta-Osório, has praised the underlying strength and resilience of the UK economy. Mr. Horta-Osório claims that his bank, which is Britain's biggest lender, would "thrive" outside the EU while emphasising that the decision whether to remain in the EU is a matter for the British people. These approaches may affect the overall positions of the institutions in question and are reflective of the diversity of the bank population.

Access to markets

PASSPORTING OF INVESTMENT BUSINESS UNDER MIFID

Of all EU legislation currently in force, one of the most important from a banking perspective is the Markets in Financial Instruments Directive (MiFID), a major piece of European legislation and one which is absolutely fundamental to the ability of banks and investment firms to conduct investment business across the EU. MiFID regulates the conduct of investment services in Member States, such as the trading of securities and derivatives, the execution of client orders, underwriting, and portfolio management. Crucially, it also gives banks in a Member State the ability to carry on business and sell services throughout Europe without obtaining a licence or similar in each individual country. This concept, known as "passporting", is a central pillar of the EU financial services regime. In contrast, third country banks, such as those based in the US or Hong Kong, cannot make use of the passport system and must establish an authorised presence in the jurisdiction in question. For this reason, many third country banks have chosen to base themselves in London through a UK subsidiary as their primary point of access to EU markets through passporting. A number of these third country banks have already begun exploring whether some of their business streams should be moved to other hubs within the EU post-Brexit. The decision tree on the following page shows how an analysis of the application of MiFID to banks might look after Brexit.

The treatment of UK-based banks post-Brexit would depend on the exit deal agreed between the UK and the EU. If the UK were to leave the EU but not retain membership of the European Economic Area (EEA), as appears likely given the political shortcomings of the EEA model, the UK would become a third country for MiFID purposes. This would mean that UK-based banks and investment firms would lose their current passporting rights. If the UK did retain EEA membership, the passporting regime for banks and investment firms would be preserved, although the UK would no longer have any ability to directly influence future EU legislation despite being subject to it in many areas. There is no common third country regime under MiFID and each Member State has its own rules, so any third country bank wishing to provide services in a particular EU jurisdiction must either (i) itself be established as an authorised entity in that Member State and authorised under MiFID or (ii) establish an authorised subsidiary in a Member State and rely on passporting rights across the EU.

This general passporting position is carried over into the second Markets in Financial Instruments Directive (MiFID II)[1], which is likely to replace MiFID in 2018. There are some significant differences between MiFID and MiFID II with regard to the treatment of third country entities. For example, MiFID II will establish two separate regimes for third countries doing business with EU entities, introducing different provisions for (i) retail clients and (ii) professional clients. In most cases[2], a bank established in a third country (such as the UK post-Brexit, assuming that the UK had not retained EEA membership) will only be able to conduct regulated investment business with a retail client in a Member State if the bank has established a branch in that Member State. In order to establish a branch, the Member State's authorities would need to be satisfied that the third country benefitted from adequate regulation in certain key areas, such as anti-money laundering and the countering of the financing of terrorism. Cooperation and tax arrangements would also need to be in place between the two countries. The UK should meet all these requirements post-Brexit, provided that politics do not hamper or delay the process.

A bank established in a third country seeking to do business with professional clients in a Member State will be able do so under MiFID II without establishing a branch in that Member State as long as it is registered in a register maintained by the European Securities and Markets Authority (ESMA). This is only possible where the third country regulatory regime is considered equivalent and a decision to this effect has been adopted by the European Commission (the Commission), so the effect on the UK would depend on whether its regulatory environment was deemed to be equivalent and whether the Commission could be persuaded to grant an exiting EU member this status[3]. In theory, the UK should easily meet the equivalence requirements,

1 In this document we use the term MiFID II to also refer to the Markets in Financial Instruments Regulation (MiFIR).
2 Where Article 39 of MiFID II is implemented, as is the case in the majority of European countries, except for the UK and Germany.
3 It should also be noted that under both the retail and professional regimes business could still be conducted by UK banks where clients have at their exclusive initiative requested the service.

but the application process can be time-consuming and, depending on how pre-Brexit negotiations had progressed, could be hampered by political factors. In particular, it would be possible for Member States and the Commission to take the political view that there was little advantage in providing an equivalence decision to the UK in financial services. The Commission could, for example, point to divergences in UK rules and legislation (perhaps, for example, the application of the bonus cap in relation to remuneration of employees) and suggest that, on this basis, the UK was not equivalent. Post-Brexit UK banks would certainly need to be able to conduct their business in most if not all Member States so it is extremely likely that the UK would do everything necessary to ensure that an equivalence decision was obtained; meaning very little change to the status quo from a regulatory perspective.

Notwithstanding the above, there are some elements of MiFID II that the UK might choose to remove or dilute post-Brexit (although if the UK was looking for equivalence (as discussed above), there would certainly be no "bonfire of the regulations"). The likely targets might include (assuming non-EEA membership):

- position limits[4]: this was the most controversial element of the MiFID II compromise for the UK. The UK rejected the underlying rationale for the position limit framework but accepted that removal of position limits altogether was not viable. It therefore sought to minimise the harm position limits could do to the liquidity of the UK's commodity market. If regulation of MiFID activities were to be reassessed upon Brexit, position limits would be a likely candidate for removal from the UK rulebook;
- the agreement on equity transparency[5]: the agreement on equity transparency is more restrictive than the UK wanted. It is possible that the infamous double volume cap[6] would be reassessed; and
- liquidity thresholds[7]: liquidity thresholds and waivers for non-equity trading would probably be reassessed as there is a clear concern that the current level two work on this could damage London's non-equity liquidity.

MiFID and MiFID II both regulate the conduct and supervisory oversight of investment activities in relation to financial instruments, such as the trading of equities, fixed income, derivatives and money market instruments. They do not regulate deposit-taking activities (save for regulated activities in relation to structured deposits) or the provision of consumer credit or loans to corporates.

So a plausible outcome of Brexit would be that UK-based firms lose their MiFID passports and therefore cannot deal with EU-based clients (at least in the short term, as it is unlikely the UK would receive a MiFID equivalence assessment in time). To continue to do business, they would need to set up an EU subsidiary and transfer the EU business and staff to that EU location. They would need to start this process shortly after the Referendum, and long before the outcome of the exit negotiations became clear.

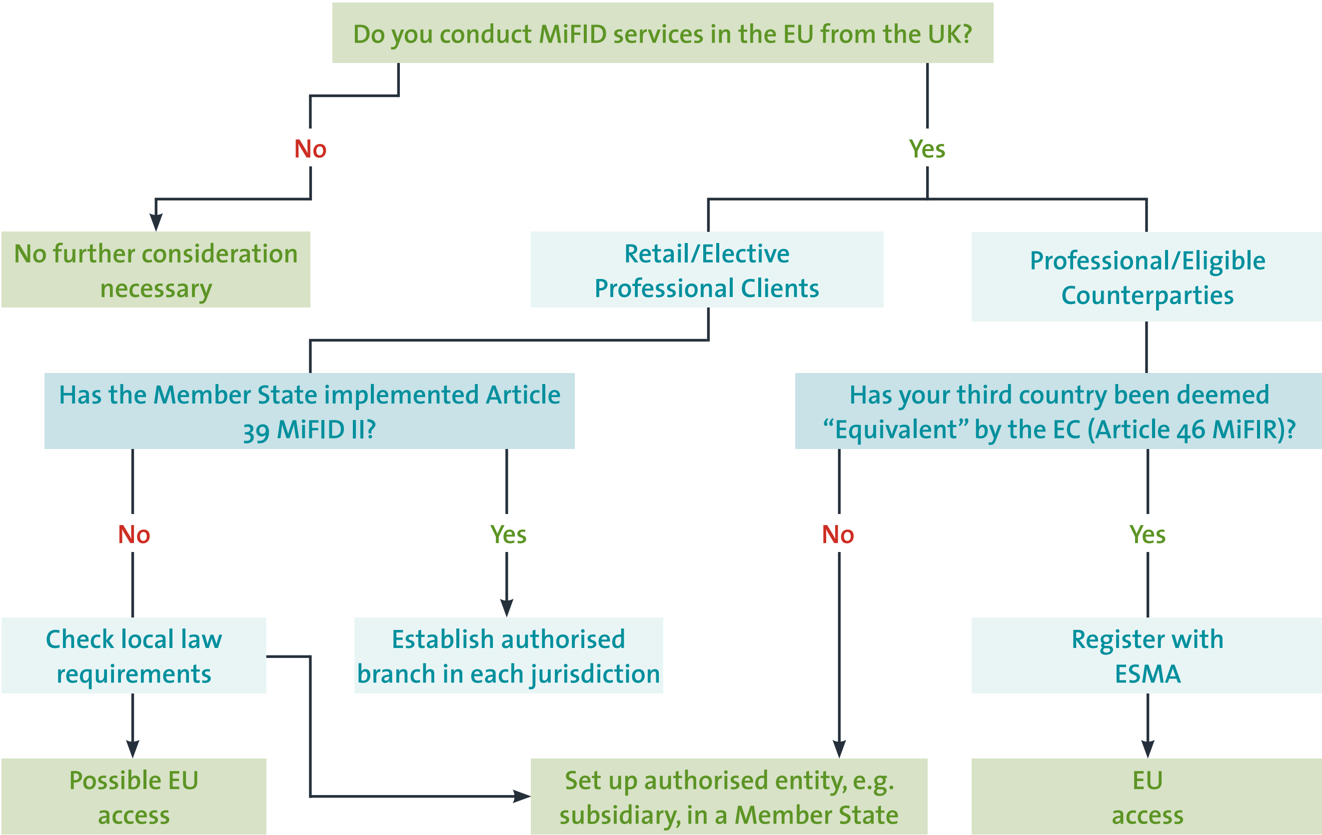
4 Limits on the holding of net positions in (i) commodity derivatives traded on trading venues and (ii) economically equivalent OTC contracts.

5 The amount of information relating to bids and offers displayed/made available to the public via a trading venue (or quotes in relation to SI).

6 The cap regulating the percentage of trades that a trading venue may undertake under the negotiated trade waiver and the reference price waiver.

7 The thresholds governing when a financial instrument is defined as "liquid". Liquid instruments are generally subject to more transparency obligations than other instruments.

MIFID II : THIRD COUNTRY DECISION TREE POST-BREXIT



PASSPORTING OF DEPOSIT-TAKING AND LENDING BUSINESS UNDER THE CAPITAL REQUIREMENTS DIRECTIVE

A similar passport regime under the Capital Requirements Directive (CRD) allows deposit-taking institutions to conduct services throughout the EU using their home-state authorisation. These services include deposit-taking, lending and participation in securities issues as well as activities which overlap with MiFID, such as trading securities for customers or on own account and safe custody services.

If the UK did not retain EEA membership following a Brexit (and thus did not maintain full access to the internal market), the position of UK banks under CRD would be far from straightforward. As under MiFID, the automatic EU passport for banking services would be lost. UK banks would therefore require new licences in multiple EU jurisdictions. This may only be possible in practice if the UK is granted equivalence status under CRD. At present, CRD envisages that third country banks may be granted general rights to establish branches in the EU, by agreement with the EU authorities. In reality, any such agreement would also need to make provision for UK branches of EU banks. However, unlike the more prescriptive MIFID II rules on equivalence, CRD contains no detail on how this agreement should be reached and is silent on the question of third country banks providing services such as deposit-taking within the EU. The scope and legal basis of any deal between the UK and EU would therefore need to be framed in advance of any substantive agreement.

TRADE REPORTING AND CLEARING REQUIREMENTS

Under the European Markets Infrastructure Regulation (EMIR), banks trading derivatives are subject to comprehensive rules regarding clearing, trade reporting and risk mitigation in line with commitments made by G20 leaders in the wake of the collapse of Lehman Brothers. As an EU regulation, EMIR is directly applicable in all Member States so it would no longer apply once the UK had fully exited the EU. Therefore, following Brexit, the UK could in theory choose to be free from EMIR-type provisions entirely. In practice, given that the UK is a G20 member, it would need to adhere to the agreed principles underpinning EMIR even if it were to leave the EU. It is therefore likely that the UK would transpose EMIR and its related secondary legislation into domestic legislation wholesale, with any necessary conforming amendments, so obligations which apply to banks under EMIR would continue to apply post-Brexit (albeit under a different, domestic, piece of legislation). Furthermore, EMIR would still apply to any EU-based counterparty of a UK bank, so, in the absence of an equivalence decision in respect of the UK regulatory regime generally, any trade transacted with an EU entity would still need to comply with certain requirements under EMIR. UK entities would need to continue to adhere to some of the procedures required by EMIR (such as establishing and communicating to their counterparties their EMIR classification) as their EU counterparties would need this information for various EMIR-related purposes. UK trading entities would also need to maintain arrangements with central counterparties (CCPs), as their EU counterparties would require eligible trades to be cleared through an appropriate CCP. No equivalence decisions have yet been issued under EMIR, although presumably, given that the UK is already EMIR-compliant, the issuance of such a decision would be forthcoming in short order (subject to any political difficulties).

CUSTODY SERVICES

UK banks currently providing custody services to certain clients may find that they are no longer able to do so if the UK leaves the EU. The Alternative Investment Fund Managers Directive (the AIFMD) restricts which entities can act as a depository for EU-incorporated alternative investment funds (AIFs); EC credit institutions and investment firms automatically qualify but third country entities do not, meaning that an AIF which currently uses a UK-based bank to provide its custody services may be required to move its business elsewhere if that UK-based bank ceases to be an EC credit institution or investment firm. The AIFMD does allow for third country recognition but, as mentioned elsewhere in this document, this process could become politically fraught if the Brexit negotiations generally have not been well received by the remaining Member States and the Commission.

Bank structure – ring-fencing and resolution

RING-FENCING

Ring-fencing requirements are extremely costly and time-consuming and are a major concern for UK banks. It is therefore unsurprising that concern has been expressed in the banking sector about the adoption by the Commission of a legislative proposal for an EU Regulation on Banking Structural Reform (the BSR Regulation). If enacted, this will impose fundamental structural reforms on in-scope EU banks (broadly, EU banks which are considered of global systemic importance) and prevent them from carrying out certain activities, including proprietary trading. These separated activities will still be able to be performed by a different entity in the same banking group, but that entity must be completely (that is, legally, operationally and economically) separate from the prohibited bank. The reforms and restrictions set out in the BSR Regulation were originally expected to take effect from January 2017 and July 2018 respectively, but this was on the basis that the BSR Regulation would be adopted by June 2015. The BSR Regulation is still pending approval and so it is expected that these dates will be pushed back to reflect this.

The BSR Regulation forms part of a wider pan-European effort to end the spectre of "too big to fail" and increase stability in the banking sector. It is also an attempt by the Commission to avoid Member States developing divergent national legislation that could affect capital movement and create problems for the cross-border supervision of banks. If the UK remains in the EU, in-scope UK banks will be required to comply with the provisions of the BSR Regulation unless the UK has existing legislation in place which has an equivalent effect to that of the BSR Regulation; if this is the case, UK banks will not need to comply with the separation requirements set out in the BSR Regulation (although they will still be subject to the prohibition on proprietary trading). This condition is likely to be met, as the UK has already introduced similar requirements under the Banking Reform Act 2013 (the Banking Reform Act), which requires banks to separate core banking services critical to individuals and SMEs from their more risky and controversial wholesale and investment banking services by 1 January 2019. It also restricts the activities which the ring-fenced entities are permitted to undertake after this date. However, this derogation from compliance is not automatic; the UK would need to obtain the approval of the Commission and meet certain criteria in order for an exemption to be granted. Furthermore, the scope of the proposed BSR Regulation is wider than the reforms brought about by the Banking Reform Act, so some UK banks which are not caught by the Banking Reform Act could nevertheless be subject to the BSR Regulation.

The Council of the EU and the European Parliament are currently considering the text of the draft BSR Regulation and the timing of its adoption and implementation could decide whether UK banks fall within its ambit. If the UK remains in the EU, whether UK banks are required to comply with both the Banking Reform Act and the BSR Regulation will depend on the final text of the BSR Regulation and, assuming that the derogation contained in the current draft is retained, whether the UK regime is considered to have an equivalent effect as that of the EU regime. If the UK votes for Brexit, there is a chance that the UK will have exited the EU by the time the BSR Regulation comes into force, in which case its provisions will no longer be relevant. UK banks will still, of course, be required to comply with the Banking Reform Act, so neither scenario appears to offer much hope of respite for banks currently grappling with the huge commitment and expenditure demanded by the new ring-fencing focused environment.

RESOLUTION

Since the onset of the global financial crisis and the resulting bail-outs of financial institutions, the way in which banks in financial difficulty are resolved has been at the forefront of global developments. The Financial Stability Board (FSB), in its "Key Attributes of Effective Resolution Regimes for Financial Institutions" report, sets out twelve features which should feature in all resolution regimes. The Commission's response to this report was the implementation of the Banking Recovery and Resolution Directive (the BRRD), which implements in the EU the FSB's proposals with respect to EU banks and investment firms.

The BRRD was implemented in the UK via amendments to the Banking Act 2009 (the Banking Act), the Prudential Regulation Authority (PRA) Rulebook and the Financial Conduct Authority (FCA) Handbook. It introduces a set of minimum standards to allow national authorities to intervene and resolve banks and investment firms in an orderly manner without recourse to taxpayer money. In particular, it requires the preparation of recovery plans and resolution plans (also known as "living wills"), and introduces the "bail-in" tool, which allows a resolution authority to write down eligible liabilities or convert them to equity in the event of an institution failing. It also introduces a minimum requirement for own funds and eligible liabilities (also known as MREL) for the purpose of bail-in, which is being phased in in the UK between 1 January 2016 and 1 January 2020. The impact that the BRRD has had on banks across Europe has been considerable, in terms of both cost and resources.

Post-Brexit, the UK would in theory be able to repeal all BRRD-implementing legislation. Unless saving legislation were introduced in this area, all secondary domestic legislation under the European Communities Act implementing the BRRD in the UK would cease to have effect once the Act had been repealed. However, the BRRD forms part of a wider ongoing EU regulatory response to the global financial crisis, of which the UK is an advocate. Indeed, even before the BRRD regime was established, the UK had implemented legislation to aid the recovery and resolution of financial institutions; the Banking Act introduced a special resolution regime for banks and investment firms, as well as building societies and recognised CCPs. The PRA and the FCA had also already introduced recovery and resolution planning requirements prior to amending their rulebooks to implement the BRRD.

Currently, Member States are required to recognise each other's reorganisation measures with respect to banks and investment firms (including application of the bail-in tool). However, post-Brexit, while the UK could legislate for Member States' resolution measures to be recognised in the UK, there would be no guarantee of reciprocal recognition in EU countries of resolution measures taken by the UK. This could jeopardise the effectiveness of any action taken by the Bank of England as the UK's resolution authority so might lead the PRA to require all UK-based banks, post-Brexit, to include a contractual recognition clause similar to the Article 55 Requirement (see Contractual recognition of bail-in below) in EU-law governed contracts. Notwithstanding this potential complication, given that the UK is supportive of the FSB initiative and pan-EU efforts generally and is an FSB member, it seems likely that the position post-Brexit would not change significantly for UK banks.

Bank funding and capital

SECURITIES ISSUANCE

Banks' issuance of securities is facilitated by a harmonised pan-EU regulatory regime, the twin pillars of which are the prospectus directive (the Prospectus Directive) and the transparency directive (the Transparency Directive). These directives work together to establish a uniform capital market across the EU and to enable UK banks to access the European capital markets with relative ease. In particular, the Prospectus Directive and its implementing regulation (the PD Regulation) allow banks to use one prospectus to offer securities in multiple jurisdictions across the EU. If post-Brexit negotiations did not result in the status quo being preserved, the UK would need to legislate to deal with the PD Regulation (and any related regulatory technical standards) ceasing to have effect under English law. It would also need to amend the FCA Handbook and the Financial Services and Markets Act 2000 to make conforming changes and to repeal the implementation of the Transparency Directive. New legislation would need to be enacted to replace this legislation, the result of which would likely be a UK prospectus regime which looked very much like the current regime but without the dimension of outbound passporting to other Member States. Any prospectus required for an offer in the UK or admission to trading on a UK market would need to be approved by the UK competent authority (unless the UK legislated to accept inbound prospectuses). Any prospectus required for an offer in another Member State or admission to trading on a market in another Member State would need to be approved outside the UK in the appropriate jurisdictions. To deviate far from the existing regime would go against the principles and standards established by the global International Organization of Securities Commissions (IOSCO), of which the FCA is a member, and is therefore unlikely. However, there are some areas which could be the subject of lobbying, for example the inclusion in certain prospectuses of mandatory summary sections in prescribed form, generally recognised to be inflexible and unhelpful.

USE OF BENCHMARKS

The EU responded to the recent global LIBOR and EURIBOR scandals by agreeing on a new regulation (the Benchmark Regulation) regulating the use and administration of benchmarks. The Benchmark Regulation aims to apply the broader IOSCO principles for financial benchmarks to a broad swath of indices. All indices used as benchmarks in financial instruments by supervised entities in the EU will be affected to varying degrees, including those administered outside the EU. Implementation is expected in early 2018 and once in force the Benchmark Regulation will affect any EU institution which administers, contributes to or uses a benchmark. It will impose different requirements depending on (i) the benchmark's underlying asset, (ii) the significance of the benchmark and (iii) the source of data used to establish the benchmark.

If the UK were to leave the EU, it would become a third country for the purposes of the Benchmark Regulation, meaning that any benchmark administered by a UK entity could only be used by supervised EU banks if it had been approved by the appropriate Member State authorities pending an equivalence decision. Although the draft text of the regulation includes various alternative approaches to achieve approval for a benchmark or administrator, ultimately all options require that the benchmark's country of origin apply the IOSCO principles in a way that is equivalent to the EU regulation. This means that in order for a UK-administered benchmark to be eligible for use by EU entities, it would need to comply with the requirements set out in the Benchmark Regulation even if the UK had exited the EU. Furthermore, given the extent of the LIBOR scandal and its impact on UK banks, the political pressure to retain protections similar to those ultimately imposed across the EU could be considerable.

CAPITAL REQUIREMENTS

A major cost of doing business for banks and investment firms is the minimum capital requirements to which they are subject. The minimum prudential capital requirements for banks and investment firms are set by the Basel Capital Accords (published by the Basel Committee on Banking Supervision) and implementation in the EU is through the Capital Requirements Regulation (CRR) and the related CRD. Signatories to the Basel Capital Accords, which include the UK, agree to give effect to the accords in their national legislation, so even if the UK were to leave the EU we would be unlikely to see substantial changes to the current requirements. However, if the UK were to leave the EU and become a third country for the purposes of the CRR, any preferential risk weights currently applicable to exposures to CRR-regulated institutions would only apply if the UK was deemed to have a capital regime equivalent to that implemented under the CRR. If the UK left the EU but did not implement an equivalent capital regime, UK institutions could be at a disadvantage when obtaining credit from EU institutions, as the cost of such credit would be likely to increase.

In terms of regulatory capital reporting, parent institutions within the scope of the consolidated capital requirements in CRR are required to consolidate all subsidiaries which are credit institutions, investment firms or financial institutions (or such subsidiaries of the same EU holding company). UK subsidiaries of EU institutions would therefore continue to be included in such consolidation by an EU parent under the CRR post-Brexit, regardless of the rules applicable in the UK. For a UK parent institution, any post-Brexit UK rules on consolidated capital requirements could include consolidation of EU subsidiaries as well as non-EU subsidiaries. However, as the CRR will continue to apply to EU regulated subsidiaries, and as there may be intermediate levels of consolidated reporting under the CRR – for instance where an EU subsidiary which itself is a parent in a Member State reports on a consolidated basis – it would make sense to apply the CRR capital requirements to the group as a whole, which suggests that the UK rules would remain broadly similar to those under the CRR.

RISK RETENTION REQUIREMENTS

In addition to implementing the minimum prudential capital requirements for banks and investment firms, the CRR also contains rules requiring retention of economic risk by the originator or sponsor of a securitisation transaction. These rules are not derived from the Basel Accords, they are an EU initiative. They are currently enforced through a requirement on the investor to ensure the transaction is compliant (the Indirect Retention Requirement), although a new obligation falling on the originator or sponsor directly is to be introduced, possibly from late 2016. Whilst the UK could choose to amend or even disapply the retention requirements in relation to a class of assets or securitisation structure (such as collateralised loan obligations (CLOs)) after Brexit, the sale of securitisation positions to investors within the rest of Europe will remain possible only if the CRR retention requirements are also met, as the effect of the Indirect Retention Requirement will be that a non-CRR compliant securitisation cannot be sold into the EU.

Transaction documentation

Generally speaking, we would view the documentation impact of Brexit as second-order in comparison to issues of access to markets and equivalency generally. Ultimately, Brexit would necessitate a (further) comprehensive due diligence exercise by all banks; existing documentation and trading arrangements would need to be thoroughly reviewed prior to Brexit to ensure that any potential pitfalls had been identified and, where necessary, eliminated. In most cases, this would be likely to form part of a wider due diligence and re-papering exercise for banks to address the implementation of any new regime. We would also expect the various industry bodies and trade associations, such as ISDA and the LMA, to assist with this on a macro level and help ensure a smooth transition wherever possible. This could give rise to additional industry protocols or standard form amendment agreements.

In this section we look first at some issues of common application across banking documentation before looking at specific market documents in more detail.

GENERAL DOCUMENTATION ISSUES

Governing law

All EU countries currently apply the same set of rules to determine the governing law of both contractual and non-contractual obligations. The relevant regulations are the EU Rome I regulation (Rome I) and EU Rome II regulation (Rome II) respectively. Both require the court in question to give effect to the parties' express choice of law in most cases, regardless of whether the contracting parties are located in a Member State and regardless of whether the parties have chosen the law of a Member State. This significantly reduces legal risk by providing certainty as to the legal rule book which will govern the parties' respective responsibilities to each other.

Post-Brexit, although Rome I and Rome II may no longer apply in the UK (although the UK and the EU could of course agree for the UK to remain subject to these regulations as part of the Brexit settlement), it is unlikely that the English courts would change their long-standing approach of respecting contracting parties' choice of law, which pre-dates Rome I. There is perhaps more of a question mark in relation to the English courts' future approach to choice of law clauses in respect of non-contractual obligations. This is because English law did not give parties an express right to choose the law applicable to non-contractual obligations prior to adopting Rome II. Nonetheless, the legal certainty produced in this area since Rome II, and the English law's respect for party autonomy generally, means it is likely that these choice of law clauses will continue to be respected post-Brexit. Rome I and Rome II would of course still apply to the remaining Member States, so they would still be obliged to give effect to an English governing law clause even if the UK were no longer an EU member.

Jurisdiction

The recast EU Brussels regulation (the Recast Regulation) determines which court has jurisdiction over a particular matter and also provides for reciprocal recognition across the EU of judgments handed down in Member States. The general position under the Recast Regulation is that proceedings against a party must be brought in its place of domicile unless the contract in question contains a clause conferring jurisdiction on a particular country (as is the case in the majority of financial contracts). Theoretically, therefore, without the Recast Regulation there could be some uncertainty as to whether the English courts would have jurisdiction to hear a specific case and / or whether an English law judgment could be enforced elsewhere in the EU (and vice versa). However, there are several other international conventions to which the UK is either already a signatory or could become a signatory, which could help to mitigate this uncertainty. These all have a similar effect to the Recast Regulation and include the Lugano Convention, which applies between all EU countries and Norway, Iceland and Switzerland. It is possible that the UK would accede to this in its own right following Brexit. It may also accede to the Hague Convention, which has a similar effect but applies only where exclusive jurisdiction clauses are used. The New York Convention (to which the UK is already a signatory in its own right) provides for reciprocal enforcement of arbitration awards. So, while Brexit could result in initial uncertainty and relatively minor changes to contractual documentation – perhaps a shift to exclusive jurisdiction clauses or even to arbitration clauses – it is unlikely to be particularly problematic in the medium to long term.

ENGLISH LAW AS AN INTERNATIONAL LAW OF CHOICE

English law has long been one of the most popular choices of governing law for international contracts, for reasons largely unrelated to the UK's membership of the EU. English law is considered to be stable and is backed by a large body of case law that can be drawn on to predict a greater certainty of outcome. The English courts have a reputation for being highly skilled, consistent, independent and fair. Furthermore, English contract law has developed largely independently of EU law and the law on key contractual issues derives principally from English common law. These factors combined suggest that English law is likely to retain its current privileged position.

However, there is no room for complacency. In particular, English law has benefitted in terms of its popularity from being, in effect, the domestic law of the EU in matters financial. Following Brexit, that rationale may be weakened. Brexit could encourage a trend towards the adoption of New York law for financing documentation.

EVENTS OF DEFAULT AND EARLY TERMINATION RIGHTS

Most financial contracts, including those based on industry standard forms such as the ISDA Master Agreement and the Loan Market Association (LMA) documentation, contain representations relating to the parties' authorisation to transact thereunder. Typically, breach of that representation will be an event of default entitling the non-defaulting party to terminate the contract. Whilst in most loan and bond documents those representations are only given by the borrower or issuer, in the case of derivatives contracts, these are given by both parties. For example, the ISDA Master Agreement contains a representation to the effect that the parties have obtained all necessary governmental and other consents, which representation is repeated every time the parties enter into a transaction under the agreement. If a bank were relying on, for example, an authorisation under MiFID which were to fall away as a result of Brexit, the bank would (i) be in breach of its contractual obligations under the ISDA Master Agreement and (ii) no longer be authorised to transact, and would therefore need to transfer all transactions to, and enter all future transactions through, an appropriately authorised entity. Similar representations are contained in the Global Master Repurchase Agreement (GMRA) and the Global Master Securities Lending Agreement (GMSLA).

The ISDA Master Agreement also contains an "Illegality" termination event, which is triggered when it becomes illegal for a party to make or receive payments or deliveries or otherwise to comply with obligations under the Master Agreement in question; however, we consider it unlikely that this termination event would be triggered in relation to existing trades by Brexit. If specific termination events had been built into an agreement to deal with, say, the investment manager of a transacting fund losing the right to do business in a relevant jurisdiction, Brexit could result in the early termination of a number of transactions.

MATERIAL ADVERSE CHANGE AND CREDIT DETERIORATION

Although there may initially be some concern around material adverse change (MAC) clauses, in our view it is unlikely that either a "Leave" vote or Brexit would, in and of itself, constitute a material adverse change event of default. Of course, if a borrower's business is particularly dependent on EU legislation and free access to EU markets, a Brexit which substantially diminished those access rights could conceivably result in a material adverse change.

Similarly, a disorderly Brexit, or poorly or inadequately negotiated Brexit terms could potentially lead to ratings downgrades for specific issuers. These could in turn lead to higher financing costs for the issuers affected and difficulties in raising new debt. They could also give rise to the early termination of transactions under contracts such as ISDA Master Agreements which had built in additional termination rights triggered by a ratings downgrade.

CONTRACTUAL RECOGNITION OF BAIL-IN

Under Article 55 of the BRRD any contract which is governed by the law of a non-EEA country and which contains a liability of an in-scope entity must include a provision through which the counterparty acknowledges that such liability may be subject to bail-in by the applicable regulator (the Article 55 Requirement). The Article 55 Requirement entered into force across Europe at the start of 2016 and has proved challenging for banks throughout Europe explaining to their non-EU borrowers and trading counterparties why the provision is needed and, in many cases, why existing contracts need to be amended. The bail-in clause must include certain specified features. The underlying rationale behind the Article 55 requirement is that the relevant EEA regulator's write-down and conversion powers will be less susceptble to challenge if the counterparty has contractually agreed to those bail-in powers.

As mentioned in Resolution above, if the UK were to leave the EU it would be free to repeal all legislation transposing the BRRD into national law, including the Article 55 Requirement. However, notwithstanding the difficulties presented by the Article 55 Requirement, it is unlikely that the UK would take this step; it is an advocate of the wider regime of which the BRRD forms part and even chose to "gold-plate" certain of its provisions – for example, the PRA implemented the Article 55 Requirement in respect of certain liabilities almost a year earlier than required under the BRRD. Consequently, it is unlikely that post-Brexit UK-based banks would see any meaningful change to requirements in this area and UK banks would still need to include provisions designed to meet the Article 55 Requirement in their contracts, even post-Brexit.

If, following Brexit, the UK did not retain EEA membership, EU banks would also need to include the Article 55 Requirement in in-scope English-law governed contracts. Were that requirement to apply, the re-papering exercise required would be substantial.

MARKET STANDARD DOCUMENTATION

LMA documentation

In terms of bank lending generally, Brexit would be unlikely to have any immediate impact on existing loan relationships. Documentation based on the LMA standard forms will most likely contain very few provisions which rely, directly or indirectly, on EU legislation. Furthermore, standard LMA construction provisions provide that references to "a provision of law is a reference to that provision as amended or re-enacted", which could help to mitigate any Brexit-related issues. Some areas of LMA documentation referencing EU-derived legislation which may need to be considered in more detail are set out below:

- appropriation as an enforcement remedy: it is routine for security documents in financing transactions to include a right to appropriate financial collateral, as part of the secured parties' enforcement arsenal. As noted in Taking security below, we consider that the financial collateral regime is of clear benefit to the UK and would therefore probably be adopted into national law;

- increased costs provisions: LMA documentation is drafted widely and generically, to ensure that borrowers compensate lenders for increased capital costs during the life of the facilities. European legislation which implements the Basel Committee's globally recommended standards for bank capital and liquidity is often directly referenced. There is no doubt that equivalent legislation would be adopted in the UK and therefore we would not anticipate any difficulty in transitioning to new standard form provisions reflecting the equivalent legislation;

- sanctions undertakings and representations: the LMA does not provide standard sanctions compliance terms but negotiated documents will routinely require that the borrower group complies with sanctions legislation administered by a number of authorities, including the EU. Brexit would not impact on this as the syndication of facilities requires wide-ranging sanctions compliance. One piece of EU legislation that lenders would be happy to see repealed is the EC Blocking Regulation, which prohibits compliance by any EU person with certain US sanctions; and

- EU provisions relating to choice of auditor: EU regulations concerning statutory audits of annual accounts and relating to public-interest entities limit the degree to which lenders can influence a borrower's choice of auditor, although lenders can still impose qualitative and capability requirements. The EU measures were introduced to improve competition (in particular expanding competition beyond the big-four accountancy firms) and it seems likely that equivalent provisions would be retained in respect of audits relating to UK entities post-Brexit.

ISDA MASTER AGREEMENTS

Neither the 1992 ISDA Master Agreement (Multicurrency-Cross Border) nor the ISDA 2002 Master Agreement contains a construction clause similar to that found in LMA documentation (see LMA documentation above), so any references to EU-derived legislation rendered obsolete or incorrect by Brexit would need to be actively managed. In the past, ISDA has handled such industry-wide issues by way of online protocols to which parties can adhere, updating all of their existing documentation in the process. We would expect a similar approach to be taken to update relevant provisions.

One such provision might be Section 13(b) of the ISDA Master Agreements, which references "Convention Courts" and "Contracting States" respectively, both of which concepts hail from EU-based legislation and may need to be re-considered. We would note, however, that parties very often amend this provision to reflect the transactions and counterparties in question, so such references may well have already been removed. Review of all its ISDA Master Agreements would presumably form part of a bank's overall Brexit due diligence exercise, and the changes required to be made would be clearer once the UK's exit package had been agreed. For example, if the UK were to sign up to the Hague Convention, we would most likely see an increase in exclusive jurisdiction clauses to ensure that contracts were covered by the convention (see Jurisdiction above).

Another amendment commonly made by parties in the Governing Law and Jurisdiction section of the ISDA Master Agreements is to extend the scope of the governing law so that it also applies to disputes relating to non-contractual obligations, in reference to Rome II. This may need to be re-considered depending on the English courts' attitude to tortious claims post-Brexit.

REPO AND STOCK LENDING DOCUMENTATION

The effects of Brexit on the functioning of the GMRA and the GMSLA would depend on the version of document being used, its boilerplate provisions, and how it had been amended by the parties. For example, as with the ISDA Master Agreements, neither the 2011 nor the 2000 form of the GMRA contains a construction clause similar to that found in LMA documentation (see LMA documentation above). However, both the 2000 and the 2010 forms of the GMSLA do. This is something on which we would expect the appropriate trade associations (ICMA and SIFMA in the case of the GMRA) to consult with their members and, if necessary, recommend an appropriate industry-wide approach, which could be achieved through standard form amendment agreements, industry protocols or other measures.

As another example, the governing law and jurisdiction clauses in the most recent versions of the GMRA and the GMSLA (2011 and 2010 respectively) extend to disputes relating to non-contractual obligations, in reference to Rome II (also see ISDA Master Agreements above). The earlier versions of these documents do not, as they were created prior to the entry into force of Rome II in 2009 (although the clause is routinely amended to widen its scope when using these older versions). As discussed above, even if Rome II no longer applied to the UK, it is unlikely that the English courts would change their approach to choice of law and jurisdiction recognition (i.e. giving effect to the parties' choice of law and jurisdiction, which is what is required by Rome II). Consequently, amendments expanding the scope of these provisions to include disputes relating to non-contractual obligations would still be of value. However, again this is something that we would expect trade associations to review with their members and consider the various options available once the UK's post-Brexit status was clear.

Dealing with counterparties

CCP RECOGNITION

We discuss above (see Trade reporting and clearing requirements) the effect from an EMIR-compliance perspective that Brexit could have on banks trading derivatives. For similar reasons, Brexit would also affect UK-based CCPs and trade repositories (TRs) and the counterparties wishing to use their services. Post-Brexit the UK would become a third country for EMIR purposes, meaning that, unless a general equivalence decision were issued in respect of the UK regulatory regime, UK-based TRs and CCPs would need to apply for recognition from ESMA in order to continue to provide services to EU counterparties. This should not be fundamentally problematic as they are already EMIR-compliant, but obtaining recognition has taken longer than expected for other non-EU entities, notably US-based CCPs, which took several years. Delays may also be exacerbated if negotiations between the UK and the EU around Brexit more generally have not gone well. Until the necessary recognition had been granted, EU counterparties would not be permitted to use their usual UK-based TRs or CCPs, which could disrupt their business significantly. A similar issue could arise with regard to UK banks which are clearing members of an EU CCP. Post-Brexit, UK banks would no longer be EU credit institutions and might therefore no longer meet their EU CCPs' eligibility criteria. As a result, such banks could be subject to additional qualification requirements, or, in the worst case scenario, not be permitted to remain as clearing members at all.

Brexit could also prompt the ECB to renew its call for clearing houses handling more than 5 per cent of the market in a euro-denominated product to be based in the Eurozone. The ECB's proposal was the subject of a ruling of the EU General Court in March 2015, which found that the ECB did not have the "competence necessary to regulate the activity of security clearing systems". This could well change following Brexit, and if such a proposal were successful it could affect the future business prospects of UK-based clearing houses and potentially force them to set up in the Eurozone in order to remain a viable option for the clearing of certain products.

COUNTERPARTY INSOLVENCY

Over recent years the UK has become the restructuring capital of Europe. This is due to a combination of the UK's flexible and sophisticated restructuring laws and the impact of the European Regulation on Insolvency Proceedings (the ECIR).

Many corporates have used English schemes of arrangement to restructure or reduce their debt and to avoid having to file for formal insolvency in their home Member State. However, one of the conditions for obtaining the English court's sanction for a scheme of arrangement is that the scheme should be recognised and effective in any other relevant jurisdiction, so that creditors in those other jurisdictions cannot avoid the effects of the scheme and gain an unfair advantage over other scheme creditors. This is usually achieved by way of the Recast Regulation. However, post-Brexit it may be difficult to persuade an English court that an English scheme of arrangement will be recognised and enforced in relevant Member States, especially if the UK chose not to accede (or was unable to negotiate accession) to the Lugano Convention for any reason (see Jurisdiction above).

An EU entity may find its financial difficulties so acute or its creditors so un-cooperative that it cannot avail itself of a scheme of arrangement to stave off formal insolvency. It may also conclude that its home state bankruptcy regime would lead to liquidation rather than rescue. If that entity has its centre of main interest (COMI) or an establishment in the UK (or if it can repatriate its COMI to the UK) then it can initiate insolvency proceedings in the UK and, under the ECIR, the insolvency proceedings will have automatic Europe-wide recognition and effect. This has proved particularly useful in large group insolvencies where several of the European subsidiaries have had their COMI in the UK because it enabled the English court to grant administration orders for all of them and appoint the same administrators to each entity, thereby facilitating a co-ordinated approach to maximising the group's insolvent estate. For banks involved in or advising on restructurings or insolvencies of European counterparties this has meant that conducting restructurings under UK restructuring laws has become an attractive option.

The combination of the ECIR, the Recast Regulation, Rome I and Rome II requires all Member States to recognise UK insolvency proceedings, UK judgments and choice of law clauses respectively. Post-Brexit these regulations will (absent any specific agreement) cease to apply and there is no assurance that the UK would be able to negotiate comparable arrangements with the EU. In the absence of any such arrangements, the fallback for English insolvency officeholders seeking recognition in Member States would be to rely upon the domestic laws of those Member States which grant assistance to foreign officeholders. These laws would differ on a state by state basis. The fallback for foreign officeholders of entities with a COMI or an establishment in a Member State and who need recognition and assistance from the UK courts would be the UNCITRAL Model Law on Insolvency (which the UK has implemented by means of the Cross Border Insolvency Regulations 2006 (the CBIR)). This gives representatives of foreign insolvency proceedings a right to apply to the UK courts for recognition and request discretionary relief. The relief available is not as powerful as the effects of the ECIR but it does facilitate cross-border effectiveness for European insolvencies needing assistance from the UK. Unfortunately, very few Member States[1] have adopted this Model Law so its usefulness for recognition of UK insolvency proceedings in other European countries would be limited. The fact therefore that foreign officeholders would have better tools for recognition and assistance available to them in the UK than UK officeholders would have in most other Member States would be a disincentive to the EU to negotiate a more reciprocal arrangement to replace the ECIR if the UK were to leave the EU.

The analysis above applies to non-bank corporate entities. Credit institutions are excluded from the scope of the ECIR and instead have their own separate winding-up and reorganisation regime governed by the Credit Institutions Winding Up Directive (CIWUD), implemented in the UK by the Credit Institutions (Reorganisation and Winding Up) Regulations 2004 (CIRWR). The CIWUD insolvency regime for credit institutions differs from the ECIR regime for general corporates described above in two main respects: (i) the CIWUD regime applies to EEA credit institutions, unlike the ECIR which only applies to corporates with a COMI or an establishment within the EU (except for Denmark), and (ii) whereas the ECIR requires the opening of main insolvency proceedings in the Member State where a general corporate entity has its COMI, CIWUD provides instead that the opening of any reorganisation measure or winding-up proceedings for a credit institution should take place in the credit institution's home Member State (i.e. the state in which it is regulated). The CIRWR were made using powers in the European Communities Act 1972 so, unless saving provisions were introduced and/or the UK signed up to the EEA, they would be revoked if the UK were to leave the EU.

Assuming the CIRWR were revoked, and the UK did not sign up to the EEA, winding-up proceedings or reorganisation measures of an EU counterparty credit institution would not be automatically recognised in the UK, and the CBIR would not help because they do not apply to credit institutions. Any assistance needed from the UK courts, for example to deal with a UK branch of the insolvent European counterparty, would need to be sought under common law principles. It is likely that our courts would strive to assist, recognising the benefits and efficiencies of principles of universality of insolvency proceedings, but it might need to instigate local parallel UK insolvency proceedings in respect of the UK branch. Likewise, for an insolvent UK credit institution with branches in a Member State, it might be the case that the Member State's regulatory authority would want control over a local insolvency process dealing with the branch's assets and creditors/depositors. In other words, the absence of the CIWUD regime would bring about the need for multiple parallel insolvency processes that may or may not co-ordinate and communicate with each other, entailing inefficiency and unnecessary expense; all the things that CIWUD was designed to avoid.

Although it would be possible to implement a replacement regime to replicate the effects of CIWUD, this could not be done by the UK unilaterally and the prospects of agreeing such a reciprocal agreement, fresh from our "divorce" from the EU, remains uncertain.

1 Greece, Poland, Romania, Slovenia and the UK.

TAKING SECURITY

The Financial Collateral Arrangements Directive, implemented in the UK by the Financial Collateral Arrangements (No.2) Regulations of 2003 (as amended) provides a preferential regime for certain types of collateralisation arrangements. In particular, for eligible security-based arrangements, perfection requirements and insolvency moratoria are disapplied, and appropriation of assets is available as a means of enforcement. The regime is broadly relied on across the financial markets, and will become still more central following the introduction of mandatory collateralisation requirements for uncleared derivatives.

Whilst is true to say that the changes wrought by the financial collateral regime were less material in the UK than elsewhere in Europe – for example, title transfer arrangements such as the ISDA Credit Support Annex (English law version) were already widely used and held to be legally robust – removal of the regime would impact the market as it is today. For example, absent the financial collateral regime, it is difficult to see how relevant market participants with custody assets in London could comply with the forthcoming requirements of the EMIR regime to hold initial margin on a basis which does not expose the margin provider to the default of the margin taker, without also becoming subject to a stay on enforcement in certain circumstances.

For that reason and others, we would expect the UK to preserve the financial collateral regime post-Brexit. Nor do we see any barrier to this, as there is no concept of passporting or equivalency in this context.

ENFORCEMENT OF SECURITY

One benefit of the ECIR is that, if an entity becomes subject to insolvency proceedings in one Member State, any rights 'in rem' (i.e. proprietary rights) granted to its creditors in respect of assets located in a different Member State when the insolvency proceedings commence are protected. So if, for example, a borrower with its COMI in the EU becomes subject to main insolvency proceedings in, say, Germany, and its lending bank has taken effective English law governed security over the borrower's UK-located assets, any stay imposed by or similar action taken under the German insolvency proceedings would not affect the English security rights in respect of the UK-based assets – so the bank would not be prevented from enforcing its security over those assets. Without knowing what arrangements would supersede this regime post-Brexit, it is hard to speculate on the effects that the ECIR ceasing to have effect in the UK would have on EU-wide insolvency proceedings. In our scenario, the protection granted by the ECIR in respect of the security rights would no longer exist, but neither would the German proceedings have automatic recognition in the UK. The pre-ECIR position was complex and frequently gave rise to conflict of law issues. Post-Brexit, if the UK and the EU were not able to negotiate a coherent set of arrangements for managing EU-wide insolvencies, we may well find ourselves back in this situation.

ANTI MONEY-LAUNDERING AND KYC

As part of ongoing global efforts to eradicate money laundering, the Financial Action Task Force (FATF) has established an international anti-money laundering (AML) framework, applicable to all FATF members. This includes most Member States and the Commission itself, meaning that they are all bound by the FATF's rules regardless of their EU membership status. As a result, if the UK were to leave the EU, it would nevertheless remain a member of FATF and would still need to abide by its requirements. Indeed, the UK has in many cases elected to "gold plate" the EU legislation giving effect to the FATF framework; for example, the UK has adopted an "all crimes approach" to AML regulation, so there is no de minimis level of predicate offence below which offences need not be reported.

Should a post-Brexit UK wish to continue to have access to the EU's single market, it would need to either be subject to the same legislative measures or be able to prove equivalence. Following the same laws without having any input into their development would appear to defeat the purpose of Brexit, so achieving equivalence seems the most likely course. In a post-Brexit environment, both the UK and the EU would presumably continue to take their lead from the FATF with regard to their respective AML requirements – for example, the Fourth EU Anti-Money Laundering Directive (the Fourth Directive) is set to come into force in June 2017 and will remove banks' ability to rely on the simplified "Know Your Client" (KYC) or "Client Due Diligence" regime currently available in respect of certain, low-risk, clients such as listed companies. This could significantly increase the time taken internally to complete the KYC process. However, the Fourth Directive stems from the latest recommendations of the FATF in this area, so the UK would be required to take similar action even post-Brexit. Achieving technical equivalence is unlikely to be an issue, but the political obstacles to such an agreement with the EU could be considerable. For example, the EU-US discussions on equivalence for the regulation of CCPs under EMIR took several years. Political factors aside, the fact that the UK has often gone above and beyond the requirements of EU directives suggests that its domestic AML provisions would be unlikely to differ significantly from those of the EU post-Brexit.

Dealing with consumers

PACKAGED RETAIL PRODUCTS

In recent years, the Commission has implemented a package of proposals on the regulation of retail investment products, with which the UK, as an EU member, has been obliged to comply. Key amongst these is the proposed EU regulation (the PRIIPS KID Regulation) on key information documents for packaged retail and insurance-based investment products (PRIIPs). As a directly applicable regulation coming into force in the next two years, it could affect entities in the UK until the UK had officially left the EU. This would mean that UK banks would need to prepare key information documents (KIDs) for a wide range of its products offered to retail investors, including small to medium sized enterprises. Each KID would need to be in a prescribed format, contain specified information, and be no more than 3 pages long. KIDs would also need to be reviewed on a regular basis (at least every 12 months, if the regulatory technical standards are adopted in their current form) and, if necessary, updated. Obligations under the PRIIPS KID Regulation would also extend to banks advising on or selling PRIIPS, which would need to provide the appropriate KID "in good time" before an investor became bound by a sale.

The PRIIPS KID Regulation is intended to enable investors to easily compare products and to make better informed investment choices. The UK's decision on whether to retain it would therefore be in large part dependent on its post-Brexit approach to retail regulation as a whole. From a business perspective, the UK may decide that to remain competitive investors should receive at least the same level of investor protection as is available in the EU – although there is no legal restriction on investors purchasing products which are not PRIIPS KID compliant, in practice, they may prefer to purchase products which are easily comparable (i.e. which comply with the KID requirements) and may perceive non-compliant, less well-regulated products as more risky and less appealing. There may also be political pressure post-Brexit to retain measures protecting retail investors. However, as the obligations imposed by the PRIIPS KID Regulation are fairly onerous, the UK Government may decide not to implement equivalent national legislation if it leaves the EU, or may implement it with amendments (for example limiting the scope of the regulation to simple products which can be easily summarised in a short document). If the requirements of the PRIIPS KID Regulation are retained in any significant form, they are likely to prove burdensome for those banks to which it applies.

PERSONAL LOANS, MORTGAGES AND PAYMENT SERVICES

One of the stated objectives of much EU legislation in relation to retail banking products and services is to enhance consumer protection. The UK has always been at the forefront of consumer protection in Europe, driving the standards to be expected of financial institutions in relation to the fair treatment of consumers and the products which can be offered to them. The recently enacted Consumer Rights Act 2015 (implementing the Consumer Rights Directive), which came into force on 1 October 2015 and the accompanying guidance from the Competition and Markets Authority issued on 31 July 2015, did not (in our view) require material change in business practice for many institutions. As a succession of UK Governments have been keen to ensure that the consumer is adequately protected from the mismatch of bargaining strength between the lender and the borrower, there appears to be little prospect that any of the EU consumer protection legislation (and elements of other relevant legislation focused on consumer protection) will be materially amended or repealed in the event of Brexit (and if the UK retained membership of the EEA it would be obliged to retain these provisions in any event).

As noted above, one of the principal effects of Brexit may be that UK firms would lose their right to provide cross-border services on the basis of a passport. However, the loss of this right may not be as profoundly felt in relation to retail banking products and services (at least in the short to medium term). The reason for this is that relatively few consumers obtain banking products and services on a cross-border basis. In its Green Paper on retail financial services published in December 2015, the Commission found that less than 5 per cent of all consumer loans, and less than 3 per cent of all consumer finance products (for example, credit cards, mortgages, credit cards) obtained by EU consumers were obtained on a cross-border basis (and our experience is that most of these financings are likely to be concentrated at the high net worth end of the retail spectrum). Clearly a substantial change in consumer behaviour is likely to be required for this to change substantially, and for banks to benefit materially from a passport in relation to the provision of retail finance (although the further digitisation of banking products and services may have an influence on this). It should also be noted that many of the UK banks which focus on retail financing are under pressure from the UK Government to ensure that they lend to UK consumers and small businesses. It is unlikely that this will change in the short to medium term. Accordingly, as equivalence may not be such a major influence in these areas (although, as noted in Access to Markets, it is not entirely clear how the equivalence assessment is to be carried out in relation to certain activities and it may be that complete equivalence across all sectors is required for the UK to achieve equivalence), it is possible that amendments may be made to legislation covering retail banking products if it was felt that there was no detrimental effect on consumers.

In relation to consumer credit, Brexit may have a positive effect as it may mean that the UK could streamline what is a complicated regulatory regime. The UK's implementation of the Consumer Credit Directive has meant that lenders have to comply with one regime for consumer loans up to £60,260 (i.e. loans which are subject to the Directive), and a separate regime for consumer loans in excess of that amount and for business loans (although lenders can contract in to the Directive regime if they wish). Consumer credit practitioners may well support Brexit if it were to mean that this bifurcated regime could be harmonised although, as UK businesses have only just implemented practices and procedures to comply with this, it remains to be seen if there would actually be appetite for further changes from the industry.

Similarly, the impact of Brexit on the UK mortgage market is likely to be limited. Under the current UK mortgage regulation regime, for regulated mortgage activities to be performed, the land on which the mortgage is secured must be in the UK. Mortgage lending into the EU from the UK by way of a services passport is subject to compliance with local law requirements and (as noted above) there is little cross-border lending within the EU. Consequently, any lending is most likely to come from a mortgage lender authorised and regulated in the jurisdiction where the property is located. The Mortgage Credit Directive (MCD), which comes into effect on 21 March 2016, introduces a Europe-wide standardised mortgage regulation such that any consumer mortgage lending within the EU is carried out to the same standards, with the intention that mortgage products available to a consumer in one Member State would be open to consumers in all others. This widens the territoriality of the UK mortgage regime, so that lending by a UK institution where the security is within the EEA will fall under the UK regime. While the MCD appears to introduce more onerous lending criteria, many of these were introduced by the FCA in 2014 following the Mortgage Market Review anyway, so there is unlikely to be any appetite to reverse the MCD provisions in the event of Brexit. Given that there is currently very little UK mortgage lending into Europe, Brexit would have a minimal impact on this market. However, UK customers buying property abroad have typically been able to secure better mortgage deals than non-EU residents in terms of the amount of deposit required and interest rates offered. It is therefore likely to be easier for a UK consumer to purchase that holiday home in Spain if the UK remains part of the EU.

The UK, as a member of the EU, is also a member of the Single Euro Payments Area (SEPA), an initiative of the European banking industry intended to create a harmonised, common market for payment processing across Europe comparable to any domestic clearing market and to promote competition among payment service providers and clearing mechanisms. The current members of SEPA include all 28 EU Member States and the four EFTA Member States as well as Andorra, Monaco and San Marino. Notably, the Crown Dependencies (the Isle of Man, and perhaps more significantly, Jersey and Guernsey) are due to join SEPA, as part of the UK, on 1 May 2016, just ahead of the Referendum. Given the current uncertainty around the post-Brexit model for the UK's relationship with the EU, it is unclear what the UK's position would be in relation to SEPA. In turn, whilst a relatively small portion of the retail banking market (given that the majority of consumers currently only benefit from local, and not cross-border, banking services), consumers and banks who have come to appreciate the benefits conferred by SEPA may find any loss of functionality, should the UK fail to negotiate post-Brexit SEPA membership, frustrating and costly. In addition, real-time (or instant) payments currently exist in some countries, and have attracted significant interest in others due to their speed and rapid adoption by consumers. As a result, the Euro Retail Payments Board and the European Payments Council are working on a pan-European standard for instant payments and peer-to-peer mobile payments which has the potential to create interoperable systems (an Instant SEPA Credit Transfer scheme). Therefore, expenditure to date by UK banks in order to comply with SEPA and business models which anticipate a pan-European growth in instant payments may both be frustrated if a post-Brexit UK does not retain its influence in relation to SEPA. In relation to the authorisation of payment services providers, currently UK-authorised payment service providers have the right to carry on business in another EEA state, with or without a branch, provided the requirements of the Payment Services Directive (PSD) (implemented in the UK by virtue of the Payment Services Regulations 2009) are met. As with other areas noted above, this important passport right allows UK-authorised payment services providers free access to EU markets. Depending on whether the UK retained membership of the EEA, Brexit could mean restricted EU market access for UK payment service providers. The likely effect of this for providers who are not authorised credit institutions within the EU (or other categories of institution which are exempt under PSD) is that they will need to establish a payment institution within the EU (i.e. a separate legal entity, not a branch of a UK legal person) which would need to be authorised under the PSD in the relevant Member State, which will likely have a significant cost impact on business. However, once that entity was established, it would then be able to benefit from EU passport rights as previously.

Doing business

EMPLOYMENT

If the Referendum results in a "Leave" vote, there is unlikely to be a wholesale change to UK employment law in the short, or even medium, term because EU employment protections are now hard-wired into the UK labour landscape. For example, the Equality Act 2010 will almost certainly not be repealed or changed in any significant way because to remove such protections from UK employment law would be too politically sensitive.

As such, it is probable that saving legislation will be implemented by the government to preserve the status quo, save in respect of certain pieces of EU-derived legislation which have been identified by the UK Government as prime targets for change. One example is the Working Time Regulations, which are disliked by businesses for a number of reasons, particularly because of the 48-hour working week cap. However, the UK has always had an opt-out to the 48-hour working week, which banks and other City institutions have been able to take advantage of in order to side step the weekly cap. On that basis, repealing this legislation is unlikely to represent any significant improvement in the flexibility of the workforce in the financial sector. Similarly, the Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE) have been cited as a popular candidate for change. However most businesses have become accustomed to the transfer of employees on a business sale and, in particular with regard to outsourcing, have become reliant on the certainty that employees will transfer on a service provision change. It therefore seems unlikely that any major changes would be made to TUPE, although it is possible that some minor amendments may be made to enable businesses to harmonise terms and conditions of employment more easily following a transfer. There is, however, one piece of legislation which, due to its unpopularity, may be repealed in its entirety: the Agency Workers Regulations. Such a repeal would benefit banks and other employers as they would be subject to far fewer restrictions and obligations with regard to temporary workers.

It is also important to note that, even if there were a desire to make sweeping changes to UK employment law, it is likely that that there would be an imposition on the UK to maintain (at least certain aspects of) EU employment policy so that the UK was not seen to be undercutting Member States for a competitive advantage by having lower employment standards. Similarly, depending on the relationship negotiated with the EU following a "Leave" vote, UK banks may be prevented from entirely disregarding EU rules governing remuneration of financial services, including the bonus cap.

Notwithstanding the above, one area which is likely to experience a significant change is the extent to which people will continue to be able to move freely from the EU to the UK and vice versa. The institutions of the City (particularly banks) often rely on a skilled, multi-lingual and mobile workforce and the free movement of people has to date facilitated this. If free movement was curtailed, or removed completely, this could significantly restrict the extent to which banks and other employers were able to recruit from the European workforce and to which they could move their people around the business. At present, the UK applies a "points-based" system to non-EU nationals which creates a series of hurdles and makes it extremely difficult to recruit from outside the EU. If this system were applied to EU nationals as well, it could impose significant restrictions on the available pool of labour and reduce access to the expertise which is often sought from a foreign workforce.

TAX

National and international influences on the UK tax system

Competence on direct taxation remains primarily with Member States rather than with the EU, so relatively few directives have been adopted in relation to direct tax and these are of limited scope. The Commission has suggested a number of much more sweeping measures, particularly the so-called common consolidated corporate tax base (also known as CCCTB). So far such proposals have not gained sufficient traction to proceed; EU law has been much more impactful in the area of customs duties and VAT (see below for more information).

The major international influence on the UK tax system over the next few years, irrespective of the result of the Referendum, will be the OECD project on base erosion and profit-shifting (also known as BEPS). Equally, the UK's existing network of bilateral tax treaties with each of the other 27 Member States would remain in place, irrespective of the result of the Referendum.

VAT

VAT is governed by a number of EU provisions, in particular the Primary VAT Directive. The provisions relating to financial services remain in broadly the form drafted in 1977 and, given the range of financial services that have developed since then, this is sub-optimal. However, the need for unanimous consent for any changes prevented the recent EU reform process from clarifying the impact of VAT on financial services. In particular, the scope of the outsourcing exemption for financial services was too controversial for unanimous consent to be possible. For that and other reasons, HMRC has had to work with industry to come up with some pragmatic interpretations and solutions in this area. Post-Brexit, the UK would need to retain some form of VAT to balance its budget. However, it would have much increased scope to clarify and improve the rules. The downside of this would be that the UK's rules would begin to diverge from the (reasonably standardised) VAT approach adopted by the remaining Member States.

Flexibility to change the UK tax system

Notwithstanding that there have been few directives, the EU has, indirectly, strongly influenced the design of the UK tax system. This is because the Member States' tax systems are not permitted to contravene the wider EU principles of freedom of establishment and free movement of capital (the Freedoms), leading to successful taxpayer claims against the UK Government which have run into the billions of pounds. It has also meant that the UK tax system has been changed to conform with the obligations imposed by the Freedoms. This would likely remain the position under a post-Brexit EEA or EFTA option. However, if the UK adopted a different post-Brexit model, then it would be freed from those rules and also from the state aid restrictions imposed by EU membership, allowing the UK to adopt tax policies promoting certain behaviours, spending or sectors. In theory, this could be used to benefit particular aspects of the financial services industry. However, in practice the UK has used its tax system to effectively penalise many areas in the UK financial services sector – through the bank levy and 8 per cent surcharge, for example – so any benefits may well arise elsewhere.

Capital markets

The UK has consistently resisted the proposed introduction of an EU financial transactions tax (FTT) unless it is introduced globally. Nine Member States are still in discussions about introducing a more limited FTT, but the UK would not be required to introduce this irrespective of the result of the Referendum. However, some of the FTT proposals would have imposed material costs on UK banks and branches; it remains to be seen how that plays out, particularly post-Brexit when the UK may not be able to rely on some of its original arguments as to why UK banks should not be exposed to such costs.

Instead of the FTT, the UK has stamp duty and stamp duty reserve tax. The rules in relation to instruments other than vanilla debt or shares are not clear, so one positive impact of the EU's capital duty directive has been to remove certain occasions of charge under the UK domestic stamp duty rules. Brexit would remove that protection. Thus, issuers of structured notes and warrants and certain convertible products would need to revisit whether they were subject to stamp charges on issue or transfer.

Group restructurings

If any of the regulatory changes above impacted the capitalisation and/or holding structures for banking businesses, then the tax consequences of the required restructuring would need to be considered. Many multinational groups undertake internal restructurings to simplify their operations under the Cross Border Mergers Directive as implemented into UK law. This process facilitates the automatic transfer of assets and assumption of liabilities, which may no longer be possible as between companies in the UK and in the remaining Member States post-Brexit.

The impact of the bank levy means that non-UK headed groups have tended to avoid using UK holding companies for foreign subsidiaries. However UK-headed multinational groups will want to consider whether, post-Brexit, they could lose access to the benefit of the so-called parent-subsidiary directive, which could lead to the imposition of withholding taxes on dividends from EU subsidiaries to a UK holding company (and not all the UK's tax treaties remove those withholding taxes).

Tax impact of economic changes consequent on Brexit

Brexit could lead to a number of wider economic changes, for example, sterling FX movements and capital flight, the tax consequences of which would need to be considered. By way of example if, as some have predicted, sterling were to depreciate immediately after a "Leave" vote, unhedged non-sterling loan assets held by banks could appreciate in sterling terms. For accounts prepared in sterling, this could give rise to FX gains which would often be taxable. These changes could be particularly dramatic for assets that are marked to market.

Future regulations

The EU has introduced rules which potentially restrict the amount of non-audit consultancy work that audit firms can provide to EU credit institutions (i.e. banks) that they also audit. These rules will apply to new accounting periods of banks commencing on or after 17 June 2016. If the UK were to leave the EU and not retain EEA membership, the rules could be withdrawn (the rules will apply to all EEA members). However, if the rules do apply to UK banks, they may need to look for a wider range of firms to provide them with certain regulatory, tax, or other advice.

INTELLECTUAL PROPERTY RIGHTS (IPRS)

While most IPRs are primarily domestic in nature, the UK's withdrawal from the EU could affect the scope of protection and the management of such rights. Brexit could also impact innovation in the banking industry and also the growing use of IPRs as security; uncertainty caused by Brexit is unlikely to reduce complexity in the short term. Some examples of the potential impact of Brexit are explained below.

- Unitary Patent: plans are currently underway at EU level to introduce a single unitary EU patent (Unitary Patent). The Unitary Patent will be a new IPR that, like the Community trade mark, takes effect across the EU. Post-Brexit, the Unitary Patent would not be available to protect inventions in the UK, although UK entities would be able to apply for patent protection across the EU in the same way as companies domiciled in any other non-EU state. However, the UK would have limited influence in the regulation of the Unitary Patent, which could be problematic as it is likely that over time this will become the preferred method of obtaining patent protection in Europe compared to the European Patent Convention.

- Unified Patent Court (UPC): once the transitional period was over, the UPC would have exclusive competence to hear disputes in respect of Unitary Patents. While UK entities should still be entitled to own Unitary Patents post-Brexit, and issue proceedings with respect to such rights at the UPC, the UK would lose its hard-won status as host to one of the principal UPC courts and its ability to influence how the courts are managed, who the judges are and the court rules of procedure and evidence. The London Division of the UPC is currently intended to focus on pharmaceutical cases and issues around patent classification, and is expected to account for a considerable proportion of the court's caseload.

- Community trade mark and design rights: the UK would need legislation to allow Community-wide trade marks and registered designs to become UK national rights. There is uncertainty as to how this would work in practice.

Copyright law would likely be less affected by Brexit, but given the fact that EU case law has shaped much of our recent understanding of such rights, Brexit could lead to uncertainty as to the scope of protection. Post-Brexit, the English courts would no longer need to interpret national laws in light of EU legislation and jurisprudence so the decisions of English courts could result in widespread divergence from those of the EU – indeed the English courts have on several occasions questioned the wisdom of a number of decisions taken by the European Courts.

DATA PROTECTION

If the UK retained EEA membership post-Brexit there would be little impact on the laws governing the use of personal data, as members of the EEA are subject to existing European data protection laws. If not, the UK would be free to legislate in this area as it saw fit, subject to the terms of any treaties it might enter into. It would then need to reassure the EU that its standards of protection were sufficient to meet EU standards in order to establish a convenient mechanism for data transfers between the UK and the EEA. Failure to do so could be disruptive to banks, which regularly transfer personal data between the UK and the EEA. Another lawful basis for such transfer would need to be found, which would inevitably result in additional time and cost burdens. Similarly, post-Brexit the UK would be left to negotiate its own mechanism for data transfers to and from the US, which is currently working with the EU to establish a new transatlantic transfer regime.

The new Data Protection Regulation, which is due to come into force across the EU in the next two years, sets out hefty fines for data breaches and would not apply in the UK if it were no longer an EU member, but would affect UK businesses operating in the EU. Without EU co-ordination on data privacy and issues such as cyber security, banks could be exposed to greater complexity in dealing with European-wide data issues.

Key questions and case studies

The banking industry in the UK is diverse. The potential risks posed by Brexit will vary widely across different institutions – see, for example, the outline case studies below. However, there are a number of questions which boards, senior managers, legal groups and regulators can be asking at this point to determine whether and when they need to take action, how to focus lobbying efforts and to help prepare themselves for questions from regulators, or, in the case of the regulators themselves, those institutions that they regulate.

ACCESS TO MARKETS

The key risk associated with Brexit is the risk that a bank may be deprived of access to key markets for any period. That is also the risk that may take longest to resolve. Key questions in this context include:

- Which businesses in London (or elsewhere in the UK) depend on an EU passport or EU legislation to access markets elsewhere in the EU?
- For each affected business line or product, does the relevant EU legislation contain an equivalency regime?
- If so, is it likely that there will be an equivalence decision sufficiently early in the Brexit process to mitigate uncertainty?
- If not, is there an entity in the remainder of the EU from which the relevant business can be operated?
- If so, what are the practicalities associated with a transfer of that business – for example IT infrastructure – and are there any additional authorisations which will be required? How will that entity be capitalised, how will it hedge and fund itself?
- If not, what is my plan B?

OTHER KEY QUESTIONS

Other questions which are likely to be relevant include:

- How will my institution be affected by potential GBP volatility, or a short/medium/long term weakening of GBP?
- Where are my investors and depositors based?
- Will my institution be able to fund itself at short/medium/long term maturities as it does currently?
- How will my access to key trading counterparties and key trading infrastructure be affected?
- Do I know whether there are potential default or termination triggers in transaction documents to which my institution is party? If there are, what are the potential cross-default consequences?
- What percentage of my workforce relies on EU rules to be able to work here and will I be able to attract and retain the talent that I need post-Brexit?
- Does my institution currently depend on the EU regime to transfer data across borders within the EU, or will it rely on the proposed EU/US regime for data transfers to the US?
- Is my regulatory team large enough to manage the transitional process?

CASE STUDY 1

Bank X is headquartered outside the EU today. It provides investment banking services through a UK-incorporated subsidiary, with no corporate presence in the remainder of the EU. Its UK workforce is highly multinational.

The key risk for Bank X is likely to be a short-term failure of access to markets where there is a hiatus in exit negotiations at the expiry of the withdrawal period. The major issue for Bank X is therefore likely to be the lack of a passport until (if at all) there is an equivalence decision from the Commission under MiFID.

Alert level: HIGH

CASE STUDY 2

Bank Y is a global bank headquartered in an EU jurisdiction outside the UK. Acting through a substantial London branch, it provides a range of investment banking, corporate lending and custody/brokerage services. Those activities are replicated elsewhere in its European network, although not always on the scale of its London operation.

The key issue for Bank Y is likely be the continued attractiveness of its London branch as a destination for investment, in the short term, and as a hub for the provision of high-value services in the medium term. That may be a balanced view taking into account potential risks of Brexit to lending and investment banking businesses, but also ways in which the attractiveness of London as a financial centre and as a location for senior personnel might be enhanced in relative terms.

Alert level: MEDIUM

CASE STUDY 3

Bank Z is a UK-headquarted bank focused on lending to corporate, SME and retail customers in its domestic market. It utilises some wholesale market funding to complement GBP deposits.

While Bank Z will not be immune to short-term disruption, key issues for Bank Z are likely to be longer-term in nature. Primarily it will be concerned with assessing the economic impact of Brexit, for better or worse, on the UK economy, and the effect of associated GBP movements.

Alert level: LOW

Glossary of terms

Term	Meaning
AIFs	Alternative Investment Funds
AIFMD	Alternative Investment Fund Managers Directive
AML	Anti-Money Laundering
Article 55 Requirement	The requirement set out in Article 55 of the BRRD (see pages 10-11 and 16)
Banking Act	Banking Act 2009
Banking Reform Act	Banking Reform Act 2013
Benchmark Regulation	Proposed EU Regulation on the Use and Administration of Benchmarks
BRRD	Banking Recovery and Resolution Directive
BSR Regulation	EU Regulation on Banking Structural Reform
CBIR	Cross Border Insolvency Regulations 2006
CCP	Central Counterparty
CIRWR	Credit Institutions (Reorganisation and Winding Up) Regulations 2004
CIWUD	Credit Institutions Winding Up Directive
CLOs	Collateralised Loan Obligations
COMI	Centre of Main Interest
Commission	European Commission
CRD	Capital Requirements Directive
CRR	Capital Requirements Regulation
ECB	European Central Bank
ECIR	European Regulation on Insolvency Proceedings
EEA	European Economic Area
EFTA	European Free Trade Association
EMIR	European Markets Infrastructure Regulation
ESMA	European Securities and Markets Authority
FATF	Financial Action Task Force
FCA	Financial Conduct Authority
Fourth Directive	Fourth EU Anti-Money Laundering Directive
FSB	Financial Stability Board
FTA	Free Trade Agreement
FTT	EU Financial Transactions Tax
GMRA	Global Master Repurchase Agreement
GMSLA	Global Master Securities Lending Agreement

Term	Meaning
ICMA	International Capital Market Association
IOSCO	International Organization of Securities Commissions
IPRs	Intellectual Property Rights
KIDs	Key Information Documents
KYC	Know Your Client
LMA	Loan Market Association
MAC	Material Adverse Change
MCD	Mortgage Credit Directive
MiFID	Markets in Financial Instruments Directive
MiFID II	Second Markets in Financial Instruments Directive
MiFIR	Markets in Financial Instruments Regulation
PD Regulation	Prospectus Directive and its implementing regulation
PRA	Prudential Regulation Authority
PRIIPs	Packaged retail and insurance-based investment products
PRIIPS KID Regulation	Proposed EU regulation on key information documents for packaged retail and insurance-based investment products
Prospectus Directive	Prospectus Directive
PSD	Payment Services Directive
Recast Regulation	Recast EU Brussels Regulation
Rome I	Rome I Regulation
Rome II	Rome II Regulation
SEPA	Single Euro Payments Area
SIFMA	Securities Industry and Financial Markets Association
TR	Trade Repository
Transparency Directive	Transparency Directive
TUPE	Transfer of Undertakings (Protection of Employment) Regulations 2006
UCITS	Undertakings for Collective Investments in Transferable Securities
Unitary Patent	Single Unitary EU Patent
UPC	Unified Patent Court

Ashurst contacts

Ashurst has formed a Referendum Thought Leadership Group that has been considering the key issues for business arising out of the Referendum and a possible Brexit.

For further information, please do not hesitate to contact your usual Ashurst contact or any of the partners detailed below.

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